LIBERALIZATION
OF THE REPUBLIC OF BELARUS
FINANCIAL MARKET
WITHIN THE EAEU

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The anticipated formation of a common financial market within the EAEU opens up new opportunities for Belarus to attract resources into its economy and enhance the efficiency of the distribution of financial resources, and creates the basis for incentivizing trade in financial services. At the same time, the combining of financial markets also entails a number of challenges for the country. In this connection, the purpose of this study was, first, to examine international experience in liberalizing access to the domestic financial market for foreign financial service providers, and in lifting restrictions in the area of the cross-border movement of capital and simplification of exchange arrangements; and second, to identify the risks that Belarus may encounter as the result of liberalization of its financial market within the EAEU. The study is based on the assumption that Belarus will fulfill the obligations it has assumed with respect to the formation of an EAEU common market (in particular, liberalization of the financial account, eliminating mandatory surrender of foreign exchange, etc.), and the recommendations offered in the paper are aimed at reducing possible risks.

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# ACRONYMS AND ABBREVIATIONS

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<th>Acronym</th>
<th>Description</th>
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<tbody>
<tr>
<td>BAMAP</td>
<td>Belarusian Association of International Road Carriers</td>
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<td>BRC</td>
<td>Banking Regulatory Commission</td>
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<td>CFMs</td>
<td>capital flow management measures</td>
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<td>CIS</td>
<td>Commonwealth of Independent States</td>
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<td>CU</td>
<td>Customs Union</td>
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<td>EADB CIS</td>
<td>Eurasian Development Bank Center for Integration Studies</td>
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<td>EADB</td>
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<td>EAEU</td>
<td>Eurasian Economic Union</td>
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<td>ECB</td>
<td>European Central Bank</td>
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<td>EEC</td>
<td>Eurasian Economic Commission</td>
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<td>ETF</td>
<td>exchange traded funds</td>
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<td>EU</td>
<td>European Union</td>
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<td>IAIS</td>
<td>International Association of Insurance Supervisors</td>
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<tr>
<td>IMF</td>
<td>International Monetary Fund</td>
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<tr>
<td>MF</td>
<td>mutual fund</td>
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<tr>
<td>NTB</td>
<td>non-tariff barriers</td>
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<td>SES</td>
<td>Single Economic Space</td>
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<td>SRM</td>
<td>Single Resolution Mechanism</td>
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<tr>
<td>TNC</td>
<td>transnational corporation</td>
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<td>UNCTAD</td>
<td>UN Conference on Trade and Development</td>
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<td>WTO</td>
<td>World Trade Organization</td>
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Analytical Summary

The anticipated formation of a common financial market within the EAEU opens up new opportunities for Belarus to attract resources into its economy and enhance the efficiency of the distribution of financial resources, and creates the basis for incentivizing trade in financial services. At the same time, the combining of financial markets also entails a number of challenges for the country. In this connection, the purpose of this study was, first, to examine international experience in liberalizing access to the domestic financial market for foreign financial service providers, and in lifting restrictions in the area of the cross-border movement of capital and simplification of exchange arrangements; and second, to identify the risks that Belarus may encounter as the result of liberalization of its financial market within the EAEU. The study is based on the assumption that Belarus will fulfill the commitments it assumes in the context of forming an EAEU common market (in particular, liberalization of the financial account, eliminating mandatory surrender of foreign exchange, etc.), and the recommendations offered in the paper are aimed at reducing possible risks.

Authorizing the Activities of Bank Branches

The creation of an EAEU common financial market presupposes, among other things, liberalization of cross-border trade in banking services in the form of authorizing the activities of member states’ bank branches inside the Republic of Belarus. An analysis of sources indicates that in recent years academic research and empirical studies by a number of countries’ central banks have given increasing attention to the form of foreign banks’ presence. Following the 2007–2009 world financial crisis, the need arose to carefully assess the risks associated with operations of foreign bank branches for the receiving countries’ financial stability and economic development. In this connection, special emphasis was placed on identifying factors determining the form of presence and the potential risks stemming from whether a foreign bank would participate in the receiving country’s market as a legal entity.

Based on a generalization of international experience, this study identifies and systematizes the risks associated with the entry into and operations of foreign banks’ branches in a receiving country. Then a qualitative assessment of those risks is made for Belarus in connection with the possible opening of branches of EAEU countries’ banks. This assessment reveals that most of the risks associated with the entry into Belarus of branches of EAEU countries’ banks are low or moderate. They can be mitigated by harmonizing in the member states the procedures and conditions for issuing banking licenses with respect to branches, prudential requirements for banks, and deposit insurance, and also by establishing a supernational banking administration and coordinating monetary policy.

At the same time, the following risks are high: 1) increase in vulnerability to shocks occurring in a branch’s country of origin and in world financial markets; 2) increase
in cyclicity of lending; 3) possibility of an outflow of funds from a branch to its parent bank. These risks are not easily controlled and mitigated by a receiving country’s regulators. Thus, it must be taken into account that the branches of EAEU member countries’ banks may become a potential source of the “transfer” of shocks to Belarus from the economy of any member country.

**Liberalization of capital flows and exchange arrangements**

Establishment of a single financial market presupposes that Belarus will carry out liberalization of capital flows and exchange arrangements with EAEU countries. It should be noted that recently in the economic literature there has been a change in attitude toward the consequences of capital account liberalization. Despite the fact that in economic theory it has been accepted to view the effects of that liberalization positively in connection with a potential inflow of capital, increase in investment, lowering of the cost of credit and loans, and increase in the external trade volume and, ultimately, in prosperity, the results of empirical analysis have by no means always been able to confirm that. A number of works indicate that there is no correlation between the openness of countries’ capital accounts and their investment volumes, or rates of economic growth. Moreover, international experience indicates that for developing countries access to international financial markets may have a procyclical effect, increase economic volatility, and ultimately contribute to the occurrence of a financial and currency crisis. Despite that, the trend of increasing capital account liberalization persists. That is due to globalization, countries’ ever increasing involvement in international trade, the development of the financial market, and regional economic integration processes.

In order that lifting barriers to capital account activity not result in crises and an increase in debt, and not threaten financial stability, it should be coordinated with a certain macroeconomic policy and fulfillment of the required prior conditions. According to IMF recommendations, those conditions include: good macroeconomic indicators; a developed financial sector capable of coping with volatility in capital flows; the steady absence of a substantial capital account deficit; a sufficient level of international reserve assets; a floating exchange rate; a cautious fiscal policy; high-quality prudential supervision and regulation in the financial sector; an effective system for monitoring capital flows; an effective risk management system on the part of economic agents in the financial and nonfinancial sectors; the use of best practices in accounting, auditing, disclosure standards and reporting rules; the lack of a practice of providing implicit government guarantees, which contribute to an excessive and unstable capital flow. A developed securities market is also cited as a condition that fosters liberalization. Countries in which the aforementioned prior conditions are not fully in place should coordinate liberalization of capital flows with fulfillment of those conditions.

The paper gives an assessment of fulfillment of the prior conditions for capital account liberalization in Belarus in the context of the EAEU. Based on its results, the conclusion is drawn that, as of Q3 2015, of the 11 prior conditions, only 4 had been met (with reservations). And the failure to meet the seven remaining conditions
by the beginning of 2017, among which are such important parameters as the steady lack of a current account deficit, an adequate level of international reserve assets, and the existence of an effective risk management system on the part of economic agents, may increase the risks for Belarus in connection with capital account liberalization.

The chief risks of capital account liberalization for Belarus would be connected with an outflow of capital — both domestic capital and that which has come in as a result of an inflow. That could result in a devaluation of the domestic currency and reduction in international reserve assets, and put pressure on the payments balance and banking sector as a result, for example, of an outflow of deposits, especially in the event of economic crises. In that connection, it would be advisable for Belarus, in lifting barriers to capital account activity, to develop and employ, where necessary, capital flow management measures. And it must be taken into account that, according to the IMF’s country studies, such measures have varying degrees of effectiveness and their effect is usually short-lived.

As a rule, capital account liberalization is accompanied by a relaxation of exchange restrictions, one of which is the requirement that exporters surrender foreign exchange earnings. The risks of eliminating it in a country must be compared with the fact that it increases enterprises’ costs as a result of the difference between foreign exchange purchase and sale exchange rates; results in enterprises’ creation of various schemes for keeping their foreign exchange earnings abroad; and reduces the country’s attractiveness to foreign investors.

For Belarus the risks of eliminating the surrender requirement appear fairly high at this time. That is due to an imbalance in the balance of payments current account, a low level of international reserve assets, and insufficient confidence in the domestic currency. As international experience shows, in that case a strategy of gradually eliminating the surrender requirement may be employed. That means not just gradually reducing the share of earnings subject to surrender, but eliminating it in a targeted fashion or by sector. For example, some countries require surrender only for sectors associated with exports of natural resources but eliminate the requirement for those that use raw materials and other materials in their production.

Liberalization of the Insurance Services Sector

Establishing a common financial market in the EAEU also means liberalizing the insurance services sector by making it possible to engage in the insurance business without establishing a legal entity, i.e., in the form of branches of foreign insurance companies. As international experience indicates, one of the most important factors determining the form of a foreign insurance company’s presence in a receiving country’s market is the level of taxation and regulation.

The following important risks for Belarus associated with the advent of insurance companies’ branches can be identified: 1) the complexity of supervision of a branch, since it is performed by the relevant authorities of its country of origin rather than of the receiving country; 2) the impossibility of stabilizing the operation of a branch by measures within the receiving country if the parent insurance company experiences
difficulties; 3) an increase in vulnerability to shocks occurring in the country of origin, which might result, for example, in the parent company’s withdrawal of resources from the branch; 4) the possibility of an outflow of foreign exchange; and 5) the crowding out of domestic insurance companies and distortion of competition in the insurance market in the receiving country, since branches (especially of large foreign companies) can offer services at lower prices and, most likely, would enter the most profitable segments of the insurance market.

In many developing countries, the advent of branches has resulted in crowding domestic insurance companies out of the market, but for Belarus that risk in the context of liberalization of the insurance market within the EAEU is fairly low. That is due to the relatively low level of insurance activity among both the public and legal entities, which is attributable partly to the low insurance culture and partly to the differences that exist in the country in permission for insurance companies under different forms of ownership to offer mandatory insurance.

For foreign insurance companies and their branches, the non-life insurance segment is important. In Russia companies with a predominance of foreign capital prefer to work in precisely that segment, as do domestic insurance companies, 74.5% of which offer non-life insurance exclusively. In Belarus the mandatory types of insurance, access to which is enjoyed only by public insurance companies and insurance companies in the authorized capital of which the state holds more than 50% interest (hereinafter, “public insurance companies”), are in fact non-life insurance. Moreover, the mandatory types of insurance occupy nearly half of the country’s insurance market and in recent years have accounted for more than 45% (46% in 2014) of the total value of insurance premiums. Thus, the market that both the branches and the subsidiaries of foreign insurance companies might enter is limited, which makes Belarus less attractive for that sort of investment.

In the context of harmonizing the insurance services market in the EAEU, a proposal was made to establish in the integration association a system for mandatory liability insurance for the owners of vehicles traveling abroad similar to the Green Card system.

The paper offers an assessment of the potential costs for transport companies engaged in international hauling in the event such insurance were made mandatory. If a mandatory system parallel to the Green Card insurance policy were instituted for traveling to all countries, Belarusian companies would be forced to purchase insurance to travel to EAEU countries. Calculations made on the basis of interviews with transport companies and representatives of the Belarusian Association of International Road Carriers (BAMAP), and the data on Green Card insurance for trucks in Belarus show that the creation of a mandatory insurance system parallel to the Green Card would result in additional expenses of approximately €1.9 mil. per year.

Liberalization of the securities market

In the context of creating a common financial market of EAEU countries it is planned to provide for reciprocal admission of professional participants in the securities market
to trading on partner states’ exchanges without the additional establishment of a legal entity, as well as reciprocal admission of securities to trading on Eurasian Economic Union exchanges.

**Analysis shows that the entry of Belarusian brokers to exchanges in Russia and Kazakhstan would be impeded in connection with the difficulty of meeting equity requirements.** Accordingly, one can assume that Belarusian legal entities and individuals wishing to invest in the markets of Russia and Kazakhstan would work through those countries’ brokerages. It should be noted that the Russian market would be of greatest interest for them. Moreover, Russian brokerages would be able to offer Belarusian investors a wider assortment of financial products and instruments, as well as various trading platforms for working in the Russian market, compared with domestic brokers that were admitted to the Russian market.

**The question of competition with foreign brokers in the Belarusian stock market depends directly on the degree of that market’s attractiveness to investors from EAEU countries.** At present the Belarusian securities market is characterized by a low level of liquidity, a relatively low percentage of freely traded shares, a shortage of high-quality financial instruments, and a predominance of government securities transactions in the total trading volume.

The risks of investing in the financial instruments of Belarusian issuers are incommensurate with prudential requirements for pension and investment funds or bank assets in Russia and Kazakhstan.

**Liberalization of the securities market in the EAEU countries presupposes the possibility of securities’ reciprocal admission to exchange trading (cross listing).** At present Belarusian issuers’ securities may already be admitted for placement and trading in the Russian stock market pursuant to the Russian Federation Federal Law On the Securities Market. Admission to trading is based on a decision by the Russian Stock Exchange.

