


GOVERNMENT OF GEORGIA SUBMITS TO PARLIAMENT THE GLOBAL COMPETITIVENESS OF THE FINANCIAL SERVICE SECTOR ACT

GEL/US\$: 1.5935 GEL/EUR: 2.3385

Galt & Taggart Index: 1,041

Government of Georgia submits to Parliament the Global Competitiveness of the Financial Services Sector Act

The government reported today that it has submitted to Parliament the draft Global Competitiveness of the Financial Services Sector Act (the "Act"), which, if passed, would trigger broad changes in 26 other laws and enhance significantly the stability and global competitiveness of the Georgian financial sector.

The key changes under the Act are described below.

Fiscal Policy

Fiscal surplus becomes mandatory, while the Future Generations Fund and Stable Development Fund will be established to absorb the surplus and privatization proceeds.

At the same time, the personal income tax will be reduced over the next five years from the current level of 25% to 15%. A change will be made in the tax code, unequivocally exempting any income received by resident individuals from non-domestic sources from personal tax. Given that there is no separate payroll or social tax, this reduction, combined with the corporate profit tax of 15% (as of 1 January 2008) will create a low-tax regime favorable for business and investment. Taxation of dividend and interest income will be reduced in line with the personal income tax and will be abolished when the personal income tax is reduced to 15%. The VAT will stay unchanged at 18%.

Free Industrial Zones & International Warehouse Regime

The tax and customs code will be amended to complete the creation of the framework under which the free industrial zone around the Black Sea port of Poti, as well as in other areas subject to investor interest, will be established. The selection process for the international operator of the Poti free industrial zone is underway.

In addition, changes will be made to the tax and customs code, allowing for the operation of the so-called international warehouses for export and re-export purposes under a favorable low-tax regime.

National Bank of Georgia, the Financial Services Authority and streamlining of the bank governance

The preservation of price stability will be declared the main objective of the National Bank of Georgia (the "NBG"). The NBG will be required to declare annually its three-year rolling inflation (CPI) target, which cannot be higher than 10%. A band of 2% will be allowed for both over-shooting and under-shooting the target. In the event of over-shooting or under-shooting the target for four consecutive quarters, the President and Vice President of the National Bank will have to address Parliament which will then conduct a vote on confidence. The board of governors of the NBG will be reduced over time to five members (including the President and Vice President), and foreign citizens will be allowed to serve on the board.

The Financial Supervising Agency (the "FSA") will be created under the auspices of the NBG, to function autonomously as the sole regulator and supervisor of the financial services sector, including banking, securities, insurance and other areas. The FSA will be governed by the board comprising five members (including the President of the NBG), with foreign citizens allowed to serve on the board.

Georgia: Key Economic Data	2004A	2005A	2006A	2007E
Nominal GDP (GEL mln)	9,824.3	11,621.0	13,783.9	16,924.8
Real GDP Growth (y-o-y; %)	5.9%	9.6%	9.4%	12.0%
GDP per Capita (US\$)	1,187.2	1,478.4	1,758.7	2,297.3
CPI (e-o-p; %)	7.5%	6.2%	8.8%	11.0%
Net FDI (US\$ mln)	483	542	1,076	1,400
Current Account Deficit as % of GDP	-6.6%	-10.8%	-15.3%	-20.2%
GEL/US\$ (e-o-p)	1.83	1.79	1.71	1.59
GEL/EUR (e-o-p)	2.49	2.12	2.26	2.33
Galt & Taggart Index	194	320	790	1,041

Source: Department of Statistics, Ministry of Economic Development, Ministry of Finance, National Bank of Georgia

Georgia has, as of the date hereof, the following sovereign credit ratings:

Standard & Poor's	Sovereign Credit Rating	'B+/B'	Positive
FitchRatings	Long Term Issuer Default Rating/Short Term Issuer Default Rating/Country Ceiling	'BB-/B/BB-'	Stable

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Changes will be made to streamline the governance of commercial banks. Executive directors will be allowed to serve on the supervisory board, creating a single-board governance regime resembling that of the UK and other common law jurisdictions. The banks will no longer be required to have an audit commission separate from the supervisory board. Instead, the supervisory board will be required to create an audit committee.

Enhancement and streamlining of the anti-money laundering and “fit and proper” regulations

The anti-money laundering regulations will be streamlined and enhanced, further improving the efficacy of the Financial Monitoring Service, the anti-money laundering watchdog operating as a unit of the FSA and increasing the transparency of the banking sector.

The “fit and proper” criteria and regulations with regard to owners of significant (greater than 10%) stakes in Georgian banks will be streamlined and enhanced, with the burden of disclosure and compliance placed primarily on the bank shareholders, rather than on the banks themselves. The “see-through” procedures, enabling the regulator to assess and evaluate the identities of beneficial owners will also be enhanced. At the same time, the procedures put in places will be clearer and more “user-friendly”, in order to encourage ownership of the local banks by reputable and legitimate institutional investors.

Taxation of financial instruments

Effective 1 January 2009, (i) tax on interest income received from deposits placed with licensed deposit-taking institutions and publicly-traded fixed income securities will be abolished, (ii) capital gains on the securities admitted to trading on a local stock exchange with a free float exceeding 25% will be abolished, and (iii) tax on dividend income from equities admitted to trading on a local stock exchange with a free float exceeding 25% will be abolished.

International Financial Institutions

The status of an International Financial Institution will be introduced, enabling foreign and local investors to establish such institutions (in banking, insurance, reinsurance, securities, fund management and administration, custody, trust and other areas) and avail themselves of the favorable tax regime. In addition, given that the International Financial Institutions will be prohibited from deriving more than 10% of their revenues from domestic (Georgian) sources and prohibited from soliciting the business of local residents (except for high net worth individuals), they will be exempt from the local prudential regulations and supervision by the FSA (but will nonetheless be subject to the local AML/KYC regulations).

The concept of Experienced Investor Funds will be introduced as well, in order to establish Georgia as an attractive jurisdiction for fund administration and wealth management. Local stock exchanges will be allowed to quote securities in any currency (with the settlement taking place in Georgian Lari).

The International Financial Institutions will be required to employ a director who is Georgian tax resident (but not citizen), in order to attract qualified individuals to reside and establish business practice in Georgia. Georgia does not require visas from citizens of OECD and certain other countries and is widely believed to have one of the most liberal labor codes in the world, without any work permit requirements for foreign citizens.

Stock exchange demutualization and other changes in the securities law

Changes will be made in the securities law, allowing for the demutualization of local stock exchanges. Remote foreign membership of stock exchanges will be allowed, facilitating access to locally traded securities for broker-dealers licensed in any of the OECD countries without the need to establish a local subsidiary and be licensed and regulated by the FSA (provided they do not solicit business from local residents).

In addition, significant changes will be made, introducing the concepts of experienced investors clarifying and simplifying the public offering procedures, and streamlining the operations of registrars.

Other laws

Laws on electronic signature and accounting and auditing (establishing IFRS as the required standard) have also been submitted under the umbrella of the Act.