

**UKRAINE'S FINANCIAL SECTOR DEVELOPMENT
STRATEGY FOR UP TO 2015**

(Draft)

2008

The mission of this Strategy is development of an effective financial sector capable of ensuring supply of the necessary financial resources to the real economy sector economy and support of social development of the country and its integration into the global economic space without endangering the national interests and economic security of Ukraine.

The Strategy has been developed by the working group of FSR, National Bank of Ukraine, and SSMSC officials in compliance with the President of Ukraine Decree 659/2007 dated 20 July 2007 “On the resolution of the Council for the National Security and Defense of Ukraine of 6/15/2007 “On the progress of the implementation of the decisions of the Council for the National Security and Defense of Ukraine with regard to the improvement of the investment climate in Ukraine”.

1. Introduction

Financial sector is one of the key areas of the national economy where financial resources are raised and distributed, and which is related to financial institutions’ activities. For the purpose of this document, financial sector means a financial market that provides for the accumulation and distribution of investment resources, interaction of providers and consumers of financial services under the rules set out by the government and its regulators. The components of the financial market are the monetary market, the insurance market, the stock market, the collective investment market, the private pension market, and other financial services markets.

The financial sector development strategy is an integrated system of views, intentions, and key actions relating to financial sector development in the medium term, with due consideration to national financial interests, social and economic needs of the country. National financial interests are priority needs of people and government in terms of cash resources, sources and mechanisms of providing them, the implementation of which guarantees financial capacity of a sustainable, sovereign and dynamic development of the country.

The need for the strategy development is caused, on the one hand, by a significant expansion of the financial sector’s role in current economic life of the country and, on the other hand, by a lack of the government document containing objectives and priority tasks of the development of Ukraine’s financial sector as an integrated system in the totality of all its components.

The lack, up to now, of an integrated government vision of an efficient model of financial sector development in the medium and long term leads to its defects and development deficiencies that, in their turn, affect the process of resolving strategic economic and social problems of the country, asserting its national financial interests. In light of the above, the preparation of the national strategy of the financial sector development is a prerequisite for further successful development of the country and its integration in the world economic space and admission into EU membership.

Place and Role of the Strategy in the System of Policy Statements on the Country Development

The proposed *Strategy outlines areas of government policies, formulates priority tasks and provides for a set of key legal and institutional actions geared towards the development of all financial market components*. The provisions of this Strategy serve as a basis for the development and revision of existing industry programs of the development of respective financial market segments. On the other hand, the Strategy, in its turn, should become a component of higher level government documents relating to long term social and economic development of the country.

The strategy contains:

- assessment of the current situation, general problems and factors of financial sector development;
- identification of the key goals and priority objectives of the development of Ukraine's financial sector development for a period of up to 2015;
- identification of the principal areas of government policies and key actions relating to further development of the banking system, of corporate lending, of insurance services, of collective investment, leasing services, non-State pension services, as well as the development of new institutions, the introduction of new financial instruments and services, the improvement of the system of State regulation and self-regulation and integration in the global financial space.

Objectives of the Strategy

The key objectives of the strategy is to ensure the resilience, openness and competitiveness of the financial sector of Ukraine.

Resilience of the financial sector implies its capacity for sustainable development, resistance to the adverse impact of other countries on Ukraine's internal financial policies, as well as neutralization of threats of global financial crises.

Openness of the financial sector implies the information transparency of financial institutions with respect to owners, services and performance, as well as the openness of government regulators relating to regulation and oversight objectives (political openness); disclosure of development benchmarks, models and projections (economic openness); disclosure of enforcement actions, results achieved and market regulation errors (market openness).

Competitiveness of the financial sector implies its ability to provide access to international financial resources and markets for domestic economic agents and duly compete for the possibility to use investment resources with other countries and world financial agents under conditions of economic globalization.

Stages of the Strategy implementation

The Strategy will be implemented in two stages. During Stage One, within two years of the approval of the Strategy, implemented are to be priority measures to overcome the consequences of the financial crisis based on the principles of this Strategy, the legal, material and technical pre-requisites are to be laid for further development of the financial sector, for the introduction of international rules and standards, and for the enhancement of the institutional capacity of the regulators. Stage Two that will last through the year 2015 will see the implementation, on the basis of the created legal framework and of the strengthened material base, of the measures envisaged by the Strategy to ensure the expected results and to bring the financial sector of Ukraine closer to the EU requirements.

2. Current Situation and General Problems of the Financial Sector

Over its formation years, the Ukrainian financial sector has achieved a certain development level. At the beginning of 2008, Ukraine had 198 banks, 482 insurance companies, 800 credit unions, 311 pawnshops, 326 asset management companies, 99 non-state pension funds and about 1,000 investment funds of different types. There were issued shares worth UAH 424.3 billion. Assets of the Ukrainian banking system totaled UAH619 billion. Assets of insurance companies reached UAH32.3 billion. Assets of credit unions reached UAH5.36 billion. Assets of other non-banking lending institutions totaled UAH 1.14 billion. They granted almost 164,000 loans amounting to UAH1.3 billion. At the end of last year, Ukraine had 39 financial companies eligible to provide factoring services and 27 financial companies allowed to enter into financial leasing contracts. During the year, they entered into factoring contracts worth UAH485 million, and effective financial leasing contracts amounted to UAH20.2 billion. Licensed to raise money from asset managers for residential construction were 101 financial companies that, within a year, established 70 Construction Financing Funds (CFF) and raised UAH5.92 billion. At the year end, there were 311 CFFs and 5 Real Estate Transaction Funds (RETF) operating in Ukraine.

In general, the financial sector is rapidly developing. At the same time, it should be noted that this development has a discrete and erratic nature, its overall level significantly lags behind average European parameters and does not meet growing demands of the national economy. In spite of its high formation dynamics, Ukraine's financial market is yet to become a key and convenient mechanism of implementing investment programs for the government, businesses and households.