**Liberalization of access to the securities market also presupposes the need to establish an integrated depository space.** At present in Belarus requirements for depositories’ minimum equity (30,000 base units, or USD 322,000) are higher than in Russia (RUB 15 mil., or USD 229,000). However, as EU experience shows, creation of an integrated depository space would entail not so much agreed financial requirements as harmonization of the procedures and rules for operation of EAEU countries’ depositories. That would entail: 1) establishment of common depository standards; 2) cooperation among member countries’ central depositories in order to achieve functional compatibility that would allow their clients to obtain identical services; and 3) closer alignment of the accounting systems of the member countries’ financial markets, and a switch to the exchange of electronic documents with digital signatures in standardized formats through telecommunications channels, with the automated processing of those documents.
Introduction

As of January 1, 2015, the Eurasian Economic Union came into existence; it represents the next stage in the process of regional economic integration following the Customs Union (2010) and the Single Economic Space (2012). The Eurasian Economic Union is a common space in which “freedom of movement of goods, services, capital and labor” is provided, and countries follow “coordinated, agreed or unified policies in sectors of the economy” such as energy, industry, agriculture and transport. It entails a new level of economic interaction and cooperation among member states and increased harmonization of macroeconomic, monetary, trade, investment and tax policies.

The EAEU also entails agreed exchange policies, harmonization of law with regard to the financial market, and the formation of a common financial market in order to create the conditions for the free movement of capital among member states. As the experience of the European Union shows, a single financial market may provide great economic benefits to both member states’ enterprises and their citizens, since it makes it possible to:

- make investments in the framework of the entire common market, receiving maximum return on them. In particular, individuals have greater opportunities to effectively invest their savings. Investors are also able to distribute risks more widely;
- engage in borrowing in the framework of the entire common market based on the cost of credit resources, which may, in turn, be lowered as the result of increased competition among banks;
- increase the volume of investment: The opportunity arises to obtain credit at a lower interest rate, which ultimately fosters economic growth.

That also provides Belarus with additional opportunities related to nondiscriminatory access to the financial markets of the EAEU member states. However, the deepening of economic integration in the financial and exchange area also presents a number of challenges. Thus, for example, following agreed exchange policies entails “the gradual elimination of exchange restrictions with regard to exchange transactions that impede effective economic cooperation and the opening or maintaining of accounts by the member states’ residents in banks located on the member states’ territories (Annex 15 to the Treaty on the Eurasian Economic Union). In turn, the creation of a common financial market (banking sector, insurance sector, securities market services sector) provides for “engaging in the business of providing financial services throughout the union’s entire territory without additional establishment as a legal entity” (Protocol on Financial Services, Annex 17 to the Treaty on the Eurasian Economic Union). In this connection, the purpose of this study is to determine how integration of the EAEU member states’ financial markets affects the functioning and development of the Republic of Belarus financial sector, and to identify possible risks. The study assumes that Belarus will fulfill the obligations it has assumed in the context of forming an EAEU common financial market (in particular, liberalization of the financial account, elimination of the surrender of foreign exchange, etc.), and the recommendations made in the study are aimed at reducing potential risks.
1. The Banking Sector

1.1. Survey of International Experience

Harmonization of law and formation of an EAEU common financial market will mean authorizing the operations of the branches of member states’ banks in the Republic of Belarus. Generally speaking, the operations of foreign banks’ branches raise a number of concerns, since it has been believed that, along with positive aspects, they contain a number of threats. In this connection, it is worthwhile to analyze the factors determining the form of a foreign bank’s presence in a receiving country, to consider the arguments for and against the operations of foreign banks’ branches, and to examine the specifics of their presence in the financial markets of various countries, especially those with transitional economies and emerging markets in Europe and Asia.

Since the 1970s both developed and developing countries throughout the world have relaxed restrictions with regard to the presence and operation of foreign banks’ branches. Over the past decade they have gained access to the banking sectors of Central and East European countries and China. In this connection, it is interesting to examine the specifics of their presence in the financial markets of various countries, especially those with transitional economies and emerging markets in Europe, Asia and Latin America.

Until recently most studies concerned with the operations of foreign banks in receiving countries have been aimed at investigating how they affect the banking sector and economic development as a whole. But in recent years increasing attention has been given to issues related to the form of foreign banks’ presence, the factors that determine it, and potential risks for receiving countries’ financial stability and economies stemming from whether a foreign bank does business in a receiving country’s market as a legal entity.

Cerutti (2007) were among the first to study, based on the example of the world’s 100 largest banks operating in Latin America and Eastern Europe, what factors influence banks’ choice of a given organizational form of presence in foreign markets. Based on the results of their analysis, they concluded that the decision on opening a branch in a receiving country will depend on:

- regulation of the branch’s operations. That is, the stricter the requirements and the more restrictions, the less likely the choice of that organizational form;
- regulation of banking in a bank’s country of origin;
- level of taxation. That is, if tax rates in the country of origin are significantly lower than in the receiving country, a branch will be the preferable form of presence;
- the parent bank’s chosen business model, which will determine the level of penetration of the receiving country’s market. If a foreign bank does not plan to offer retail banking services, the probability of its opening a branch is high;
Inset 1.1. Forms of foreign banks’ presence in a receiving country

- A foreign bank’s office is opened in a receiving country in order to provide information about that bank. Its activities are limited to assisting in establishing relations between the bank’s headquarters and the receiving country’s banks, financial institutions and enterprises. The foreign bank’s office engages in the preparation of information about the general state of the economy, business trends and investment climate in the receiving country for presentation to the bank’s clients. The foreign bank’s office is not authorized to engage in any banking or financial operations (granting loans, accepting deposits, opening client accounts, etc.) in the receiving country.

- A foreign bank’s branch performs operations through the parent bank and is an inseparable part of it. A foreign bank branch is not a legal entity in the receiving country and, consequently, does not fall under its banking supervision requirements. Empirical data for various countries indicates that the extent of activities permitted to foreign banks’ branches and the degree of their penetration of receiving countries’ banking markets differ widely and depend primarily on the banking regulation system.

- A bank with foreign participation is a legal entity that performs operations in a receiving country. It is controlled by two or more parent banks or financial institutions, including those belonging to foreign partners.

- A subsidiary bank is a legal entity wholly owned by a foreign bank that operates in a receiving country.

Source: prepared by authors.

- level of political and economic risks in the receiving country, especially if it is characterized by macroeconomic instability and government interference in banking. The higher the risks, the greater the likelihood of a foreign bank’s presence in the form of a branch;
- degree of development of the financial market.

Based on the fact that regulation of operations has the greatest influence on banks’ choice of the organizational form of their presence in a receiving country’s market, Cerutti et al. (2007) draw the conclusion that governments can use regulations to control that process. In the opinion of Fiechter et al. (2011), international banking groups’ decision to open a branch may be related to the fact that in that case:

- costs are lower than for opening a subsidiary bank. For example, in the latter case the cost of attracting external financing will be higher;
- there are advantages associated with the movement of capital and revenue, which will make it possible to increase the efficiency of the banking group’s operations;
there are advantages related to regulation and supervision. For example, it is necessary, by and large, to meet only the supervisory requirements in the bank’s country of origin.;

Besides that, the choice of the organizational form of presence may be attributed to the advantages and disadvantages that a foreign bank sees in a specific country. That may be related to how a bank’s clients view branches, to the specific features of the organization of the deposit insurance system in the receiving country and the country of origin, and to a number of other factors.

For their part, Fáykiss, Grosz and Szigel (2013) studied 34 branches and 50 subsidiary banks belonging to 19 international banking groups in six countries in Central and Eastern Europe in order to find out which factors most affect the choice of organizational form. That was because in those countries branches had become the dominant form of foreign banks’ presence and, furthermore, there had been a process of converting subsidiary banks to branches. That was largely due to joining the EU and the need to implement the European Commission’s directive on facilitating the provision of cross-border financial services (Directive 2005/56/EC). The results of their calculations shows that the choice in favor of a branch or subsidiary bank depends on the parent bank’s business strategy. If a bank is oriented toward working with corporate clients in the receiving country, it will most likely open a branch. That form will also be chosen if it lies at the basis of a strategy of expanding a bank’s activities in foreign markets. The study in question did not identify the significance of such a factor as banking regulation and the tax burden in a decision to open branches in the countries analyzed, which is most likely due to the fact that they are all EU members.

Before the 2008–2009 world financial crisis, there were virtually no empirical studies of differences in the behavior of foreign banks’ branches and subsidiary banks in a receiving countries’ financial markets, i.e., of how foreign banks behave depending on their organizational form of presence in various phases of the economic cycle, especially during a downturn. However, in the postcrisis period that question has become the subject of detailed study by specialists of the central banks of developed and developing countries and by scholars. That is due to the need to carefully assess the risks associated with the operations of foreign banks’ branches to receiving countries’ financial stability and economic development.

In the opinion of a number of authors, the presence of foreign banks in the form of a legal entity is becoming increasingly preferable. For example, Pontines and Siregar (2012), based on an analysis of six Asian countries (Indonesia, Korea, Malaysia, the Philippines, Singapore and Thailand), found out that foreign banks operating in the form of branches reduced the credit they granted during crises to a much greater extent than subsidiary banks did. Consequently, they concluded that regulators in countries with emerging markets and in developing economies should provide incentives for the presence of foreign banks in the form of a legal entity rather than a branch.

A similar conclusion with regard to lending to the economy was reached by specialist with the Federal Reserve System. Thus, in the opinion of Goulding and Nolle (2012), much more significant changes occurred in the operation of foreign banks in the US in the postcrisis
period than in the operation of domestic banks. From the standpoint of assets, they noted a very weak granting of trade and commercial credit and a very substantial increase in the percentage of cash and funds placed in federal reserve banks, which became dominant in assets. Consequently, the funds of foreign banks’ branches comprise one-third of the Federal Reserve System’s liabilities. From the standpoint of branches’ liabilities, dependence on borrowing from parent banks’ has increased very greatly.

Hoggarth, Hooley and Korniyenko (2013) from the Bank of England also conclude that the granting of loans by foreign banks’ branches in the United Kingdom is much more cyclical than the provision of loans by banks that are legal entities. During the 2008–2009 financial crisis they reduced lending much more drastically than did legal entity banks, which was felt by the country’s economy. Despite the fact that interbank loans and securities accounted for more than 50% of the assets of foreign banks’ branches in the United Kingdom, while they accounted for no more than 30% of the assets of subsidiary banks, they became an important source of credit to the nonfinancial sector and households. That occurred both directly and through interbank lending, where the percentage accounted for by branches reached 40%. It should also be noted that branches engage in virtually no deposit operations in the retail banking business system, and accordingly, the deposits of individuals account for a very small share of their liabilities. The funds of nonresidents dominate in the assets and liabilities of branches (70%–72%), and they are highly dependent on the financing of nonresident banks, including those unrelated to their parent bank. Thus, foreign banks’ branches, on the one hand, are highly vulnerable to the impact of external shocks, and on the other, are a potential source of the transfer of those shocks to other countries’ economies.

Branches are also highly sensitive to how risks are assessed by the parent bank, which may overstate them. For example, Albertazzi and Bottero (2013) show that after the Lehman Brothers bankruptcy the sharpest drop in lending was by the branches of banks that are geographically remoted from Italy, which is attributed to their lack of information about the quality of borrowers. Brei and Winograd (2012), using data on the banking sectors of Uruguay and Argentina, also conclude that branches are less inclined to risk; consequently, during the crisis they had a lower percentage of nonperforming loans. The authors note that such a trend also characterized foreign banks’ branches in Hungary, but that had more to do with the structure of their loan portfolios, where loans to large corporate borrowers predominated. Overall, in Hungary foreign banks’ branches differed substantially from subsidiary banks and banks with foreign participation in terms of operational activities. They are “niche players,” focusing their activities on treasury operations, the government securities market and swaps. Branches do virtually nothing by way of offering retail services, and in lending are oriented toward large corporate clients and transnational corporations (Fáykiss, Grosz and Szigel, 2013).

Experience indicates that during a crisis a parent bank is also inclined to use branches’ funds to increase lending in the country of origin, which may strongly affect lending volumes in the receiving country. Cetorelli and Goldberg (2011) have shown that in the second half of 2007 the headquarters of US banks drew capital from their foreign branches in all receiving countries.
Consequently, after the crisis a number of countries toughened laws governing the entry of foreign banks’ branches into their markets. Restrictions were imposed on lending to branches by parent banks; emphasis was also placed on the requirement that loans in the country be linked to attracted deposits and not dependent on cross-border financing.

At the same time, Fiechter et al. (2011) conclude that neither a branch nor a subsidiary bank is a preferred form of presence from the standpoint of financial stability in the receiving country. That stability can be ensured only when there is an effective oversight mechanism for cross-border banking groups, which presupposes effective supervision in the country of origin and the receiving country, an information sharing agreement, procedures for resolving cross-border disputes, and an agreement on sharing expenses in the event that problems arise.

It should be noted that a number of countries place requirements on branches similar to the requirements for domestic banks. For example, Argentina, Bolivia, Brazil, Chile, Ecuador, India and South Korea have set capital adequacy requirements and liquidity requirements for branches analogous to those applied to banks that are legal entities in the respective countries, and also require domestic representation on their executive boards or boards of supervisors.

Branches’ activities are regulated based on the objectives of the receiving country’s monetary policy. In order to monitor risk, a given country’s supervisory authorities may require of a foreign bank’s branch the same information that is required from resident financial institutions. For example, they may require that a foreign bank’s branch periodically submit reports on its activities (statistical data); report on the terms for its attraction of deposits, provision of loans, and other banking operations and services; and provide information as to whether it is a member of any payment system.

In the European Union, the conditions for the opening and operation of the branches of foreign banks (of member countries) are governed by Directive 2013/36/EU of June 26, 2013 of the European Parliament and European Council (see Inset 1.2). Under that Directive, the powers of a receiving country’s supervisory authorities are very limited and in practice come down to the possibility of obtaining information about a branch’s activities and participating in consolidated supervision in the event that it is a systemically critical financial institution. However, that approach has been employed only since 2013, when regulations pertaining to prudential requirements for lending institutions and investment firms in the EU were radically revised. New Regulation (EU) No. 575/2013 of June 26, 2013, which contains prudential requirements for lending institutions and investment firms,1 established uniform minimum standards for prudential regulation in the EU.2 Adoption of that Directive and Regulation was the result of the EU countries’ movement in the direction of establishing a banking union and a Genuine Economic and Monetary Union3 based on four structural units:

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1 Regulation (EU) No. 575/2013 and directive 2013/36/EU have been referred to as CRD IV and CRR (Capital Requirements Directive and Regulation) and should be considered together.

2 The most important uniform prudential requirements include: structure of own funds; capital requirements, credit risk, market risk, operational risk, settlement risk, credit valuation adjustment risk, and the methods for calculating those risks, and also the procedures for calculating the capital adequacy ratio; large exposures; transferred credit risk; liquidity ratios, and the leverage ratio.

3 Towards a Genuine Economic and Monetary Union. Report by President of the European Council Herman Van Rompuy, Brussels, June 26, 2012, EUCO 120/12, PRESSE 296 PR PCE 102.
Inset 1.2. Opening and prudential supervision of foreign banks’ branches in the EU

Within two months after the supervisory authorities of the country of origin have transferred information to the receiving country’s supervisory authorities about a legal entity (that information is transferred within three months from the day of its receipt from a bank and contains the structure of the branch and types of proposed activities, the name and address of the branch’s executive officers, and the amount and structure of its equity and calculations of its exposures made pursuant to Articles 92 (3) and (4) of Regulation (EU) No. 575/2013), the receiving country’s supervisory authorities must prepare for supervision of the credit institution pursuant to Section 4 of that Directive.

The receiving country’s authorities do not grant permission to open a branch and do not require “donors capital” (capital transferred from the parent bank to the branch for supporting its activities).

The receiving country’s supervisory authorities do not directly regulate a branch’s activities, but they may appeal to the supervisory authorities of a bank’s (lending institution’s) country of origin if the branch does not meet the requirements of Directive 2013/36/EU or Regulation (EU) No. 575/2013. However, in the event of an emergency and threat to financial stability, they may take preventative measures up to and including suspending any operations on their territory.

The receiving country’s supervisory authorities may require that lending institutions with branches on their territory regularly submit information to them about the branches’ activities.

The country of origin’s supervisory authorities must cooperate with the receiving country’s supervisory authorities and regularly provide information about the parent bank’s governance, equity structure, liquidity, solvency, deposit guarantees and limiting of large exposures. If a parent bank has or may have problems with liquidity, the information should be provided promptly.

The receiving country’s supervisory authorities may be given the opportunity to participate in consolidated supervision with the authorities of the country of origin if they consider a branch to be a systemically critical financial institution — for example, if it accounts for 2% or more of total deposits.


Source: Directive 2013/36/EU of the European Parliament and the Council of June 26, 2013, on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms.
an integrated financial framework, an integrated budgetary framework, an integrated economic policy framework, and democratic legitimacy and accountability. From the EU standpoint, an integrated financial framework is needed to ensure financial stability, minimize the costs associated with bank bankruptcy, and regulate the problem of bank insolvency and guarantee clients’ deposits.

Thus, only with the implementation of the uniform minimum standards contained in Regulation (EU) No. 575/2013, were the powers of a receiving country’s supervisory authorities in regulating the activities of foreign banks’ branches substantially limited by Directive 2013/36/EU. Previously supervision had been based on Directive 2006/48/EU, which allowed greater oversight of branches on the part of the supervisory authorities in a branch’s country of origin. For example, liquidity ratios could be established for foreign banks’ branches. If the branches participated in the payment system and operations of the central bank of the receiving country, reserve requirements applied to them.

In the European Union countries, foreign banks’ branches account for an average of 5%–10% of a banking system’s total assets (excluding the United Kingdom, where in 2007, for example, they accounted for 45%) and are on approximately the same level as in the US – 9%.

China has permitted the opening of foreign banks’ branches since 2001, after the country jointed the WTO and restrictions on the activities of foreign financial institutions were lifted. At first, a branch was the organizational form that was the most common means for foreign banks to enter the Chinese market. For example, at the end of 2006 74 banks from 22 countries had opened 200 branches in China. Many of those banks had followed clients that were investing in the Chinese economy. Branches for the most part worked with VIP clients – foreign and domestic companies. But in recent years there has been a trend toward a change in the organizational form of foreign banks’ presence in the Chinese financial market and an increase in the number of subsidiary banks and banks with foreign participation (Hope, Laurenceson and Qin, 2008). According to the information of the China Banking Regulatory Commission, at the end of 2013 there were 92 foreign banks’ branches and 42 banks in the form of legal entities in the country. Of those, 57 branches were authorized to perform operations and provide services using the yuan, while 27 branches were authorized to work only with derivatives. Only banks operating in the form of legal entities were authorized to issue bonds and credit cards.

At the end of 2014 China substantially eased access by foreign banks’ branches to its financial market in order to enhance competition in the banking sector. Previously, opening a branch required that a foreign bank first open an office; it was also necessary for a parent bank to transfer a certain amount of funds to operational management. A foreign bank’s branch had to be present in China for at least three years in order to obtain permission to perform operations in yuan. There were also restrictions on branches’ attraction of deposits, granting of loans, trading in shares and bonds, and issuing credit cards.

1.2. Risks Associated with Opening Branches: International Experience

To generalize the analysis presented above, one can identify the following risks associated with the advent and activities of foreign banks' branches in a receiving country.

1. The responsibility for the supervisory authorities of a branch’s country of origin for ensuring its stable operation in the receiving country’s market, where those authorities have no powers. In turn, the powers of the receiving country’s supervisory authorities with respect to oversight of the branches’ activities are very limited. It is believed that in the EU this risk may to a certain extent be eliminated by the Single Supervisory Mechanism (SSM). It includes the ECB and domestic supervisory authorities and is established for developing common approaches to the supervisory system for the purpose of standardizing supervisory policies, harmonizing remedial measures and actions in the area of supervision, and ensuring uniformity in the application of rules.

In order to respond to challenges in the area of regulation of the banking sector and contribute to improvement of cross-border supervision of banking operations, in 2011 the European Union established the European Banking Authority, whose objectives include developing technical standards, performing the role of intermediary in the event of disputes between national supervisory authorities, and protecting consumers’ rights. However, since that authority’s powers are limited, there are concerns as to whether

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6 Following approval by the European Commission, they become standards and rules in the member countries.

it has realistic capabilities, especially as intermediary. Moreover, establishment of the European Banking Authority and its endowment with broader functions compared with the previous Committee of European Banking Supervisors in no way affects the cause of risks – free cross-border movement of assets and liabilities between a parent bank and its branches (Hampl and Tomšík, 2011).

2. A receiving country’s authorities’ lack of the ability to stabilize the operation of a branch by recapitalizing it if its parent bank is experiencing difficulties (Fiechter et al., 2011). In the EU that risk is supposed to be mitigated by the Single Resolution Mechanism (SRM). It will help carry out the recapitalization of banks from the Single Resolution Fund. EU banks must make contributions to the fund according to a flat scale and also at a risk-adjusted rate. The size of the fund is supposed to be at least 1% of the total amount of open deposits of all lending institutions accredited in all participating member countries.

3. Increase in vulnerability to shocks occurring in a country of origin and world financial markets, which results, in part, in increasing the cyclicity of lending in the receiving country and, in part, in reducing the lending volume by branches. A study by Pawłówskaj et al. (2014) based on the example of Poland shows that the connection between a parent bank and its structures in a receiving country is an important shock transmission channel. Thus, the crisis in the eurozone resulted in adjustment of the balance sheets of foreign banks’ branches, while the same thing did not happen for domestic banks. In particular, parent banks’ problems during the debt crisis in the eurozone were one of the chief factors explaining a slowdown in the growth in loans in foreign exchange for housing construction in Poland.

4. Transfer to a branch of risks from the parent bank, including sovereign risks expressed, for example, in the risk of liquidity loss. In addition, as experience of recent years shows, in the event of a liquidity crisis in a country of origin, a parent bank uses a branch as a source of funding, which causes an outflow of funds and also results in a substantial reduction in lending volumes in the receiving country (Kwan et al., 2015).

5. Distortion of competition in the deposit market in the receiving country, especially if depositors have greater confidence in the deposit insurance system in the country of origin. For example, in Hungary in 2006 branches accounted for 0.3% of individuals’ deposits and 4% of legal entities’ deposits, while at the beginning of 2013 those percentages had risen to 4% and 12%, respectively.

6. Distortion of competition in the credit market, when foreign banks’ branches skim off the “best” clients. For example, the experience of the Central and East European countries shows that domestic banks chiefly lend to local companies and individuals, while branches work with large corporate clients, including transnational and foreign companies.

7. The possibility of excessive increase in lending volumes and, accordingly, an increase in the debt load of individuals and legal entities in the receiving country.

8. Difference in deposit insurance systems: If a foreign bank’s branch attracts deposits in the receiving country, their insurance occurs in the bank’s country of origin. That contains a threat related to the fact that in the event of the parent bank’s bankruptcy,
the deposit insurance fund in the country of origin may not have sufficient resources to pay depositors in the receiving country. One vivid example of the plausibility of such a threat is the case of the bankruptcy of the Icelandic Landsbanki bank, as the result of which more than 343,000 depositors from the United Kingdom and the Netherlands with deposits in that bank’s Icesave branch lost €6.7 bil. in savings. The Icelandic deposit and investor guarantee fund was unable to make payments to depositors, as a result of which the governments of the United Kingdom and the Netherlands took a political decision to compensate their citizens for deposits of €4 bil., and subsequently Iceland did not reimburse them for that amount. It should be noted that in a number of countries, such as the US, foreign banks’ branches, with a number of exceptions, are forbidden to attract deposits from US residents or citizens.

9. A worsening of the debt by maturity statistics, since the funds provided to a branch by its parent bank are reflected in the receiving country’s national statistics as external debt. Although in actuality branches’ money does not entail any refinancing risk, short-term external debt is often viewed as a whole, without analysis of its structure on the basis of repayment risk.

1.3. Opportunities and Risks Associated With Opening Foreign Banks’ Branches in Belarus

Table 1.2 presents the opportunities and risks associated with opening foreign banks’ branches in Belarus, and an assessment of the extent of their presumed impact.

Opening branches of EAEU foreign banks offers relatively low benefits pertaining to the transfer of new technology and know-how, since the level of development of banking technology among member states does not differ that much.

The chances of realizing benefits from expansion of legal entities’ and individuals’ access to financing in connection with the advent of foreign banks’ branches also appears moderate. That is because, as international experience indicates, especially in the first stages, branches employ “niche” strategies and enter a receiving country’s market to follow large corporate clients served in the parent bank.

With respect to Belarus, the opening of branches within the Eurasian Economic Union would entail both opportunities and virtually all of the risks noted above, some of which, however, may be considerably mitigated.

For example, we assess the risks associated with the supervision of branches on the part of authorities in a country of origin to be moderate. That is because, pursuant to Annex 17 (Clause 22) of the Treaty on the Eurasian Economic Union, member countries must harmonize requirements with regard to the regulation and supervision of lending institutions, following best international practices and the Core Principles for Effective Banking Supervision of the Basel Committee on Banking Supervision, including with respect to a lending institution’s minimum authorized capital, the procedures for forming it and means for paying it in; requirements with respect to executive officers’ professional

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8 With the exception of several branches of foreign banks that were permitted to attract deposits before adoption of the International Banking Act of 1978, which prohibited that activity on the part of foreign banks’ branches. For those to which that activity was permitted, a special regulation was passed authorizing them to attract deposits and insure them with the Federal Deposit Insurance Corporation (FDIC).
<table>
<thead>
<tr>
<th>Opportunities</th>
<th>Risks</th>
</tr>
</thead>
<tbody>
<tr>
<td>Increase in efficiency of the Belarus banking sector through an influx of technology and know-how</td>
<td>Supervision of branches performed by authorities of country of origin</td>
</tr>
<tr>
<td>High</td>
<td>Moderate</td>
</tr>
<tr>
<td>Lack on the part of receiving country authorities of the ability to stabilize a branch through its recapitalization if parent bank experiences difficulties</td>
<td>High</td>
</tr>
<tr>
<td>High</td>
<td>Moderate</td>
</tr>
<tr>
<td>Increase in vulnerability to shocks occurring in a branch’s country of origin and in world financial markets, increase in cyclicity of lending</td>
<td>High</td>
</tr>
<tr>
<td>Transfer to a branch of risks from the parent bank, including sovereign risks expressed, for example, in the risk of liquidity loss. In the event of a liquidity crisis in a country of origin, a parent bank uses a branch as a source of funding, which causes an outflow of funds.</td>
<td>High</td>
</tr>
<tr>
<td>Distortion of competition in the deposit market in the receiving country.</td>
<td>High</td>
</tr>
<tr>
<td>Distortion of competition in the credit market, when foreign banks’ branches skim off the “best” clients.</td>
<td>High</td>
</tr>
<tr>
<td>Subsidiary banks of EAEU countries’ foreign banks operating in the Belarusian market will be reregistered as foreign banks’ branches. that phenomenon has been seen in Central and East European countries after their joining the EU.</td>
<td>High</td>
</tr>
<tr>
<td>The possibility of excessive increase in lending volumes and, accordingly, an increase in the debt load of individuals and legal entities.</td>
<td>High</td>
</tr>
<tr>
<td>Difference in deposit insurance systems in a country of origin and Belarus. The risk that in the event of a parent bank’s bankruptcy the deposit insurance fund in the country of origin might not have funds for making payments to depositors.</td>
<td>High</td>
</tr>
<tr>
<td>A worsening of the debt by maturity statistics, since the funds provided to a branch by its parent bank are reflected as Belarus’ external debt.</td>
<td>High</td>
</tr>
</tbody>
</table>

Source: prepared by authors.
qualifications and business reputation; ensuring of the financial soundness of a lending institution, banking group or bank holding company; and prudential ratios and required reserves.