The share of non-banking financial segment in the structure of Ukraine's financial market is unreasonably low, accounting for only 7% of total assets of financial institutions. The stock market trade and settlement infrastructure is inconvenient, costly, and incomplete. As a result, over 90% of the total volume of securities issued in Ukraine is traded over-the-counter. Ukrainian financial institutions provide a rather narrow range of financial services to their customers, and legitimate rights and interests of users of such services are poorly protected.

One of the main factors of this state of affairs is imperfect legal environment and

defects of government regulation. The legal framework which is intended to regulate various aspects of professional activities in the financial marketplace is contradictory and incomplete.

Dissipated government regulation and oversight make it impossible to take a comprehensive approach to the development of the market as a holistic system and do not allow for efficient control over activities of financial conglomerates and consolidated supervision of professional participants in various market segments. In its turn, it leads to the fragmentary development of the market, its activities becoming shadowy and criminalized, and to an enormous outflow of capital from the country. The existing legal framework does not provide effective means to combat price manipulation, especially in a stock market, and illegal use of insider information. Uncertainty regarding the ways and limits of self-regulation, on the one hand, leads to the unreasonable government intervention in market practices and, on the other hand, makes it impossible to involve intellectual and organizational resources of market participants in the financial market development.

The financial sector development is slowed down, first of all, by low capitalization of financial institutions. The total capital of the entire banking system of Ukraine equals the equity of a medium-sized European bank. Inadequacy of the capital of banking institutions and low capitalization of insurance companies act as a serious barrier to providing the real sector of the national economy with long-term financial resources. Investment possibilities of financial institutions are limited by a deficit of financial instruments attractive for long-term investments. Underdeveloped collective investment institutions, non-state pension system and trust management make it impossible to have households fully contribute their savings to the investment process. Another obstacle is a lack of effective mechanisms of tax motivation of investment activities of the public and a lack of legal framework for implementing investment insurance.

One of the significant factors that have an adverse impact on the market development as a whole is the low transparency of government regulators and insufficient disclosures from financial institutions, specifically, a lack of information about their owners, performance and services. Existing legal requirements and disclosure procedures do not meet internationally recognized standards and needs of investors and users of financial services, make it impossible to assess the level of reliability, credit capacity, and financial resilience of market operators. Among other barriers are poor development of the rating system and existing monopoly in the rating services market, lack of assessment practices and failure to disseminate information about efficiency of investing activities of asset management companies and institutional investors.

Ukrainian financial institutions are characterized by noncompliance of their activities with international standards, in particular, rules and procedures set out in EU Directives. The most significant deviations from generally accepted standards are: low level of uniformity of requirements for financial institutions, including with respect to disclosures of regular and special information; lack of efficient mechanisms of protection of shareholders, especially in bankruptcy or restructuring of companies, and customers of financial institutions in the event of fraud and abuses by managers and owners.

3. External Factors of the Financial Sector Development

Among the main factors that shape the financial sector development for a period of up to 2015 and that should be considered in developing a strategy are economic, integration, globalization and political factors.

The key components of the economic factor are the growing deficit of energy resources, the threat of global and regional financial crises, natural disasters and man-made catastrophes, and a worsening deficit of food products. The result of the above is price hikes for fuel and agribusiness products in the world markets, the increasing cost of investment resources and insurance services, and the need to allocate major financial resources.

The effect of the integration factor lies in the need of dedicated steps to join the global and European financial community. This requires taking into consideration new approaches to the ongoing regulation reform and envisions: uniformity of the oversight procedures as applicable to institutions operating in various segments of the financial market; the introduction of risk-based supervision; control over ultimate owners and CEOs of financial institutions; uniformity of corporate governance requirements; standardization of the procedures of managing risks, assets and liabilities; more stringent counteraction to money laundering; concentration and integration of oversight functions, their accumulation in a single regulatory authority; capacity and willingness to collaborate effectively with international financial bodies and regulators' associations.

The important factor of Ukraine's financial sector development under current conditions is economic globalization which means primarily the globalization of investment practices, uniformity of mechanisms and technologies of financial markets operations, strengthening of interaction between businesses of different countries based on the same set of principles and standards.

For transition economies, globalization provides benefits relating to the use of modern management approaches and implementation of innovative technologies, grants access to new markets and investment sources. At the same time, globalization brings serious threats primarily in the financial domain; among such threats the most significant are risks associated with activities of multinational corporations, with the possibility of losing sovereignty and the escalation of fight for investment resources.

To win in this tough competition, it is necessary to offer more beneficial terms of providing investment resources: stable and predictable legislation, technologically equipped financial market with the attractive and wide range of financial services and instruments.

Based on trends in the world financial space, the number of countries where effective and competitive financial markets can survive and continue their full value and sovereign existence is gradually reducing. There are reasons to believe that in the next 10 years such national financial markets will exist in a small number of countries and their existence will be one of the most essential signs of the competitiveness of such economies, their important place in the world community, a prerequisite of economic and, therefore, political sovereignty. That is why, efforts to

ensure that the Ukrainian financial sector is effective and competitive in the medium and long term should be the top priority of Ukraine's economic policy.

Analysis of the components of the external political factor leads to the following practical conclusions: 1) it is necessary to take into account the growing influence of the Russian capital, which should be converted to mutually beneficial economic cooperation; 2) it is important to develop versatile relations with the United State of America; 3) it is necessary to proceed with the dedicated and consistent efforts aimed at integrating Ukraine with the European Union.

It is this clear and well-balanced policy of Ukraine that is capable of ensuring favorable political environment for the development of the Ukrainian financial sector.