The risks associated with the lack on the part of the National Bank of Belarus of the ability to stabilize the operation of a branch through its recapitalization if its parent bank experiences difficulties are deemed to be high in the event that such a situation arises. The National Bank would be able to suspend the operation of a foreign bank’s branch in Belarus only if a threat to financial stability arose.

We assess as high the risks associated with an increased vulnerability to shocks occurring in a branch’s country of origin and world financial markets; with an increase in the cyclicity of lending; with transfer to a branch of risks, particularly sovereign risks, from the parent bank; and with the possibility of a parent bank’s using a branch as a source of financing, which would result in an outflow of funds. That is due to a number of factors. First, international experience indicates a fairly high frequency of realization of such risks. Second, of all the EAEU member countries, the advent in the Belarus market of Russian banks is the most likely. Since there is a high degree of synchronization of business cycles between Belarus and Russia, and the latter, in turn, is sensitive to changes in world commodity and financial markets, one can assume a fairly high degree of such risks.

The possibility of the materialization of risks due to a distortion of competition in the deposit market in the receiving country is regarded as low in connection with the fact that, as a rule, foreign banks’ branches very rarely engage in attracting deposits. Moreover, unlike other EAEU member countries, in Belarus the government guarantees full (100%) reimbursement of a deposit in the currency of a deposit in Republic of Belarus banks if the National Bank revokes a bank’s banking license.

The risk of distortion of competition in the credit market in connection with foreign banks’ skimming off the “best” clients is deemed to be low. In fact, as international experience shows, branches often focus on working with large corporate clients, including TNCs and foreign companies. However, considering that the subsidiaries of the largest Russian lending institutions and Raiffeisenbank already operate in Belarus, it is fairly unlikely that the advent of other member countries’ banks would cause an outflow to them of clients from Belarus resident banks. The risk that Belarusian subsidiary banks of Russian lending institutions would be reregistered as branches, as seen in a number of Central and East European countries, appears low, since that would not offer significant benefits (the taxation level and banking regulation do not differ significantly), while entailing substantial risks associated, at the minimum, with the procedures for registering a branch.

The fact that branches prefer to work with large corporate clients and generally do not engage in retail business means that the risks associated with the possibility on increasing the debt load of individuals and legal entities are low.

The risk that in the event of a parent bank’s bankruptcy the deposit insurance fund in a branch’s country of origin might not have sufficient funds to make payments

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9 In Russia bank deposits are insured at 100% (regardless of the number of deposits in one bank), but by no more than RUB 1.4 mil. (for insurance events occurring after December 29, 2014). In Kazakhstan – by no more than T 5 mil in total for all deposits opened in the same bank. In Kyrgyzstan by som 100,000. In the Republic of Armenia – by RA dram 4 mil, if the amount is invested only in foreign exchange; the maximum amount of a guaranteed deposit is dram 2 mil.
to depositors is deemed to be low. That is because branches, as noted above, practically do not engage in attracting individuals’ deposits, and placement of deposits in Belarusian banks is more attractive from the standpoint of reimbursement of a deposit in the event a bank has problems. Moreover, pursuant to Annex 17 to the Eurasian Economic Union Treaty, member countries must harmonize the establishment and operation of the system for insuring individuals' deposits (including amounts of compensation paid out).

Since the funds provided to a bank by a parent bank are reflected as an external debt for Belarus, there is a moderate risk of a worsening of debt by maturity statistics, especially with respect to short-term debt.

Thus, most of the risks associated with the advent in Belarus of branches of EAEU member countries’ banks are low or moderate. They can be additionally mitigated through member states’ harmonization of the procedures and conditions for issuing banking licenses with respect to branches, prudential standards for banks, and deposit insurance, and through the establishment of a supernational banking administration and coordination of monetary policy.

At the same time, such high-risk factors as increased vulnerability to shocks occurring in a branch’s country of origin and world financial markets, increased cyclicality of lending, and a possible outflow of funds from a branch to its parent bank are virtually immune to control and mitigation on the part of the receiving country’s authorities. Thus, it must be taken into account that branches of EAEU member countries' banks might act as a potential source of transfer of shocks from one member state’s economy to another.
2. Lifting Restrictions on Capital Account Activity and Eliminating Surrender of Foreign Exchange Earnings

The Eurasian Economic Union Treaty calls for the member states’ development of agreed approaches to the regulation of currency relations and their liberalization. Pursuant to that treaty provision, the Eurasian Commission has prepared a draft agreement containing those approaches. It stipulates, in particular, that exchange operations between EAEU member countries’ residents will not require permits; nor will they require the opening and maintenance of bank accounts by residents of one member state in another member state’s authorized institutions. Moreover, exchange restrictions on settlements between EAEU member countries’ residents will be eliminated: For example, settlements related to the transfer of goods; to the acquisition of shares and participation interest and making of deposits; to the acquisition through member countries’ organized markets of government securities and other securities issued by member states’ residents; to obtaining and using bank guarantees; to obtaining and repaying credit; to the payment of interest; to the remittances by individuals within the EAEU’s borders; and to other exchange operations. The agreement also provides for member states to lift foreign exchange surrender requirements for the residents of their own states. All of the aforementioned means for Belarus the liberalization of capital flows and exchange arrangements with EAEU countries.

Traditionally economic theory has held that capital account liberalization can have a number of advantages for a country associated with the inflow of capital, such as causing an increase in investment, reducing the cost of loans, and increasing external trade and ultimately prosperity. It can also contribute to the efficient distribution of resources, and an increase in incomes and consumption (Fischer, 1998, 2003; Obstfeld, 1998; Rogoff, 1999; Summers, 2000). However, by late 2000 an alternative view, based on the results of empirical analysis, to the effect that there is no correlation between the openness of a country’s capital account and the volume of its investment or rates of economic growth. Thus, the benefits from capital account liberalization, if any, are not obvious compared with the costs (Rodrik, 1998). In recent years, especially since the 1997–1998 Asian crisis and the 2008–2009 world financial crisis, the focus of the debate has gradually shifted from discussion of when liberalization should be carried out to whether it needs to be carried out at all, if it doesn’t result in economic growth and increased efficiency but creates an inflow of speculative capital. International experience shows that for developing countries access to international financial markets may have a procyclical effect. International investors invest money in given countries at times of economic stability and withdraw it at the first indications of problems in a national or the world economy. That intensifies the volatility
of the economies of countries receiving investments and ultimately may contribute to the development of a financial and exchange crisis.

Despite all these debates, the trend toward increasing the extent of capital account liberalization persists. This is related to globalization, countries’ ever increasing involvement in international trade, and development of the financial market and of regional economic integration processes. All of the aforesaid, in turn, is resulting in making it possible to circumvent restrictions on the movement of capital flows. Moreover, for developing countries and countries with transitional economies, capital account liberalization serves as a kind of signal of adherence to rational economic policy. One should also note the fact that no country that has lifted restrictions on capital flows in recent decades has strategically reversed that decision, but only, in a number of cases, suspended it for a certain time or instituted temporary restrictions.

International experience indicates that removing barriers to capital account activity should be coordinated with certain measures in macroeconomic policy. Otherwise it may result in crisis phenomena and an increase in external debt, especially short-term debt, and create a threat to financial stability. The necessary prior conditions for opening the capital account are (IMF, 2013, 2015):

- good macroeconomic indicators;
- a developed financial sector capable of coping with capital flow volatility;
- a steady lack of substantial current account deficit;
- a sufficient level of international reserve assets;
- a floating exchange rate;
- a cautious fiscal policy;
- high-quality prudential supervision and regulation in the financial sector;
- an effective system for monitoring capital flows;
- an effective risk management system on the part of economic agents in the financial and nonfinancial sectors;
- use of best practices in accounting, auditing, disclosure standards, and reporting rules;
- absence of the practice of providing implicit government guarantees, which encourage an excessive and unstable capital flow.

A developed securities market is also cited as a condition favoring liberalization. Countries in which the aforementioned prior conditions are not fully met must coordinate liberalization of capital flows with fulfillment of those prerequisites.

In 2015 the Independent Evaluation Office of the IMF published a report on the IMF’s approaches to assets and liabilities (IMF, 2015). It notes that the Integrated Surveillance Decision adopted by the IMF in 2012 contains an institutional view of the problem of capital account liberalization and management of capital flows (IMF, 2012a). According to that institutional view, complete capital account liberalization is not always advisable for all countries, and in certain circumstances measures may be taken for managing capital flows (CFMs). That institutional view is not contrary to Article
2. LIFTING RESTRICTIONS ON CAPITAL ACCOUNT ACTIVITY AND ELIMINATING SURRENDER OF FOREIGN EXCHANGE EARNINGS

VII of the IMF Articles of Agreement, according to which “no member shall, without the approval of the Fund, impose restrictions on the making of payments and transfers for current international transactions” (IMF, 2011). Thus, capital account liberalization does not rule out the possibility of a temporary reinstitution of capital flow management measures if necessary to achieve financial stability, or of maintaining some of those measures out of national security considerations (IMF, 2013). And the pace of capital account liberalization should correspond to the level of development of a country’s financial system and institutions (IMF, 2013).

Based on the foregoing, Table 2.1 provides an assessment of fulfillment of the prior conditions for capital account liberalization in Belarus within the EAEU.

As of Q3 2015 only four of the 11 prior conditions have been fulfilled. And it is highly unlikely that by the first of 2017 Belarus will be able to fulfill the seven remaining, among which are such important parameters as the steady lack of substantial current account deficit, sufficient level of international reserve assets, and the existence of an effective risk management system on the part of economic agents. All that may increase the risks for Belarus in connection with capital account liberalization. Table 2.2 gives an expert assessment of those risks.

As evident from Table 2.2, for Belarus the risks associated with an inflow of capital are deemed low or moderate, primarily because of its undeveloped securities market. Yet they still exist — for example, in connection with a difference in interest rates on deposits in the domestic currency and in dollars/ euros, compared with other EAEU countries. As international experience shows, a difference in interest rates results in an inflow of capital into those countries where they are higher.

The chief risks for Belarus, however, are associated with the possibility of an outflow of capital — both domestic capital and that which has come in as a result of an inflow.

<table>
<thead>
<tr>
<th>Prior Conditions for Capital Account Liberalization</th>
<th>Yes</th>
<th>No</th>
</tr>
</thead>
<tbody>
<tr>
<td>Good macroeconomic indicators, including low inflation rate</td>
<td>✔</td>
<td></td>
</tr>
<tr>
<td>Steady lack of substantial current account deficit</td>
<td>✔</td>
<td></td>
</tr>
<tr>
<td>Sufficient level of international reserve assets</td>
<td>✔</td>
<td></td>
</tr>
<tr>
<td>Floating exchange rate</td>
<td>✔</td>
<td></td>
</tr>
<tr>
<td>Cautious fiscal policy</td>
<td>✔</td>
<td></td>
</tr>
<tr>
<td>Developed financial sector capable of coping with capital flow volatility</td>
<td></td>
<td>✔</td>
</tr>
<tr>
<td>High quality of prudential supervision and regulation in the financial sector</td>
<td>✔</td>
<td></td>
</tr>
<tr>
<td>Effective system for monitoring capital flows</td>
<td>✔</td>
<td></td>
</tr>
<tr>
<td>Effective risk management on the part of economic agents in financial and nonfinancial sectors</td>
<td></td>
<td>✔</td>
</tr>
<tr>
<td>Use of best practices in accounting, auditing, disclosure standards, and reporting rules</td>
<td>✔</td>
<td></td>
</tr>
<tr>
<td>Absence of practice of providing implicit government guarantees, which encourage excessive and unstable capital flow</td>
<td>✔</td>
<td></td>
</tr>
</tbody>
</table>

Source: authors’ assessment.
First of all, that may result in devaluation of the domestic currency and a reduction in international reserve assets, and put pressure on the payments balance and the banking sector as a result, for example, of an outflow of deposits.

In this connection it would be a good idea for Belarus, in removing the barriers to capital account activity, to develop capital flow management measures and apply them where necessary. It should be considered that, according to IMF country studies, they have varying degrees of effectiveness and their effect is usually short-lived.\footnote{See, for example, Baba and Kokenye (2011); Saborowski et al. (2014).}

However, it should also be noted that CFMs may make it possible to buy time until the government has taken the necessary measures to mitigate the negative effects resulting from capital inflow or outflow, and macroeconomic adjustment has occurred (IMF, 2010).

Capital flow management measures divide into two groups:

- those aimed at limiting capital inflow;
- those aimed at reducing capital outflow.

In turn, in each of those two groups, the IMF (IMF, 2013, 2015) identifies:

- CFMs based on the principle of residency. They constitute a wide selection of measures (taxes, regulation) affecting cross-border financial activity and applied

\begin{table}
\centering
\begin{tabular}{|l|l|l|l|}
\hline
                      & \textbf{Risks of capital inflow} & \textbf{Risks of capital outflow} & \\
\hline
\textbf{Overheating of economy} & High & Moderate & Low & High & Moderate & Low & \\
\hline
\textbf{Revaluation of domestic currency and resulting lowering of competitiveness in EAEU markets} & High & Moderate & Low & High & Moderate & Low & \\
\hline
\textbf{Bubbles in the assets market} & High & Moderate & Low & High & Moderate & Low & \\
\hline
\textbf{Balance of payments crisis} & High & Moderate & Low & \\
\hline
\textbf{Insufficient financial resources on part of economic agents (financial and nonfinancial sectors)} & High & Moderate & Low & \\
\hline
\textbf{Reduction in production volumes} & High & Moderate & Low & \\
\hline
\end{tabular}
\caption{Assessment of Risks for Belarus in Connection with Capital Account Liberalization}
\end{table}
differently to residents and nonresidents (for example, a limit for nonresidents on the purchase of government securities);

- other CFMs that are applied equally to residents and nonresidents. An example of such measures is a minimum ownership period and reserve requirements for deposits in foreign exchange.

Each of these groups includes both direct regulatory measures (limits and prohibitions) and price or market measures raising costs (for example, taxes, non-interest-bearing required reserves, etc.). CFMs may also be distinguished according to whether they pertain to any specific operations associated with capital inflow/ outflow (for example, only to portfolio operations) or cover everything. They may also apply only to short-term capital flows. Table 2.3 gives examples of capital flow management measures used by various countries in recent years.

Thus, as international experience shows, in liberalizing the capital account countries may choose the course of gradually lifting restrictions in order to provide protection against turbulence in international markets and carry out necessary reforms and transformations in the economy. Overall, according to the 2014 IMF Annual Report on Exchange Arrangements and Exchange Restrictions, most countries to one degree or another use measures for controlling capital account operations. For example, 151 of 188 countries control operations in the securities market, and 94 control operations in the capital of individuals.

It should also be noted that capital account liberalization is usually accompanied by an easing of exchange restrictions, one of which is the surrender by exporters of foreign exchange earnings. IMF databases on exchange arrangements and exchange restrictions indicate that the percentage of countries using such a measure has steadily declined since the end of the 1990s. Consequently, it dropped from 44.7% in 1997 to 29.4% in 2006. After that, however, following the 2008–2009 world financial crisis, it began to rise (see Figure 2.1.), and the percentage of states requiring the surrender of foreign exchange earnings had risen to 32% by 2014.

According to the 2014 IMF Annual Report on Exchange Arrangements and Exchange Restrictions, the number of measures aimed at tightening the conditions of repatriation and surrender of foreign exchange earnings (33) exceeded the number associated with liberalization (15). In 2014 60 countries required the surrender of foreign exchange earnings (for comparison: in 2009 the number was 50, in 2007 – 57), including Argentina, Brazil, India, the Philippines and the Republic of South Africa, despite the fact that this measure, generally speaking, negatively impacts:

- enterprises’ costs as a result of the difference between foreign currency purchase and sale exchange rates, and it also results in additional expenses associated with bank margin. This is especially sensitive for enterprises that import intermediate goods for the production of end products. An increase in costs in connection with the surrender of foreign exchange affects enterprises’ competitiveness;

- receipts of foreign exchange earnings in a country, since enterprises create various schemes for keeping them abroad;

- a country’s investment climate and its attractiveness to foreign investors.
### Measures Used by Countries to Limit Capital Flows

<table>
<thead>
<tr>
<th>Country</th>
<th>Date</th>
<th>Measure</th>
<th>Objective</th>
</tr>
</thead>
<tbody>
<tr>
<td>Brazil</td>
<td>2009</td>
<td>Imposition of a 2% tax on portfolio investment and inflow of debt</td>
<td>Tax imposed directly on inflow</td>
</tr>
<tr>
<td>Indonesia</td>
<td>2011</td>
<td>Establishment of: 1) six-month period for ownership of central bank bonds; 2) limit of 30% of capital on banks’ short-term foreign borrowing</td>
<td>Aimed at reducing demand for foreign capital</td>
</tr>
<tr>
<td>Korea</td>
<td>2011</td>
<td>Establishment of 14% tax on interest income and dividends paid to nonresidents acquiring treasury and monetary stabilization bonds (in addition to 20% profit tax on stock market operations). That tax may be reduced for nonresidents from countries with which agreements on avoidance of dual taxation have been entered into, and state investors are also exempt from it.</td>
<td>Raising tax on foreign investors in order to reduce capital inflow</td>
</tr>
<tr>
<td>Peru</td>
<td>2010</td>
<td>Increase in commission on nonresidents’ purchase of central bank securities from 10 to 400 base points</td>
<td>Reducing capital inflow by nonresidents</td>
</tr>
<tr>
<td>Thailand</td>
<td>2006</td>
<td>Institution of requirement on setting aside non-interest-bearing reserves of 30% of amount of capital inflow (excluding direct foreign investment) exceeding USD 20,000. In event of early removal, only two-thirds of amount is returned. Subsequently investments in exchange-traded shares were also exempted from that requirement.</td>
<td>Raising tax on foreign investors in order to reduce capital inflow</td>
</tr>
<tr>
<td>India</td>
<td>2014</td>
<td>Reinstatement of limits withdrawn in 2013 on interest rates on nonresidents’ deposits in rupees (they are lower than for residents)</td>
<td>Reduction of capital inflow by nonresidents</td>
</tr>
<tr>
<td>Argentina</td>
<td>2001</td>
<td>Establishment of corralito, which imposes limits on withdrawal of funds from bank accounts and on transfers and loans in foreign exchange</td>
<td>Direct limit on capital flows</td>
</tr>
<tr>
<td>Iceland</td>
<td>2008</td>
<td>Termination of conversion of accounts in foreign exchange for operations related to movement of capital</td>
<td>Direct limit on capital flows</td>
</tr>
<tr>
<td>Malaysia</td>
<td>1998</td>
<td>Institution for nonresidents of 12-month waiting period for conversion of earnings from sale of Malaysian securities</td>
<td>Discrimination based on residency principle for limiting capital outflow</td>
</tr>
<tr>
<td>Ukraine</td>
<td>2008</td>
<td>Institution for nonresidents of five-day waiting period for converting investment earnings in domestic currency to foreign exchange</td>
<td>Discrimination based on residency principle for limiting capital outflow</td>
</tr>
<tr>
<td>Thailand</td>
<td>1997</td>
<td>Institution of limits on forward transactions and requirement of surrender of export earnings</td>
<td>Limit on exchange operations for reducing capital outflow</td>
</tr>
<tr>
<td>Cyprus</td>
<td>2013</td>
<td>Limit on transfer of money abroad (more than €5,000 — only with central bank permission) and withdrawal of deposits, foreign credit card transactions (€5,000 per month), and export of money by individuals (€3,000 per trip)</td>
<td>Reduction of capital outflow</td>
</tr>
</tbody>
</table>

Source: IMF (2013), authors’ assessment.
At the same time, countries requiring the surrender of foreign exchange earnings compare those costs with the potential risks of lifting it — an increase in the volatility of the exchange rate and the possibility of its drastically weakening in the case of external shocks and also with the increased dollarization of the economy.

For Belarus, unquestionably, despite all the costs mentioned above, the risks of eliminating surrender are also fairly high. That is due first of all to a balance of payments imbalance, a low level of international reserve assets, and a lack of sufficient confidence in the domestic currency. It is difficult to make a quantitative assessment of those risks in connection with the difficulty of putting a number on both potential shocks and the effects associated with the degree of confidence in the Belarusian rubel. But the experience of EAEU partner countries and of Russia in particular indicates that the volume of offers to sell foreign exchange may abruptly and substantially decline, placing strong pressure on the domestic currency, which results, in turn, in the need for intervention on the part of the central bank. Therefore, for Belarus in eliminating the surrender of foreign exchange earnings, the level of reserves, state of the payments balance and degree of confidence in the domestic currency must be kept in mind. International experience shows that in a number of cases countries employ a gradual approach to eliminating it. For example, Argentina permitted enterprises not to surrender foreign exchange if they needed to service external debt. Some countries require surrender only for sectors related to the export of natural resources, and lift the requirement for those that use imported raw materials and other materials in their production.

12 In the first half of December 2014 the Bank of Russia spent $10.302 bln. in the course of exchange interventions aimed at supporting the ruble exchange rate. According to the RF Central Bank, on December 14 alone it sold USD 2.383 bln., and on December 15 it sold USD 1.961 bln. Despite that, on December 16, 2014, in trading on the Moscow Interbank Currency Exchange the value of the dollar fluctuated between RUB 58.1 and RUB 80.1, and there was no one that wanted to sell dollars and euros in the market. Consequently, the RF Government had to practically coordinate the sale of the earnings of large Russian exporters. At the end of August 2015, amid a strong devaluation of the Russian ruble, the demand for dollars on the Moscow Interbank Currency Exchange substantially exceeded supply in the market: for example, on August 28, 2015, it exceeded it by fourfold, and consequently total offers for the sale of foreign exchange fell to the lowest since December 2014 (for the main trading session). Available at: http://www.finanz.ru/novosti/valyuty/kurs-dollara-otelet-za-chasn-rublya-1000786220.
3. The Insurance Sector

As noted above, the creation of a common financial market in the EAEU contemplates the possibility of engaging in the provision of services in the insurance sector throughout the Union’s entire territory without establishment of a legal entity, i.e., in the form of insurance company branches. On the one hand, that opens up additional opportunities for potential insurers and may foster development of the insurance market, while on the other, it requires consideration of the risks associated with the activity of branches and the development of measures to neutralize them. Special attention should be given to a system of prudential supervision of insurance company branches and coordination of supervision within the EAEU.

It has been believed that insurance companies follow virtually the same criteria as banks in choosing a form of presence in a receiving country’s market. Therefore, it is appropriate to apply to them the factors proposed by Cerutti et al. (2007) and Fiechter et al. (2011), in determining whether an insurance company will enter in the form or a branch or a subsidiary. In a general sense, these factors can be divided into exogenic and endogenic. The first group includes the regulatory system in the receiving country, the level of taxation, the degree of development of the financial market, and the existence of economic and political risks. Endogenic factors include the business model and market entry strategy used by the parent company.

Experience indicates that the most important factors are the level of taxation and business regulation. Branches may also be preferable as the initial model for market entry and if an insurance company plans to engage in wholesale operations. For example, reinsurance is quite often conducted through branches. Insurers may also prefer branches because they entail lower operating costs: In particular, branches do not require the existence of an executive board, may obtain capital from the parent company, and their regulation may differ from that which is applied to domestic companies.

In general, the risks associated with the advent of insurance company branches have much in common with risks in the banking sector. First of all, the following are usually identified:

- the complexity of supervision of a branch, since it is performed by authorities of the country of origin rather than the receiving country;
- the impossibility of stabilizing a branch through the efforts of the receiving country’s authorities if the parent insurance company experiences difficulties;
- increased vulnerability to shocks occurring in the country of origin, which may, for example, result in the parent company’s withdrawal of funds from the branch;
- the possibility of an outflow of foreign exchange;
- crowding out of domestic insurance companies and distortion of competition in the insurance market in the receiving country, since branches (especially of large insurance companies) may exploit the lower costs associated with operating branches.

13 These factors are considered in more detail in Section 1.1 of this paper.
foreign insurance companies) are often able to offer services at lower prices. They may also enter the most profitable segments of the insurance market.

In order to mitigate all of the aforementioned risks, receiving countries’ supervisory authorities develop approaches to regulating branches based on the specific features of the domestic insurance market. The International Association of Insurance Supervisors (IAIS) identifies three types of differences in supervision of branches: 1) between jurisdictions and areas of authority, i.e., between that which the country of origin’s supervisors are responsible for and that which the receiving country’s authorities are responsible for; 2) between branches engaged in primary insurance and those engaged in reinsurance. In this respect the differences lie not so much in the plane of distinctions between the regulation of traditional insurance and reinsurance companies as in the level and depth of monitoring of their activities; 3) between branches and domestic insurance companies (including the subsidiaries of foreign insurance companies).

International experience in regulating insurance company branches indicates that countries’ approaches to licensing, financial obligations, the conduct of business, and the governance and financial soundness of insurance company branches differ. According to the International Association of Insurance Supervisors (IAIS, 2013), in most countries branches must obtain a license for which the requirements are similar to those for domestic insurers.

An important issue in the regulation of insurance company branches is the financial obligations that, as a rule, they must assume in the receiving country’s insurance market. Table 3.1 presents a survey of financial requirements imposed by receiving countries’ supervisors on insurance company branches. Such financial obligations take the form of brought-in capital. They are expressed in the fact that branches, in order to obtain a license, must keep a certain amount of assets in the form of a deposit in a bank or trust fund, or in some other form. That is a kind of security capital that is required along with meeting the assets backing insurance liabilities requirement. The approach to determining those financial requirements may differ among countries. For example, Switzerland emphasizes the type of insurance business and the extent of its exposure. As noted above, the amount in question is either deposited in a bank or held by a trustee. Other arrangements may also be used. In addition, in a number of countries a branch must obtain approval of the receiving country’s supervisor if it wants to gain access to its assets for performing operations. In the EU countries branches of foreign insurance companies must have assets equal to at least half their guarantee fund. The latter equals one-third of the solvency margin or a minimum amount indicated in a European Commission directive. In addition, branches must have reserves.

Also, as a rule, a receiving country’s supervisors regulate branches. In particular, in many countries they are forbidden to offer either life or non-life insurance services within a single legal entity. In a number of countries that allow a single branch to offer both types of insurance, it must meet a number of conditions.