4. Priority Tasks of the Financial Sector Development

The following priority tasks must be accomplished by the year 2015:

- ***to implement the State regulation reform*** intended to: 1) eliminate legal obstacles to the financial market development and fullest possible consideration of interests of its professional participants, investors, securities issuers and service users; 2) improve dramatically the efficiency of oversight and bringing it as close as possible to the UE standards, and 3) lay the ground for the establishment of a single regulator;
- ***to strengthen the competitiveness of domestic financial institutions*** by way of raising their capitalization level and assets diversification and quality, improving the qualification of their staff; introducing modern technologies and investment principles, and operation and management principles;
- ***to ensure information transparency of financial institutions*** with regard to ultimate controllers, products, services and performance;
- ***to re-orient the demand of domestic business subjects on the internal sources of financial resources*** and to promote, to this end, the operations of institutional investors;
- ***to ensure that transaction costs of raising capital be reduced*** by way of the development of convenient and effective stock market infrastructure, including its trading, clearing, settlement, and record-keeping components;
- ***to create favorable conditions for the emergence of new institutions, financial instruments and services***, in particular, by applying appropriate tax incentives;
- ***to introduce effective mechanisms to protect rights and legitimate interests of consumers*** of financial services and of investors;
- ***to liberalize currency regulation*** and simplify international financial market access procedures;
- ***to ensure that the income of potential financial service users increases significantly*** by way of pursuing more actively the State social policy and enhancing the support of entrepreneurship development;
- ***to create an advantageous investment climate*** by way, among other means, ensuring political stability, introducing clear rules of business operations, predictable

enforcement, and strengthening private ownership protection;

- to promote the practice of resolving legal disputes through tertiary courts and through the introduction of the institute of a financial ombudsman.

5. Principal Areas of State Policy and Key Measures for the Financial Sector Development

Government policies relating to the further development of all components of Ukraine's financial sector should be implemented in the following areas:

1. Improving effectiveness of government regulation and strengthening of uniformity of regulatory requirements
2. Reforming the government oversight system by separating it from other regulatory functions and implementing prudential oversight in all segments of the financial market
3. Implementing the transition from the extensive development to intensive development of the financial market
4. Creating prerequisites for raising the level of capitalization of financial institutions, ensuring their reliability and solvency
5. Enhancing informational transparency of financial institutions and openness of regulators.
6. Strengthening the level of protection of rights and legitimate interests of financial market participants
7. Carrying out well-balanced and gradual integration of Ukraine's financial sector into the world financial space through the implementation of international professional market activities standards and government regulation and oversight procedures.

5.1. Banking System (NBU research center version)

Current Situation Assessment

The banking system is the strongest segment of Ukraine's financial sector accounting for 93% of total assets of Ukraine's financial institutions. Research of the banking system status and analysis of its development trends leads one to the conclusion that the banking system has been largely formed and is in line with the current requirements, including the recommendations of the Basel Committee on Banking Oversight. In 2001-2007, the system saw dynamic development, with its quantitative and qualitative characteristics improving and Ukrainian banks competitiveness strengthened. The stability and the capacity of Ukrainian banks had

proved its worth when put to the test by the social unrest in Ukraine in late 2004; despite the crisis, the banking system of Ukraine withstood successfully the liquidity crunch. The stable development of the banking system is demonstrated by the ratio of its key performance indicators to GDP. During 2002-2007, assets to GDP rose 61 percentage points to reach 84%; lending to GDP rose 52 percentage points to 68%; liabilities to GDP rose 55 percentage points to 74%, and banks' balance capital to GDP rose 6 percentage points to reach 10%.

Banks' operations in 2003-2007 saw strengthened financial stability, improved assets quality, growing capital base, inflow of deposits, and higher operating efficiency. The regulatory capital has grown seven-fold in the previous five years and came to UAH 72.3 billion (Euro 9.7 billion), or 10.1% of GDP. At the same time, the economic processes in Ukraine require further growth of the banks' capitalization and concentration.

In 2003-2007, banks' liabilities rose 9.8 times, reaching UAH 529.8 billion by the beginning of 2008. Actively increasing was the volume of savings by individuals (up to UAH 163.5 billion), the steepest growth rate being that of term deposits. Funds of retail customers became the principal source for the banks' funding base increase.

Banks have upped their operations. Their total assets rose nine-fold in 2003-2007 and made up UAH 619 billion, their major component being bank loans whose volume rose over this period 10.4 times to reach UAH 486 billion. Long-term loans grew by the outstripping rate, laying the ground for economic growth and strengthening the positive impact of the banking system on the socio-economic development of Ukraine.

Efficiency of bank's operations has improved. For example, the banking system earnings had been UAH 6.6 billion in 2007, with ROA topping 1.5%.

In recent years, foreign banks have been more active in Ukraine's banking services market, their participation in the capital of Ukrainian banks reaching 35%.

Problems

Analysis of the current status of Ukraine's banking system points out the presence of symptoms indicating the need to improve further its stability, transparency and competitiveness. These symptoms (inadequacies) have been brought about by a number of problems.

The major problems of the banking system, including its development problems, are as follows:

- the need to further increase banks' capitalization in order to ensure sustainable economic growth based on adequate level of resources in terms of their volume, cost and terms;
- the need to improve the quality and competitiveness of banking services;
- inadequate corporate governance in banks; and

- inadequate banking risk management.

The key areas of the State policy

The key areas of Ukraine's banking system development in terms of resolving its development problems are as follows:

- raising the amount of banking sector's capitalization;
- improving the quality and competitiveness of banking services;
- proximity to international corporate governance principles; and
- improving the level of protection of creditor and depositor rights.

Key development measures

Increasing the capitalization of banks

- attracting additional shareholder capital to banks;
- banks developing capital increase action plans, taking into account the growing volume of active operations;
- improving capital quality and sufficient coverage of bank's risk exposure;
- applying incentives for profits capitalization, in particular through improving banks' taxation.