According to IAIS data, foreign insurance company branches engage in a receiving country market in underwriting, claims adjustment, and management of information about the insured. However, they engage in practically no brokerage, since they quite often sell their own products.
A receiving country’s supervisory authorities also impose a number of requirements with respect to management of branches. In particular, the latter must have a representative from the receiving country either involved in management or representing the interests of the insured. The solvency of foreign insurance companies’ branches is one indicator that is continuously monitored by a receiving country’s supervisory authorities. In that connection, branches

### Table 3.1. Financial Requirements Imposed by Receiving Countries’ Supervisors on Foreign Banks’ Branches

<table>
<thead>
<tr>
<th>Country</th>
<th>Financial obligations in receiving country</th>
<th>Requirement of deposit held in bank or funds held by trustee</th>
<th>Obtain permission of the receiving country's supervisor for access to assets</th>
<th>Identical requirements for branches and domestic insurers</th>
</tr>
</thead>
<tbody>
<tr>
<td>Australia</td>
<td>Yes</td>
<td>Other&lt;sup&gt;1&lt;/sup&gt;</td>
<td>Yes&lt;sup&gt;2&lt;/sup&gt;</td>
<td>Yes</td>
</tr>
<tr>
<td>Canada</td>
<td>Yes</td>
<td>In trust</td>
<td>Yes&lt;sup&gt;3&lt;/sup&gt;</td>
<td>No</td>
</tr>
<tr>
<td>France</td>
<td>Yes</td>
<td>Other&lt;sup&gt;4&lt;/sup&gt;</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Germany</td>
<td>Yes</td>
<td>Deposit</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Italy</td>
<td>Yes</td>
<td>Deposit</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Japan</td>
<td>Yes</td>
<td>Other&lt;sup&gt;6&lt;/sup&gt;</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>South Korea</td>
<td>Yes</td>
<td>Deposit</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>The Netherlands</td>
<td>Yes&lt;sup&gt;7&lt;/sup&gt;</td>
<td>Deposit</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Poland</td>
<td>Yes</td>
<td>Deposit</td>
<td>Yes&lt;sup&gt;8&lt;/sup&gt;</td>
<td>No</td>
</tr>
<tr>
<td>Singapore</td>
<td>Yes</td>
<td>Other&lt;sup&gt;9&lt;/sup&gt;</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>Spain</td>
<td>Yes&lt;sup&gt;10&lt;/sup&gt;</td>
<td>Deposit</td>
<td>Yes&lt;sup&gt;11&lt;/sup&gt;</td>
<td>Yes</td>
</tr>
<tr>
<td>Switzerland</td>
<td>Yes&lt;sup&gt;12&lt;/sup&gt;</td>
<td>Deposit&lt;sup&gt;13&lt;/sup&gt;</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>UK</td>
<td>Yes&lt;sup&gt;14&lt;/sup&gt;</td>
<td>Deposit</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>US (Michigan)</td>
<td>Yes</td>
<td>Deposit</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>US (Washington)</td>
<td>Yes</td>
<td>In trust</td>
<td>Yes</td>
<td>Yes</td>
</tr>
</tbody>
</table>


Notes:
1. In the case of property insurance, the amount is held by a custodian. In the case of life insurance, there must be a statutory fund that relates exclusively to that activity and it must be kept in a separate bank account. That fund must include all assets related to the activity associated with the fund and all liabilities of the insurer stemming from life insurance operations.
2. In the event it is planned to reduce capital or to make a material change in the capital position.
3. Excluding cases in which the withdrawal of assets is offset by their analogous receipt.
4. Deposit in Caisse des Dépôt et Consignations, or account in Banque de France.
5. Amount equal to at least the minimum guarantee fund must be invested in Italy. An amount in cash or bonds equal to at least half the guarantee fund must be deposited as security in Cassa depositi e prestiti or the Bank of Italy.
6. A deposit of 200 mil. yen in a special depository entity.
7. At least half of the minimum guarantee fund must be placed in deposit.
8. Although it is not explicit in law.
9. Amount depends on type of activity.
10. Applies only to one-fourth of the minimum guarantee fund.
11. The financial market supervisor (FINMA) determines the required amount for each branch. The amount fluctuates from 20% to 50% of the minimum capital requirement. In addition, an insurance deposit must be made in an amount proportional to the solvency margin for that type of activity in Switzerland. The amount of that deposit is determined by FINMA. There is also a requirement for the minimum amount of funds that must be held for restricted assets. For newly established branches the required amount of restricted assets is at least 750,000 Swiss francs for life insurance and 100,000 Swiss francs for property insurance (non-life insurance).
12. Entity funds (paid-in share capital) must be kept in a bank account in Switzerland, and an insurance deposit (proportional to the solvency margin) — in the National Bank of Switzerland.
13. Excluding reinsurance and Swiss companies offering property insurance.
must continuously assess that indicator and report on their solvency margin. If a receiving
country’s supervisors believe that regulation of solvency is performed properly in the country
of origin, calculation of the margin may be performed in accordance with those standards.

In most countries supervisors require that branches reflect transactions with the receiving
country’s residents on their balance sheets and that assets covering insurance liabilities
(co-called linked assets) be present in the receiving country. Yet a number of countries,
such as Austria, Germany and Belgium, have no such requirement, and Singapore’s
supervisors may require that condition to be met if they deem it necessary. Table 3.2
presents information on countries that require that assets covering insurance liabilities
be present in the receiving country.

In virtually all countries the receiving country’s supervisors require that branches submit
audited financial statements that must be available to the public. Those authorities may

<table>
<thead>
<tr>
<th>Australia</th>
<th>Yes&lt;sup&gt;1&lt;/sup&gt;</th>
<th>Other&lt;sup&gt;2&lt;/sup&gt;</th>
<th>No&lt;sup&gt;3&lt;/sup&gt;</th>
<th>Other&lt;sup&gt;4&lt;/sup&gt;</th>
</tr>
</thead>
<tbody>
<tr>
<td>Canada</td>
<td>Yes</td>
<td>In trust</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>France</td>
<td>Yes&lt;sup&gt;5&lt;/sup&gt;</td>
<td>Other&lt;sup&gt;6&lt;/sup&gt;</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Germany</td>
<td>No</td>
<td>In trust&lt;sup&gt;7&lt;/sup&gt;</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>Italy</td>
<td>No</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>Japan</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>South Korea</td>
<td>Yes</td>
<td>Deposit</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>The Netherlands</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>Poland</td>
<td>No</td>
<td>N/A</td>
<td>N/A</td>
<td>Yes</td>
</tr>
<tr>
<td>Singapore</td>
<td>No</td>
<td>N/A</td>
<td>N/A</td>
<td>Yes</td>
</tr>
<tr>
<td>Spain</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
<td>No&lt;sup&gt;8&lt;/sup&gt;</td>
</tr>
<tr>
<td>Switzerland</td>
<td>No</td>
<td>Other&lt;sup&gt;9&lt;/sup&gt;</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>UK</td>
<td>Yes&lt;sup&gt;10&lt;/sup&gt;</td>
<td>No</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>US (Michigan)</td>
<td>Yes</td>
<td>In trust&lt;sup&gt;11&lt;/sup&gt;</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>US (Washington)</td>
<td>Yes</td>
<td>In trust</td>
<td>Yes</td>
<td>No</td>
</tr>
</tbody>
</table>


Notes:
<sup>1</sup> With respect to property insurance.
<sup>2</sup> With respect to property insurance — held by a custodian or agent; with respect to life insurance — in authorized capital.
<sup>3</sup> Supervisors must be informed of a planned reduction in capital or a material change in capital position.
<sup>4</sup> With respect to property insurance, there are no requirements for national insurers that assets be held by a custodian or agent.
<sup>5</sup> There is a specific list of assets that insurance companies must have in order to cover liabilities.
<sup>6</sup> Assets covering technical reserves must be kept in Caisse des Dépôt et Consignations, or an account in Banque de France.
<sup>7</sup> With respect to life, health and long-term healthcare insurance.
<sup>8</sup> In the case of domestic insurers, assets may be kept in any country in the European Economic Area.
<sup>9</sup> Must be kept in Switzerland separately from other assets associated with insurance activity.
<sup>10</sup> Excluding reinsurance.
<sup>11</sup> A trustee must be a qualified US financial institution, i.e., a bank or trust company established on the basis of federal or state law.
perform both external monitoring and direct inspections of branches, and may also take part in audits performed by the country of origin’s authorities. Furthermore, in many countries supervisory authorities of the country of origin have the right to intervene in a branch’s activities where necessary.

For example, since in times of crisis a branch’s assets may be withdrawn by the parent insurance company, in many countries the receiving country’s authorities may prohibit the transfer of assets to other countries in order to protect resident policyholders (see Tables 3.1 and 3.2). In some countries, such as New Zealand, such a prohibition may be imposed only in certain situations. If a threat arises that a foreign insurance company branch’s capital or technical reserves might prove lower than the required minimum, the receiving country’s supervisors may require that the capital or technical reserves be increased. In a number of countries the requirement that capital be increased is made when a branch’s reserves for covering losses fall below 100%, and for some the threshold is 150% or 200% of insurance companies’ solvency requirements. In many countries the receiving country’s supervisors also have the authority to suspend the operation of a branch or close it.

At the same time, according to EU law, supervision of the branches of European Economic Area insurance and reinsurance companies falls within the exclusive jurisdiction of an insurance company’s country of origin. And if a branch’s operation threatens a country’s financial stability, the receiving country’s authorities may request that the country of origin’s authorities take appropriate measures.

Thus, international experience indicates that there is a selection of measures enabling a receiving country’s supervisory authorities to regulate foreign insurance company branches in order to prevent them from endangering financial stability. That makes it possible to substantially reduce the aforementioned risks associated with supervision, the possible withdrawal of funds by a parent company, and vulnerability to shocks in the country of origin.

However, there are still risks associated with a potential crowding out of domestic insurance companies and distortion of competition in the insurance market in the receiving country by virtue of the fact that branches (especially of large foreign insurance companies) often can offer services at lower prices.

In the experience of Central and East European countries, liberalization of the insurance services market has been accompanied by a substantial increase in the foreign capital percentage of insurance companies’ total authorized capital. In Poland, for example, the foreign investment percentage of authorized capital in 2009–2010 was 78% (Ratowska, 2011). In Central and East European countries as a whole, the foreign capital percentage of total authorized capital ranges from 50% to, for example, 95% in Hungary. In Ukraine, following its joining the WTO and a gradual easing of the limit on the foreign capital share of insurance companies’ authorized capital, the presence of foreign companies in the market substantially increased. Whereas at the end of 2007 the foreign capital percentage was 19.5%, as of the beginning of 2013 it was already 32.8%. And of the 10 leading Ukrainian insurance companies, 9 belonged to foreigners (Zhabynets, 2013).

In many Central and East European countries foreign capital has a fairly active presence in the form of branches of foreign insurance companies (see Table 3.3). For example,
Inset 3.1. Regulation of insurance companies and their branches within the EU

Insurance companies that are legal entities of an EU country or country in the European Economic Area, starting in 1990 for property insurance and 1992 for life insurance, have been able to offer services on the territory of another member state. To do so they must notify the relevant authorities of the country where their headquarters is located and where the branch is located.

From the time that a member state’s relevant authorities receive all the required information, an insurer in the member state in which the company was founded is admitted to provide services in another member state. General provisions governing the operation of member states’ insurance market are contained in the European Commission Delegated Regulation 2014/35. It not only includes regulations related to the insurance business but also harmonizes the means and methods of supervising insurance companies.

Pursuant to the Solvency II Directive, separate supervision must be performed of activity related to life insurance, on the one hand, and property insurance, on the other. Accordingly, a company’s funds must be separated and separate assessments must be made of minimum capital. The Directive also contains approaches and criteria for assessing the solvency of insurance companies associated with third countries.

Source: prepared by authors.


according to OECD information, in Latvia 63% of insurance companies operating in the market are foreign branches. In Slovakia they constitute 61%, and in that country non-life insurance is offered exclusively by foreign branches. On average, foreign companies’ branches account for 20%–30% of all insurance companies in Central and East European countries.

Branches mainly offer property insurance, and they have very strongly crowded domestic companies out of that market. In Hungary, of 57 insurance companies operating in the market, 15 are foreign company branches. And 14 of them deal solely in property insurance, while there are only six domestic insurers in that market. And there is an equal number of foreign companies that are Hungarian legal entities. In the Czech Republic 15 foreign branches and just 8 domestic companies offer property insurance; in Latvia the comparable numbers are 7 branches and 3 domestic companies, and in Estonia those numbers are 4 and 3, respectively (Table 3.3) This situation differs fundamentally from that which exists in developed countries’
insurance markets, where the presence of branches is much less significant. For example, in the US they account for 0.3% of the total number of insurance companies, in the UK — for 3%, and in Germany — for 1.6%. That is due both to the high degree of competitiveness of domestic insurers and to regulation of branches by supervisory authorities.

The above analysis makes it possible to assess the opportunities and risks for Belarus associated with liberalization of the insurance market within the EAEU and the anticipated entry of branches of member states’ insurance companies. On the whole, as Table 3.4 makes apparent, the benefits\(^\text{14}\) of regional liberalization are regarded as low or moderate. That is because the level of technology and know-how in the insurance sector and the quality and selection of insurance services of partner countries, and Russia in particular, are on a level close to that in Belarus, and the macroeconomic situation in the EAEU states is not conducive to branches’ being able to obtain cheaper resources from parent companies.

The risks associated with opening branches, as international experience shows, may be substantially mitigated through the high requirements that supervisory authorities often impose on branches. However, for many developing countries and transitional economies the advent of branches has resulted in crowding domestic insurance companies out of the market. For Belarus such risks in the context of liberalization of the insurance market within the EAEU are low.

\(^{14}\) The list of opportunities that a country may gain from liberalization of the insurance sector is based on international experience.
The appearance of foreign branches from partner countries will be restrained by the fact that society’s insurance culture is relatively low, and that results in a low level of insurance activity on the part of both individuals and companies. Moreover, Belarus insurance law provides inadequate incentives for development of the insurance market: In particular, there are differences in the authorization of insurance companies under different forms of ownership to offer mandatory insurance.

As the data in Tables 3.3 and 3.5 show, for branches and foreign insurance companies operating in the Central and East European countries, the non-life insurance segment is important. In Russia companies with predominantly foreign capital prefer, in general, to operate precisely in that segment, as do domestic insurers, 74.5% of which offer exclusively non-life insurance.

In Belarus the mandatory types of insurance, which only public insurance companies may offer, are precisely non-life insurance. Moreover, the mandatory types of insurance represent nearly half of the country’s insurance market, and in recent years have accounted for more than 45% of the total value of insurance premiums (46% in 2014); the percentage of mandatory motor vehicle owners’ civil liability insurance, counting the Green Card, is up to 78% in the structure of all contracts and more than 45% in the structure of premiums for mandatory types of insurance. Thus, the market that might be entered by both the branches and subsidiaries of foreign insurance companies is limited, which reduces Belarus’s attractiveness for that sort of investment. Moreover, the size

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15 Since January 1, 2004, only public insurance companies and insurers with more than 50% public ownership of their authorized capital have had the right to offer mandatory civil liability insurance, and since August 1, 2004, only they have had the right to offer Green Card insurance.
of the life insurance segment is limited, as noted above, by the low insurance culture and activity of the population. Consequently, the foreign capital percentage of Belarus insurance companies’ authorized capital is low: In 2014 it was 0.9%, whereas the limit was 30% (Zakharyenok, 2015).

Green Card

In the context of harmonizing the insurance services market in the EAEU, it has been proposed that a system of mandatory civil liability insurance for motor vehicle owners traveling abroad analogous to the Green Card be established in the integration association, and that the member countries mutually recognize the new insurance policy. For Belarus, however, that proposal entails a number of risks associated with the fact that if such insurance were mandatory it might result in increasing costs for transport companies engaged in international haulage. At present Belarusian transport companies perform hauls from third countries to EAEU partner countries (mainly Russia) and transit through EAEU partner countries (usually Russia). By buying a Green Card that covers all countries, the transport companies simultaneously insure both hauls from third countries to a partner country and transit hauls, since that system includes all European countries, including Russia, and a number of routes that are in demand, such as Turkey. Institution of a mandatory parallel system would mean that, besides a Green Card insurance policy for all countries, Belarusian companies would be compelled to buy insurance for all EAEU countries. To get a rough estimate of the possible costs, interviews were conducted with transport companies and the Belarusian Association of International Road Carriers (BAMAP), and data on Green Card truck insurance in

Table 3.5. Distribution of Foreign Insurance Companies by Types of Insurance in Several Countries

<table>
<thead>
<tr>
<th>Country</th>
<th>Foreign insurance companies</th>
<th>Of which, offering types of insurance</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>life</td>
<td>non-life</td>
</tr>
<tr>
<td>Hungary</td>
<td>23</td>
<td>7</td>
</tr>
<tr>
<td>Latvia</td>
<td>3</td>
<td>1</td>
</tr>
<tr>
<td>Poland</td>
<td>45</td>
<td>21</td>
</tr>
<tr>
<td>Slovakia</td>
<td>15</td>
<td>5</td>
</tr>
<tr>
<td>Slovenia</td>
<td>4</td>
<td>1</td>
</tr>
<tr>
<td>Czech Republic</td>
<td>23</td>
<td>2</td>
</tr>
<tr>
<td>Estonia</td>
<td>9</td>
<td>4</td>
</tr>
<tr>
<td>US</td>
<td>624</td>
<td>156</td>
</tr>
<tr>
<td>Korea</td>
<td>11</td>
<td>3</td>
</tr>
<tr>
<td>UK</td>
<td>139</td>
<td>15</td>
</tr>
<tr>
<td>Russia</td>
<td>86**</td>
<td>16</td>
</tr>
</tbody>
</table>

Source: OECD. Stat.

* Offer various types of insurance (property, personal, liability, life).
** Data for 2009.
Belarus were used. Calculations showed that, based on the assumptions used, the existence of a system of mandatory insurance parallel to the Green Card would result in additional costs of €1,881,649 a year for transport companies.

In this connection, two important points should be noted. First, Belarusian transport companies would incur virtually none of the aforementioned costs if, for hauls to Russia, where BAMAP estimates roughly 95% of the hauls from third countries and transit hauls within the EAEU are made, they were able to avoid acquiring EAEU insurance and instead to use Green Card insurance with its coverage of “all countries.” That is due to the need to make hauls from third countries to EAEU countries and perform transit through EAEU partner countries.

Besides the aforementioned assumption concerning the number of trips, the assumption was made that the value of mandatory insurance in the EAEU would equal the value of Green Card insurance in Russia. It should be noted that the assumption about the cost of insurance is highly provisional — it would probably be greater.

Source: prepared by authors.

* Data of Belarusian Transport Insurance Bureau provided by Ministry of Finance.
4. The Securities Market

In the course of creating a common financial market of the EAEU countries, it is planned to carry out the reciprocal admission of professional participants in the securities market to trading on the member states’ exchanges without their additionally establishing a legal entity, and to reciprocally admit securities to trading on Eurasian Economic Union exchanges.

Liberalization of the securities market in developing countries and transitional economies began 20–25 years ago and has become an important stage in development of the financial sector in both those countries and the world as a whole. On the one hand, it has enabled foreign investors to invest in shares in markets that are opening up, and on the other, it has enabled domestic investors to perform transactions in foreign securities. However, both the process of lifting restrictions and the degree of openness of the market in various countries have differed widely, which has resulted in differing degrees of effectiveness of liberalization of the securities market. To a large extent, those differences have been due to how capital account liberalization occurred, what limits were placed on capital inflow and outflow, and whether conditions were imposed for making foreign portfolio investments.\(^{17}\)

Liberalization of the capital account and the securities market have in many cases also meant the opportunity for domestic investors (legal entities and individuals) to perform transactions abroad through foreign brokers and for foreign investors to use the same brokers for entering the domestic market. That has created the preconditions for an intensification of competition among brokerages, both domestic and foreign, in several areas. The first is competition for domestic investors seeking to invest in equity markets abroad. In that case domestic investors have made a choice between a domestic investor with access to the international market\(^{18}\) and a foreign broker, depending on how the advantages and disadvantages of working with each of them were perceived.

*Advantages of working with a domestic broker with access to international financial markets:*
  - ability to work with a domestic legal entity;
  - ability to use an account in own country for performing transactions.

*Disadvantages of working with a domestic broker with access to international financial markets:*
  - insufficiently wide assortment of products and services usually offered by domestic brokerages. Access primarily to traditional securities market products (shares, currency and commodities);
  - generally higher transaction costs.

*Advantages of working with foreign broker:*
  - possibility of faster and higher-quality execution of transactions, and often a more convenient trading platform;

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\(^{17}\) See Section 2 of this paper.

\(^{18}\) If domestic brokers do not have access to an international market, a foreign broker is the only option for a domestic investor.
• larger number of instruments for analysis;
• access to a wider selection of financial products and instruments, such as derivatives;
• possibly lower transaction costs, and better level of service.

Disadvantages of working with foreign broker:
• usually, need to deposit funds in brokerage account abroad;
• possibly higher tax rate on transactions in foreign products and instruments in country where account is opened.

The second area of competition between domestic and foreign brokers is for the foreign investor who has an interest in the domestic market. In this connection it is important how attractive the domestic market appears to foreign investors and foreign brokers from the standpoint of investment opportunities and ease of access.

Market access can be assessed according to the following criteria (MSCI, 2014):
• existence of limits on the percentage of foreign ownership. For example, in Brazil foreign legal entities and individuals may own no more than 49% of voting shares;
• existence of qualification requirements for investors. For example, in China only a foreign entity with the status of a qualified foreign institutional investor may make investments in type-A shares (denominated in yuan) on the Shanghai and Hong Kong exchanges. In India it is also necessary to be registered as a foreign institutional investor;
• extent of liberalization of the exchange market and existence of direct or indirect limits on capital inflow and outflow;
• number and type of documents a foreign investor must have for working in the domestic securities market. For example, in Malaysia, even if transactions are made through a foreign broker, you must declare that you are a nonresident and open a personal account in the national securities depository;¹⁹
• regulation of the securities market and the possibility of sudden changes in law;
• direct operation of the exchange, in particular the “convenience” of making trades, including use of the English language;
• quality, availability and timeliness of obtaining of information in English about companies whose shares are traded on the exchange; domestic companies’ use of international reporting standards;
• existence of a clearing and settlement system based on international standards;
• level of competition among depository banks and presence of a global depository bank in the stock market;
• existence of a well-operating central depository;
• level of competition among brokers and presence of global brokers.

From the standpoint of investment opportunity, a market is assessed, according to MSCI (2014):
• volume and number of transactions in it;

• capitalization of the exchange and number of companies on the exchange list;
• existence of an exchange index;
• procedures for companies’ admission to the securities market;
• corporate governance and accounting standards;
• existence of political and economic risks, and a number of other factors.

On the whole, investment attractiveness is a more important factor for foreign investors than ease of access, since foreign and domestic brokers generally offer document preparation services (if required) for executing trades on an exchange. Therefore, as international experience shows, foreign brokers often offer foreign investors to execute trades on well-known, large exchanges. For example, of all Germany’s exchange, that means the Frankfurt and sometimes the Stuttgart exchange, of Japan’s nine exchanges — the Tokyo exchange, in America — the New York Stock Exchange and the Nasdaq, etc. East European countries’ exchanges, despite the fact that they have no formal limitations for investment, are of little interest to foreign investors because of the relatively small number of listed companies. One means of increasing capitalization and, accordingly, investor attractiveness, is to consolidate exchanges. Thus, in 2003, the OMX company was established, consolidating a number of Scandinavian and Baltic countries’ exchanges: in particular, the Stockholm, Copenhagen and Iceland exchanges, the Helsinki Exchange, and the Vilnius, Riga and Tallinn exchanges.

Thus, admission of foreign professional participants in the securities market to trading on exchanges without their additional foundation of a legal entity intensifies competition with domestic professional participants only if the latter have access to international financial markets and if the domestic exchange market is of interest for foreign investors from the standpoint of its investment attractiveness and ease of access.

The reciprocal admission of professional participants in the securities market to trading on the EAEU member states’ exchanges without the additional establishment of a legal entity, with simultaneous capital account liberalization, would mean a number of challenges for Belarusian brokers.

Intensification of competition for domestic investors wishing to make trades in EAEU stock markets, especially in Russia.

In order to serve Belarusian clients wishing to work in EAEU stock markets, domestic brokers must obtain access to their trading systems. In this connection:

• they must obtain a license and other possible permits to engage in activity in a partner state’s securities market;
• a Belarusian broker must meet requirements that the partner country’s law imposes on brokers with respect to capital adequacy, risk management system, and computer systems used in engaging in professional activities in the securities market.

It should be noted that the stock market admission procedures for professional participants in the securities market differ among the member states. However, the problem of obtaining licenses can be resolved if the EAEU countries enter into an agreement on reciprocal recognition of licenses or other types of qualifications certificates issued for
doing business in the securities market. In that case Belarusian brokers would be able to work in member countries’ stock exchanges.

The second condition pertaining to capital adequacy could be a substantial obstacle to the admission of Belarusian brokers to EAEU stock markets. At present in Belarus the minimum equity requirement for operating as a broker or dealer is 3,000 base units (approximately USD 30,000).21

For Russia and Kazakhstan, whose exchanges could potentially interest Belarusian brokers, that number is much higher. In Kazakhstan the minimal authorized capital for engaging in brokerage and/ or dealer activity is 400,000 monthly units of account,22 which is the equivalent of USD 2.9 mil. at the current exchange rate.23 Such high equity requirements were instituted in 2013, which resulted in a decline in the number of entities acting as brokers or dealers from 52 at the end of 2010 to 24 in 2014; at the same time, the assets of brokerages declined fourfold.24

In Russia brokers’ minimum equity is RUB 35 mil. and the minimum equity for the self-governing brokers’ organization is RUB 15 mil.25 (about USD 230 at the current rate). It should be noted that the equity of the largest Russian brokers is much higher: BD Otkrytye Brokerage House — more than RUB 1 bil., BCS — about RUB 1 bil., Anton — RUB 3.5 bil., and Finam — RUB 3.8 bil. Brokerage firms must also meet standards developed by the National Association of Securities Market Participants (NAUFOR).

Thus entry of Belarusian brokers into the exchanges of Russia and Kazakhstan will be made difficult in connection with the high equity requirements. Accordingly, it may be assumed that Belarusian legal entities and individuals wishing to invest in the markets of Russia and Kazakhstan will work through those countries’ brokerages. And it should be noted that their greatest interest will be in the Russian market, since Kazakhstan’s stock market, despite its potential promise, is characterized at present by low liquidity due to the shortage of high-quality financial instruments: Government securities transactions and repo operations predominate in it, since Kazakh companies are not inclined to attract investment through the securities market. On the whole, Kazakhstan’s securities market is more oriented toward institutional investors.26

It should also be kept in mind that Russian brokerages will be able to offer Belarusian investors a wider selection of financial products and instruments and various trading

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20 The Eurasian Economic Commission has prepared a draft agreement under which brokers and dealers of the Eurasian Economic Union countries would be able to work in the member states’ exchanges without additional licensing. However, they would be able to enter only with their own clients, since they would be forbidden to engage in attracting clients in another member country. All the remaining requirements (excluding licensing) of a receiving country’s regulatory law pertaining to the activities of professional participants in the securities market would need to be met by the brokers and dealers of Eurasian Economic Union member countries entering a given market.


23 1982 tenge.


platforms for working in the Russian market compared with those domestic brokers that are admitted to the Russian market.

*Competition with other EAEU member states’ brokers for foreign investors from those countries that wish to work in the Belarusian market.*

The issue of competition with foreign brokers in the Belarus securities market is directly related to the attractiveness of that market for investors from the EAEU countries. At present the securities market is characterized by a low level of liquidity, a relatively small percentage of freely traded shares, an insufficiency of quality financial instruments, and predominance in trading of government securities transactions.