Raising the quality and competitiveness of banking services

- activate the processes of banks' consolidation;
- develop the banking system structure pursuant to the optimal combination of major banks with extended branch networks, regional, cooperative and specialized banks for the purpose of bringing bank offices closer to the population;
- implement up-to-date and reliable bank technologies; automated systems and their backup (duplication), restoration of seamless operation of the above systems after a negative impact of external factors;
- laying the groundwork for expanding the range of electronic banking technologies;
- raising the staff qualification level;
- stimulation (promotion) of factoring and leasing development;
- creating the environment for a significant increase in the volume of non-cash settlements in the economy through the introduction of non-cash payment instruments instead of cash transactions to be used in the up-to-date labor compensation and pension payout techniques and through the expansion of non-cash public payments for goods and services, including via plastic cards;
- stimulate lowering of bank services cost and leveling the terms of lending in foreign and national currency;

- stimulate S&MB and households services, develop new segments of the bank services market oriented on wide-range services provision, including retail consumer lending and mortgage.

Promotion of international standards for corporate governance

- ensure that the resolution of corporate governance organization in banks be established on the legislative level;
 - enhance the responsibility of managers and owners of banks for safety and sustainability thereof;
 - amend the relevant legislation so as to entitle the National Bank of Ukraine to set the requirements to the proper qualification and business reputation of bank top managers;
 - toughen qualification (professional) and work record requirements for members of bank supervisory boards;
 - impose on the bank supervisory board the duty of taking steps to prevent conflicts of interest at the bank and to assist with the remedies thereof;
 - NBU is to expand the list and toughen requirements for the contents of information subject to mandatory disclosure (on the financial standing, owners, management structure, quality characteristics of management, key investments etc.);
 - launch the practice of the NBU performing the evaluation of corporate governance in banks;
 - improve the efficiency of bank internal control systems;
 - improve the quality of internal and external audit, particularly through proper enforcement of International Standards of Audit and through objective certification of external auditors;
 - improve protection of minority shareholder rights;
 - develop and prepare for submission of draft law on amendments to the law on Banks and Banking Activity to be considered by the Verkhovna Rada as regards corporate governance and initiate its approval following the passage the Joint Stock Company law;
 - continue working on the harmonization of Ukraine's banking legal framework to the requirements of the EU legislation and of the Basel Committee on bank oversight.

Development of risk management

- improve the system of risk management;
 - constantly monitor risks pursuant to efficient operations of management systems and internal controls; prevent uncontrolled and unregulated decisions related to bank risks by bank management and employees;
 - continue approximation of external bank audit to audit standards and ethics of International Federation of Accountants (IFAC);
 - improve the methods of calculating the formation of bank reserves to cover risk exposure;
 - support the formation of credit bureau system and operation of collection agencies and ensure efficient exchange of information on unreliable debtors;

- improve the legal framework for the operation of financial market derivatives, which assumes significant importance for banking services development;
- ensure legal regulation of syndicated lending in order to clearly distribute risks;
- improve the system of bank oversight and regulation and its structure;
- introduce gradually differentiated rates of regulatory collections as a system to stimulate the improvement of risk management at banks that are participants to individual deposits guarantee funds.

Protection of creditors, depositors and clients rights

- improve procedure for public disclosure by banks in their reporting of the information on their ultimate controllers and major shareholders;
- establish criteria for assessment of business reputation of bank founders, participants and top managers;
- provide favorable environment for the development of up-to-date lending and improve mechanisms for protection of lenders and consumers of bank services;
- promote the formation of an effective system of safekeeping and using credit histories;
- assist in the creation of the institute of corporate liquidators;
- establish a wide network of rating agencies as independent assessors of the banks' financial standing and their risks;
- initiate amendments to the legislation in response to problems with exercising property rights concerning pledged assets by way of ceding this right by law and enforcing this right by court bailiffs;
- amend the law so as to provide that the moratorium creditor claims is not to come into effect earlier than on the date of the public announcement about initiating the case on bankruptcy;
- simplify and unify forfeiture (foreclosure) procedure and the procedure of satisfying pledge backed demands of creditors;
- assist in the practical application of extrajudicial foreclosure proceedings by providing pledge holders with a right to enter into notary certified transactions with pledgers that are legal entities, at any moment of the liability validity, and not only after the emergence of grounds for foreclosure;
- improve the system of registration of property rights for real estate and restriction thereof;
- facilitate public access to the Single State Register of legal entities and individuals-entrepreneurs so that creditors may get the necessary information on the State registration of a legal entity, its top managers authorized to sign contracts, and its owners;
- improve the mechanisms of liquidating banks in case of their license revocation;
- improve the regulatory acts governing the banks' mergers and acquisitions;
- launch the practice of the NBU publication of annual reports on the banking

- system development;
- amend the Law of Ukraine “On Individual Deposits Guarantee Fund” regarding financing of such Fund for the purpose of increasing capitalization and financial capacity of the Fund, including transfer of up to 20% of earnings that exceed the expenditures of the National Bank of Ukraine to the Fund, placing Fund investments, alongside government securities, in mortgage bonds.

5.1. Banking System

Current Situation Assessment

The banking system is the strongest segment of Ukraine’s financial market accounting for 93% of the total assets of financial institutions in Ukraine. The characteristic feature of its development until recently has been a rapid increase in active transactions, primarily in consumer and mortgage lending, growing profitability of banking institutions, and a bigger presence of foreign capital. As of January 1, 2008, the number of banks operating in Ukraine reached 175; they serviced 120 million clients, of which number 1.9 million were business subjects. As of that date, banks’ equity totaled UAH 1.9 billion, total assets reaching UAH 617.6 billion.

Problems

Despite the dominant role of the banking system in the structure of Ukraine’s lending market, as a whole, it can be described as underdeveloped, because, based on such measures as equity/GDP and assets/GDP ratios, it lags behind most countries across the world. Its main weaknesses are: low level of bank capitalization, as a consequence – inability of the banking system to support economic growth with necessary lending resources in terms of amount, price and time; most banks have no planning, development strategy, effective risk management mechanisms and tools; noncompliance of banks’ corporate governance principles with international standards.

Most pressing problems of the development of bank activities in the lending market that require immediate resolution are:

Inadequacy of the amount of bank equity to the volume of lending transactions;

Mismatch of terms of raised funds and terms of loans granted;

Uncompetitive pricing of existing lending services and inflated interest margin;

Noncompliance of the bank management with current international standards;

Poor effectiveness of banking oversight;

Substantial reliance of lending activities on the currency component and external political and economic factors.

Main Areas of Government Policies

Banking activities in the lending market should be developed in the following main areas:

Improving bank capitalization, quality and competitiveness of bank lending services;
Introducing of modern systems of risk management and promoting international corporate governance standards;

Implementing modern risk management systems

Strengthening the protection of rights of depositors, clients and creditors of banking institutions;

Establishing a separate banking oversight function and implementing the strategy of pro-active oversight intended to identify red flags in bank operations at an early stage and provide a timely response.

Key development measures.

To implement main areas of government policies relating to the development of banking activities in the lending market, the following actions should be taken.

Increasing capitalization of banks and competitiveness of bank lending services

capitalization increase should be performed taking into consideration the growing volume of lending transactions, through attraction of additional shareholders' capital to banks, enhancement of earnings capitalization in banks, introduction of mandatory quoting and trading of own shares by banks at the regulated securities market;

implement up-to-date and reliable bank technologies; automated systems and their backup (duplication), restoration of seamless operation of the above systems after a negative impact of external factors;

decrease off-bank cash flows, particularly, through implementation of up-to-date labor compensation techniques, and expansion of non-cash public payments for goods and services, including via plastic cards and other cashless payment instruments;

develop new S&MB and households oriented segments of the bank services market, including factoring, leasing, retail consumer lending and mortgage;

expand the array of instruments for banks re-financing, in particular, loans on mortgage;

implement effective National Bank controls of operation of Construction Funding Funds and Funds for Transactions with Real Estate established by commercial banks, in order to stimulate participation thereof in the development of residential construction and real estate market.

Promotion of international standards for corporate governance

Convert banks into open joint stock companies through imposing restrictions on certain bank transactions when licenses are issued to banks established as closed joint stock companies, namely, restriction on deposits acceptance, opening and keeping

accounts of individuals;

Increase responsibility of managers and owners of a bank for safety and sustainability thereof, toughen qualification (professional) requirements for the members of supervisory boards at banks and prevent conflicts of interests;

For the National Bank of Ukraine – expand the list and toughen requirements for the contents of information subject to mandatory disclosure (on the financial standing, owners, management structure, quality characteristics of management, key investments etc.).

Improve efficiency of internal control systems; the quality of internal and external audit, particularly through proper enforcement of International Audit Standards, objective certification of external auditors; and enhance improvement of training processes for such auditors.

Risk management

Introduce and constantly monitor risks for efficient operation of management systems and internal controls; prevent uncontrolled and unregulated decisions related to bank risks by bank management and employees;

Continue approximation of external bank audit to audit standards and ethics of International Federation of Accountants (IFAC);

Support the formation of credit bureau system and operation of collection agencies and ensure efficient exchange of information on unreliable debtors;

Ensure legal regulation of syndicated lending in order to clearly distribute risks;

Introduce gradually differentiated rates of regulatory collections as a system to stimulate the improvement of risk management at banks that are participants to individual deposits guarantee funds.

Protection of creditors, depositors and clients rights

Improve procedure for disclosing publicly accessible information of banks in their statements on owners and biggest stakeholders; establish new mechanisms for preventing dishonest individuals from taking over control of banks;

Establish criteria for assessment of business reputation of the bank founders and toughen requirements for buyers of banks' shares;

Provide favorable environment for the development of up-to-date lending and improve mechanisms for protection of lenders and consumers of bank services;

Establish a wide network of rating agencies as independent assessors of the banks' financial standing and their risks;

Simplify and unify forfeiture (foreclosure) procedure and meet pledge backed demands of lenders; apply extrajudicial foreclosure proceedings by providing pledge holders with a right to enter into notary certified transactions with pledgers that are legal entities, at any moment of the liability validity, not only after emergence of grounds for foreclosure; improve the system of registration of property rights for real estate and restriction thereof;

Improve mechanisms for liquidation of banks whose licenses for bank

transactions are cancelled; and mechanisms for establishment of cooperative liquidators institute;

Amend the Law of Ukraine On Individual Deposits Guarantee Fund regarding financing of such Fund for the purpose of increasing capitalization and financial capacity of the Fund, including transfer of up to 20% of earnings that exceed expenditures of the National Bank of Ukraine to the Fund, placing investment of the Fund alongside government securities in mortgage bonds, and coverage of deposits in bank metals by government guarantees;

Spread the practice of settling legal conflicts through Tertiary courts and implementation of financial ombudsman institute.