Furthermore, the risks of investing in the financial instruments of Belarusian issuers do not meet Russia’s and Kazakhstan’s required prudential ratios for pension and investment funds, or for bank and insurance assets. For example, the Kazakhstan Unified Pension Accumulation Fund may invest no more than 25% of its pension assets in government securities issued by the central governments of foreign states with a sovereign rating no lower than “BBB-” on the Standard & Poor’s international scale, or with an analogous rating of other rating agencies, and no more than 15% in those with a sovereign rating of “BBB-” to “B.” Belarus’s credit rating is “B-” long-term/ “B” short-term (Standard & Poor’s), and “B3” (Moody’s). The Unified Pension Accumulation Fund may invest in nongovernmental debt securities issued by foreign entities if they have a Standard & Poor’s rating no lower than “BBB-”27 (no more than 30%), from “BBB-” to “B” (no more than 20%), and “A-” (no more than 3%).28

Kazakh mutual investment funds may, under law, invest in the units of investment funds that have a Standard & Poor’s international rating (principal stability fund ratings) no lower than “BBm-” or a Standard & Poor’s Fund rating (credit quality ratings) no lower than “BBf-”; in securities with government status issued by the central governments of foreign states with a sovereign rating no lower than “BBB” on the Standard & Poor’s international scale, or an analogous rating by other rating agencies; in debt securities and shares issued by foreign entities with a rating no lower than “BB-”; and in principal protected notes issued by entities with a rating no lower than “A-”.29

Russian banks’ possibility of investing in Belarusian securities is limited by the fact that those securities, according to Russian Central Bank regulations, are classified as very high-risk financial instruments, since they have a country rating of 7 (according to the Export Credit Agencies’ classification).30 In turn, Russian mutual funds31 invest mainly in ETFs (exchange traded funds)— foreign exchange traded investment funds whose securities are traded on the leading world exchanges (US, Germany, UK, China).

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27 Or an analogous rating from another rating agency.
31 At present Russia has about 30 mutual funds of 10 management companies investing investors’ money in foreign shares and bonds.
32 Foreign exchange traded investment funds.
Russian nongovernmental pension funds also may not invest in Belarusian corporate or government securities, since that is prohibited under the rules for investing pension accumulation resources. Pursuant to those rules, those funds may invest resources only in the units (shares, ownership stakes) of foreign index funds established by the Bank of Russia.\textsuperscript{33}

Liberalization of the securities market in EAEU countries presupposes the possibility of the reciprocal admission of securities to trading on exchanges (cross listing). As international experience shows, a cross listing decision is based on a comparison of the indicators of the exchange on which it is proposed to place securities and those of the domestic exchange. European companies prefer to trade their securities in the more liquid and larger markets, and also where investors are better protected and securities of companies associated with the same type of activity are already traded (Pagano et al., 2001). At the same time, even the European Union has a problem with cross listing, since the securities of issuers with less developed markets are supposed to be admitted to the more developed markets. Therefore, in fact member countries often impose additional requirements on the securities of issuers from other EU states with less developed financial markets that wish to be quoted on their exchanges. At present the securities of Belarusian issuers may be admitted to placement and trading in the Russian securities market pursuant to the Russian Federation Federal Law On the Securities Market.\textsuperscript{34} Admission to trading is based on a decision of the Russian Stock Exchange.

Liberalization of access to the securities market also entails the creation of an integrated depository space. At present in Belarus the requirement for depositories’ minimum equity (30,000 base units, or USD 322,000) is higher than in Russia (RUB 15 mil.,\textsuperscript{35} or USD 229,000). However, as the EU experience shows, the creation of an integrated depository space would entail not so much coordination of financial requirements as harmonization of the procedures and rules for the operation of EAEU countries’ depositories:

- establishment of common depository standards;
- cooperation among member countries’ central depositories in order to achieve functional compatibility that would enable their clients to obtain identical services;
- closer alignment of the accounting systems of the member countries’ financial markets, and a switch to the exchange of electronic documents with digital signatures in standardized formats over telecommunications lines, with automated processing of those documents.

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\textsuperscript{33} Regulation on Establishment of Additional Limits on Investment of Pension Accumulation Resources of a Nongovernmental Pension Fund Offering Mandatory Pension Insurance, Additional Requirements for Lending Institutions in Which Pension Accumulation Resources and Accumulation Resources for Housing for Military Personnel are Placed, and Additional Requirements that Management Companies Must Meet during the Effective Period of an Agreement on the Fiduciary Management of Pension Accumulation Resources (approved by the Bank of Russia December 25, 2014, No. 451-P) (wording of June 24, 2015). Available at: https://www.consultant.ru/document/cons_doc_LAW_174641.


Conclusion

This work has examined international experience in liberalizing access to domestic financial markets by foreign suppliers of financial services, including without establishing a legal entity, and in lifting restrictions in the area of cross-border movement of capital and exchange arrangements. On that basis it identifies the risks that Belarus may encounter as the result of carrying out proposed measures for liberalizing its financial market within the EAEU.

One measure for establishing a common EAEU financial market is supposed to be liberalization of cross-border trade in banking services in the form of permitting the operation of the branches of member states’ banks in the Republic of Belarus. Based on international experience, the work identifies and systematizes the risks associated with the entry and operation of foreign banks’ branches in a receiving country. Those risks include: the limited powers of the receiving country’s authorities with respect to the oversight of branches; the receiving country authorities’ lack of the ability to stabilize the operation of a branch by recapitalizing it if the parent bank experiences difficulties; increased vulnerability to shocks occurring in the country of origin and world financial markets, which results in increasing the cyclicality of lending; a parent bank’s transfer to a branch of risks, particularly sovereign risks; distortion of competition in the deposit and lending market in the receiving country; an increase in the debt load of individuals and legal entities; differences in deposit insurance systems; and a worsening of external debt by maturity statistics.

Based on the identified risks, qualitative assessment of them has been made for Belarus in connection with the possible opening of branches of EAEU countries’ foreign banks. The analysis shows that most of the risks associated with the advent in Belarus of the branches of EAEU countries’ banks are low or moderate. They may be mitigated through harmonization in the member states of the procedures and conditions for issuing banking licenses with respect to branches, prudential requirements for banks, and deposit insurance, and through establishment of a supernational banking administration and coordination of monetary policy.

At the same time, high-risk factors such as increased vulnerability to shocks occurring in a branch’s country of origin and world financial markets, the increased cyclicality of lending, and the possibility of an outflow of resources from a branch to its parent bank are not readily controlled and mitigated by a receiving country’s authorities. Thus, it must be taken into account that the branches of EAEU countries’ banks may become a potential source of the transfer of shocks to Belarus from the economy of a member state.

Establishment of a common financial market in the EAEU entails liberalization of the insurance services sector by granting the ability to engage in insurance business without establishing a legal entity, i.e., in the form of branches of insurance companies. Risks associated with the advent of insurance companies’ branches have much in common with risks in the banking sector and are due to the difficulty of supervision, since it is
performed with respect to a branch by authorities of the country of origin rather than the receiving country; to the impossibility of the receiving country authorities’ stabilizing the operation of a branch if the parent insurance company experiences difficulties; to increased vulnerability to shocks occurring in the country of origin, which may, for example, result in a parent company’s withdrawal of resources from a branch; to the possibility of an outflow of foreign exchange; to the crowding out of domestic insurance companies and distortion of competition in the receiving country’s insurance market, since branches (especially of large foreign insurance companies) are often able to offer services at lower prices. They also may enter the most profitable segments of the insurance market. It should be noted that in many developing countries and transitional economies the advent of branches has resulted in crowding out domestic insurance companies from the market.

For Belarus, those risk in the context of liberalization of the insurance market within the EAEU are low. That is related to the relatively low level of insurance activity on the part of both individuals and legal entities, which is due in part to the low insurance culture, and also to the differences that exist in the country in the authorization of insurance companies under various forms of ownership to offer mandatory insurance.

For foreign insurance companies and their branches, the non-life insurance segment is important. In Russia companies with predominantly foreign capital prefer to work precisely in that segment, as do domestic insurers, 74.5% of which offer exclusively non-life insurance. In Belarus the mandatory types of insurance, which only public insurance companies are authorized to offer, are in fact non-life insurance. Moreover, mandatory types of insurance occupy practically half of the country’s insurance market; in recent years they have accounted for more than 45% (46% in 2014) of the total value of insurance premiums. Thus, the market that might be entered by both the branches and subsidiaries of foreign insurance companies is limited, which reduces Belarus’s attractiveness for that sort of investment.

In the context of harmonizing the insurance services market in the EAEU, it has been proposed that a system of mandatory civil liability insurance for motor vehicle owners traveling abroad analogous to the Green Card be established in the integration association, and that the member countries mutually recognize the new insurance policy. Calculations made on the basis of interviews with transport companies and the Belarusian Association of International Road Carriers (BAMAP), and data on Green Card truck insurance in Belarus have shown that the existence of a system of mandatory insurance parallel to the Green Card would result in additional expenses of approximately €1.9 mil. per year for transport companies.

The establishment of a single financial market contemplates that Belarus would carry out liberalization of capital flows and exchange arrangements with the EAEU countries. In order to prevent removal of the barriers to capital account activity from resulting in crises and an increase in external debt, and from creating a threat to financial stability, such removal should be coordinated with a certain macroeconomic policy and with the fulfillment of a number of prior conditions. According to IMF recommendations, those conditions include: good macroeconomic indicators; a developed financial sector capable
of coping with volatility in capital flows; the steady absence of a substantial capital account deficit; a sufficient level of international reserve assets; a floating exchange rate; a cautious fiscal policy; high-quality prudential supervision and regulation in the financial sector; an effective system for monitoring capital flows; an effective risk management system on the part of economic agents in the financial and nonfinancial sectors; the use of best practices in accounting, auditing, disclosure standards and reporting rules; the lack of a practice of providing implicit government guarantees, which contribute to an excessive and unstable capital flow. A developed securities market is also cited as a condition that fosters liberalization.

On that basis, the study offers an assessment of the fulfillment of prior conditions for capital account liberalization in Belarus within the EAEU. Based on its results, the conclusion is drawn that as of Q3 2015, of the 11 prior conditions, only 4 had been met. And the failure, by the beginning of 2017, to meet the seven remaining conditions, which include such important parameters as the steady lack of a current account deficit, an adequate level of international reserve assets, and the existence of an effective risk management system on the part of economic agents, may increase the risks for Belarus in connection with capital account liberalization.

The chief risks for Belarus would be associated with the possibility of an outflow of capital — both domestic capital and that which has come in as a result of an inflow. First of all, that could result in devaluation of the domestic currency and a reduction in international reserve assets, and put pressure on the payments balance and the banking sector. In that connection it would be advisable for Belarus, in lifting barriers to capital account activity, to develop and employ, where necessary, capital flow management measures. And it must be taken into account that, according to the IMF’s country studies, such measures have varying degrees of effectiveness and their effect is usually short-lived.

Capital account liberalization is usually accompanied by a relaxation of exchange restrictions, one of which is the requirement that exporters surrender foreign exchange earnings. It increases enterprises’ costs because of the difference between foreign exchange purchase and sale exchange rates; forces enterprises to employ various schemes for keeping their foreign exchange earnings abroad; and reduces the country’s attractiveness to investors. At the same time, despite all of the aforementioned costs, for Belarus the risks of eliminating the surrender requirement at this time appear fairly high. First of all, that is due to the imbalance in the balance of payments, a low level of international reserve assets, and insufficient confidence in the domestic currency. As international experience shows, in that case a strategy may be employed of gradually eliminating the mandatory surrender of foreign exchange earnings. That means not only a gradual reduction in the share of earnings subject to surrender but eliminating it in a targeted fashion or by sector. For example, some countries require surrender only for sectors associated with exports of natural resources but eliminate the requirement for those that use imported raw materials and other materials in their production.

In the context of creating a common financial market of EAEU countries it is planned to provide for reciprocal admission of professional participants in the securities market.
to trading on partner states’ exchanges without the additional establishment of a legal entity, as well as reciprocal admission of securities to trading on Eurasian Economic Union exchanges. Analysis shows that the entry of Belarusian brokers to exchanges in Russia and Kazakhstan would be impeded in connection with the difficulty of meeting equity requirements. Accordingly, one can assume that Belarusian legal entities and individuals wishing to invest in the markets of Russia and Kazakhstan would work through those countries’ brokerages. Unquestionably, it is the Russian market that would be of greatest interest for them. Moreover, Russian brokerages would be able to offer Belarusian investors a wider assortment of financial products and instruments, as well as various trading platforms for working in the Russian market compared with domestic brokers that were admitted to the Russian market.

The question of competition with foreign brokers in the Belarusian stock market depends directly on the degree of that market’s attractiveness to investors from EAEU countries. At present the Belarusian securities market is characterized by a low level of liquidity, a relatively low percentage of freely traded shares, a shortage of high-quality financial instruments, and a predominance of government securities transactions in the total trading volume.

Furthermore, the risks of investing in the financial instruments of Belarusian issuers are incommensurate with prudential requirements for pension and investment funds or for bank assets in Russia and Kazakhstan. For their part, Russian mutual funds invest abroad mainly in ETFs (exchange traded funds) – foreign exchange traded investment funds, whose securities are traded on the leading world exchanges in the US, Germany, the UK and China.

Liberalization of the securities market in the EAEU countries presupposes reciprocal admission of securities to exchange trading (cross listing). At present the securities of Belarusian issuers may already be admitted to placement and trading in the Russian securities market pursuant to the Russian Federation Federal Law On the Securities Market.

Liberalization of access to the securities market also entails the creation of an integrated depository space. At present in Belarus the requirement for depositories’ minimum equity (30,000 base units, or USD 322,000) is higher than in Russia (RUB 15 mil., or USD 229,000). However, as the EU experience shows, the creation of an integrated depository space would entail not so much coordination of financial requirements as harmonization of the procedures and rules for the operation of EAEU countries’ depositories. That would mean the establishment of common depository standards; cooperation among member countries’ central depositories in order to achieve functional compatibility that would enable their clients to obtain identical services, closer alignment of the accounting systems of the member countries’ financial markets, and a switch to the exchange of electronic documents with digital signatures in standardized formats over telecommunications lines, with automated processing of those documents.
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