Bank regulation and supervision

In order to approximate Ukraine's bank system to international standards and improve safety of bank operations, continue more actively the implementation of the key Basel Committee documents on bank supervision targeted on risk-based supervision and the implementation of active bank oversight strategy;

For this purpose, develop risk oriented approaches of bank supervision, namely, quantitative evaluation of risks and assessment of risk management, both on the level of individual banks, and total banking system. Such approaches shall provide for the following:

- shift the accent in inspections from how correctly bank transactions are performed to evaluation of risks resulting from such transactions;

- concentrate banks supervision on quantitative evaluation of risks and assessment of risk management quality;

- switch from evaluation of past event in the bank operation to projecting bank's development and risks typical for it;

- implement supervision of banks operation on a consolidated bases including evaluation of risks based on relations within groups of banks, holdings etc., provided such risks may, currently or potentially, affect the objects of bank supervision (banks); develop and implement consolidated supervision method aimed at determining participants of consolidated groups, improving the contents of consolidated statements and ensuring that they are correct; develop procedure to analyze the influence of consolidated group members on the bank's operation and indicators in its consolidated statements, both in off-site (documentary) supervision, and onsite inspections;

Improve the procedure for liquidation of banks, including for sale of property (assets) of the bank under liquidation;

Ensure legal regulation of re-organization of banks;

Improve efficiency of technologies (procedures) for banks' recovery (curing), in particular, improve guidelines for determining problems criteria in operation of banks and legal regulation of procedure for selling banks when a temporary administration is appointed; establish crisis managers institute (temporary administrators and liquidators);

- Improve the procedure of banks' liquidation, including the sale of property (assets) of banks under liquidation;

Improve the mechanism of State support for the banking system during financial crises.

5.2 Lending cooperation

Assessment of current situation

Credit unions and joint credit unions are participants of the domestic cooperative lending market. As of January 1, 2008, the State Register of Financial Institutions included 765 credit unions, including 4 joint credit unions. The total number of credit union participants exceeded 2.391 million. There were two active all-Ukrainian associations of credit unions. As of the beginning of 2008, credit unions drew UAH 3.451 billion. Total amount of credits issued by such financial institutions reached UAH 4.5 billion.

Problems

The most acute problems hampering credit cooperation development in Ukraine are the following:

Gaps in the legislation regulating entities of lending cooperation system, particularly, the existence of unjustified restrictions for providing financial services to the members thereof and to legal entities; lack of adaptation of laws and regulations regulating cooperative lending market to the EU legislation;

Low capitalization and financial instability of some credit unions; the lack of efficient mechanisms for maintaining financial sustainability of credit unions;

Low public awareness on the operation of credit unions, their services and opportunities they offer;

High credit interest rates and comparatively short lending terms, which limits significantly the opportunity for credit unions to work on the market of mortgage lending of small business and farms;

Operation of numerous credit unions on the cooperative lending market that do not comply with fundamental principles of international cooperative movement and requirements for protection of rights of their members;

Lack of efficient mechanisms for protection of credit union rights and the system for guaranteeing deposits.

Main trends in the State policy

National cooperative lending shall develop on the market basis with minimum intervention of the government, and follow positive international experience.

State policy in supporting cooperative market should include:

- Improved protection of property rights of credit institutions members;
- Effective state regulation and implementation of prudential oversight in credit cooperation;
- Support of long-term lending development;
- Provision of proper financial reliability and solvency of credit cooperation institutions;

- Support of integration of credit cooperation institutions within the framework of the multilevel system controlled by such institutions;
- Creation of environment for the formation of proper infrastructure of the credit cooperation system;
- Public awareness on credit institutions and results of their operation.

The State policy with regard to the development of credit cooperation system will be implemented with credit unions associations and research institutions as participants.

Key development measures

In order to implement state policy regarding cooperative lending, the following actions are necessary:

- ensure proper capitalization of credit unions;
- specify the list of regulatory requirements for credit unions, taking into account risks, amounts and nature of transactions, and availability of a network of separated offices;
- introduce the principles of cooperation movement in credit unions management, improve efficiency of their public management and control bodies;
 - expand lending opportunities of credit unions in line with the needs of small businesses and farms, and mortgage lending for broad public;
- enhance activities of credit unions in supporting the development of local communities and socially oriented programs for lending to the members of credit unions in the staffs of companies, institutions and organizations, academic institutions, branch trade unions, public and religious organizations;
- arrange effective state regulation and supervision in cooperative lending, taking into account international experience and involving credit union associations;
 - improve mechanisms to ensure credit unions liquidity, including by way of implementing economic norms and requirements for reservation of funds; re-financing mechanisms; and specify procedure for application of such requirements;
- determine place and role of associated credit unions and cooperative banks in the system of credit cooperation, and amend the legislation that regulates them respectively;
- set up a single national system for stabilization and financial cure of credit unions, arrange methodological and resources provision;
- introduce efficient mechanism for protection of rights and lawful interests of members in cooperative lending institutions; legal and institutional background is necessary for operation of the deposits guarantee system for the members of credit unions;
- enhance organization of a proper infrastructure of credit cooperation system; consolidate credit unions associations and their activities aimed at implementation of common qualification and technological standards on the market of cooperative lending, including on self-regulation basis;
- ensure keeping public, particularly small businesses and farms, informed of opportunities, terms and risks of cooperative lending;

- determine requirements and procedures for mandatory disclosure of information on operation of institutions, and improve the quality of their audit.

5.3. Insurance market

Current situation assessment

As of January 1, 2008, 482 insurance companies in Ukraine held licenses for provision of insurance services, 65 of them being life insurers. Participants of the market also include insurers, insured individuals, beneficiaries, re-insurers, mutual insurance companies, insurance and re-insurance brokers, insurance agents, actuaries, average commissioners, and associations of operators and consumers of insurance services. Total amount of assets of Ukrainian insurance market as of the above date was around 4.5% of GDP. The dynamics of key market parameters over the previous years has been showing stable growth. Receipts of gross insurance premiums in 2007 came to UAH 18.008 billion, including UAH 12.4 billion net insurance premiums. Year-on-year, 2007 gross insurance premiums rose 30%, and net insurance premiums grew by 41%. The total assets of insurers increased 34% to reach UAH 32.2 billion. The total re-insurance level rose by UAH 802 million in 2007 and was UAH 6.4 billion. However, institutional and functional characteristics of the national insurance market all-in-all do not meet actual needs of the state and European standards. The share of premiums of Ukrainian insurers is about 0.2% of the total premiums in Europe. On average, Ukraine per capita insurance premiums is a mere Euro 52, which is significantly lower than in other countries of Europe (e.g., Euro 1,250 in Germany and Euro 120 in Poland). The 2007 gross insurance premiums to GDP in Ukraine was 2.5%, whereas in the leading countries of the world this indicator is between 8% and 16%. Insurance premiums for life insurance contracts came to just 4.3% of the total premiums in Ukraine, whereas in the EU member states this amount is more than 50% of the total premiums.

Problems.

In Ukraine, an average insurance premium per capita is €52. This is much lower than in other European countries. For instance, in Germany this figure is €1250, and in Poland it is €120. In 2007, the ratio of insurance premiums and GDP in Ukraine reached mere 2.5%, while in the developed countries this ratio is 8-12%. Insurance premiums on life insurance contracts totaled only 4.3% of the entire amount.

The biggest obstacles hampering domestic insurance market are the lack of legal regulation in the insurance sector, underdeveloped market for life insurance and other types of personal insurance; low solvency of potential insurance services consumers, their low trust for the insurance system, fraud and neglect of the rights of insured people by some insurers; and the lack of information on insurance companies and services they provide.

Even today Ukraine does not have a legal basis for implementation of mandatory medical and pension insurance. Under developed are still such areas as insurance against agrarian, ecological and disaster risks. Entrepreneurs keep using insurance

services to evade taxes. Unfair competition (dumping) exists, especially in pricing some kinds of insurance services. Legal regulation of the operation of insurance mediators, actuaries and average commissioners still has gaps. There is still no effective mechanism for pre-court protection, the ombudsman institute is not in place yet.

Key areas of the State policy

State policy in insurance must address the following aspects:

- Formation of an up-to-date and dynamic insurance market with a highly developed infrastructure and wide range of insurance services;
- Adaptation of the Ukrainian insurance market to the international requirements for financial regulation and oversight, and active cooperation with European and international organizations;
- Creation of insurance oversight which is harmonized with international standards and oriented at protecting the consumers of financial services;
- Updating insurance business and systems for managing insurance companies;
- Development of insurance mediation and strengthening control of mediators (brokers, agents and advisors);
- Implementation of micro-insurance system for low-income population, state support of socially important types of insurance;
- Formation of public insurance culture and improving financial literacy of the insurance market participants.

One of the priority areas in the development of the insurance market is the development of personal insurance, long-term life insurance, including investment and pension insurance, active participation of insurers in the system of non-state pension provision and implementation of mandatory medical insurance.

The establishment of a stable insurance market requires objective informing of all its participants on key terms, requirements and risks in their operation. In order to improve public insurance culture, transparency must be ensured in the operation of all insurance market participants; and public shall be informed via mass-media on the state and prospects of the insurance market and benefits from getting insurance services.

Integration of Ukraine's insurance market into international financial services markets requires higher competitiveness of domestic insurers and gradual implementation of international accounting and financial reporting standards. In order to protect the national insurance market, actions will be taken to allow foreign insurers to the market gradually and carefully, conditions will be created to ensure exchange of information among the State Commission for Regulation of Financial Services Markets and insurance regulators in other countries about operation of insurers, their affiliates, insurance mediators and insurance groups (insurance holdings).

The development of the insurance market will also be facilitated through the

improvement of insurance (re-insurance) activities taxation and tax incentives.

Key development measures

Development of new types of insurance and investment activities of insurers

Develop and implement a program for introduction and development of investment insurance;

Create legal basis for the implementation of medical insurance and a background for the development of agricultural insurance;

Allow life insurance companies enter into long-term medical insurance contracts (10-15 years) and sell insurance policies for additional risks (accidents, critical diseases etc.), separately from the survivor and death risks;

Taking into account the consequences of the financial crisis, review requirements and the list of securities and other financial instruments in which insurance companies may invest their reserves;

Allow insurance companies to transfer accumulated funds, namely reserves or a part thereof, to asset management companies for trust management.

Protection of Insurance Services Consumers' Legitimate Interests

Improve the monitoring of insurers' activities and strengthen control over insurers' compliance with the requirements to ensuring solvency, financial soundness, net assets size, the statutory capital and to persons owning a significant share of insurers' capital.

Implement the prudential oversight system providing for maximum consideration by insurers of the following parameters: the degree of risk, the adequacy of insurer's measurement of the real degree of risk, the quality of the internal risk management and control system, adequate accounting and financial reporting and identification of gaps in insurers' operation on the early stages of their development.

Amend legislative acts for the purpose of prioritizing the insurers' claims in the general line of other creditors and excluding insurance reserves for all types of insurance from the liquidation mass of insurance company.

Promote the creation of insurance guarantee funds, including for life insurance.

Streamline the regulatory and legal framework with regard to formation and investment of insurance assets, the procedure for currency purchase and insurers' access to overseas securities markets.

Design the regulatory and legal acts aimed at development of insurance mediation capable to ensure alternative dispute resolution on the insurance market;

Develop the requirements to operation of the internal audit systems of insurers and improve the analysis of statistical information on insurance and insurers' and insurance agents' reporting;

Guarantee protection of legitimate rights of insurance policyholders to insurance indemnities, including by means of creation and development of institutions for out-of-court protection and support to the associations of insured.

Streamlining Legal Framework, Regulation, Supervision and Control over Activities of Insurance Market Participants

Ensure effective government regulation and supervision in the field of insurance with due account for principles and standards recommended by the International Association of Insurance Supervisors.

Ensure further adaptation of Ukrainian insurance legislation to the EU legislation.

Pass the new version of the Insurance law of Ukraine.

Amend the Civil and Commercial Codes of Ukraine, the Laws of Ukraine On Financial Services and State Regulation of Financial Services Markets, On Insurance, On Mandatory Insurance of Civil Liability of Land Transport Vehicle Owners for the purpose of bringing them into conformance between themselves, improving the contract relations in the field of insurance, classifying risks and types of insurance and strengthening the system of government regulation of the insurance services market.

Enact a new language of the Law of Ukraine on Insurance.

Facilitate protection of the economic competition on the insurance market to improve the conditions of its operation on a competitive basis.

Amend legislation to ensure long-term life insurance development and insurers' participation in the non-state pension provision system.

Develop the concept and facilitate the adoption of the relevant laws regarding insurers' involvement in the mandatory medical insurance;

Implement stimulating tax policy to develop individual insurance, long-term life insurance, including investment insurance and insurers' participation in the non-state pension provision system and mandatory medical insurance by means of referring premiums on these types of insurance to the gross expenditures of legal entities and streamline the natural persons' income taxation.

Amend the legislation to gradually transfer the insurance (not just life insurance) from the taxation gross revenue from insurance activity to the profit taxation.

Clearly determine the government policy on the mandatory insurance, reduce the number of mandatory types of insurance and ensure expert examination of social and economic expediency of implementing each new type of mandatory insurance.

Improve the legal framework for operation of mutual insurance partnerships.

Ensure the development of legislative acts preventing the use of the insurance market for unlawful and shady transactions including money laundering.

Improve legal regulation of actuaries' activities; complete the system of training and certification of actuaries in Ukraine with gradual transfer of these functions to an SRO.

Ensure development of legal and regulatory acts regulating the activity of insurance agents, consultants and average commissioners and implement their registration.

Increase of Insurers' Capitalization and Competitiveness of National Insurance Market

Facilitate the insurance market concentration by amending legislation on formation of the statutory capital, guarantee fund and free reserves.

Implement information exchange and effective cooperation between the State Commission for Regulation of Financial Services Markets in Ukraine and foreign insurance regulators with regard to insurers' activity, their branch offices, insurance intermediaries and insurance groups (insurance holdings).

Facilitate phase-in of international accounting and financial reporting standards into insurance sector.

5.4 Securities and Term Contracts Market

Assessment of Current Situation

The domestic securities market on its face has developed fairly well. In Ukraine as of the end of 2007 there were 10 securities trade organizers registered in the form of stock exchanges and trade and information systems, operated 3 securities depositories, 225 custodians, 372 independent registrars and 792 securities traders. The securities trading volume over the last three years has increased 1.9 times and at the beginning of 2008 was UAH 754.3 Bio. Only during the last year there were issued securities with the total face value of UAH 133.3 Bio, including shares for UAH 50 Bio, corporate bonds for UAH 44.5 Bio and investment certificates for UAH 31.1 Bio. Despite this, the Ukrainian stock market remains unattractive for both domestic and foreign investors and does not fulfill its main function of providing the enterprises and the national economy with the required investment resources.

Problems

The domestic securities market is notable for its low capitalization, lack of transparency and limited liquidity. It has a shortage of high investment quality financial instrument. Trading with derivatives and term contracts, in particular with financial and commodity futures is almost absent at all. Securities trading on the regulated markets accounts for only about 10% and is virtual to a considerable extent, since on the regulated markets the securities trades are mainly executed but not settled. The stock market infrastructure remains incomplete and inefficient. Investor rights especially those of individual investors are poorly protected.

Key Directions of the State Policy

The securities market development strategy for the period through 2015 should be aimed at resolving the following tasks:

Transform the stock market into one of the main tools for funding investment needs of Ukrainian businesses;

Increase the competitiveness of the domestic securities market and its professional participants;

Revamp the trade and settlement as well as record-keeping infrastructures of the securities market;

Strengthen investor rights protection and that of other securities owners; reduce non-market risks of investment activity on the market;

Streamline the legal and regulatory framework for market operation, state regulation and self-regulation.

Key Measures for Development

To achieve the aforementioned goals it is necessary to take the following actions:

Create favorable macroeconomic prerequisites to increase the stock market competitiveness through harmonization of monetary and fiscal policy;

Increase concentration of trades on the regulated securities market through implementing the unified rules and standards on the existing trade platforms as well as concentration of trades with securities of issuers having strategic importance for the state economy and monopolists-issuers on the stock exchanges;

Institutional strengthening of the regulated securities market of Ukraine through developing the objects of its infrastructure and use of the modern technologies for servicing trades, as well as state-of-the-art information technologies and modern software;

Demutualize and consolidate the trade and settlement as well as record-keeping infrastructure;

Increase capitalization and liquidity of equity securities markets, in the first place the shares and bonds markets, in particular the government ones;

Create legislative framework to develop derivatives and term contracts markets and their broad application for prices projection and hedging financial risks, specifically in energy and commodity trading;

Implement a legislative tool for protection of minority shareholder rights and investor rights in M&A;

Implement the European standards of regulated securities markets operation into the Ukrainian legislation, in particular, introduce a notion of a “qualified investor” as a legal entity and a natural person, whose experience and qualification allows him or her to evaluate investment risks adequately and based on such evaluation to enter into securities transactions on his/her own;

Make prices manipulation for financial instruments and unlawful use of insider information impossible through enactment of a special Law on Insider Information and Prices Manipulation Prevention clearly defining a term “insider information” according to the international practice, the list of insiders and restrictions on the use of insider information, preventive measures and establishing liability for the caused damage;

Ensure the effective protection of investor legitimate interests through increasing the informational transparency of the market, guaranteed settlement of executed trades and streamlining the record-keeping of securities ownership rights;

Simplify the legislative procedure for foreign portfolio investments to enter the Ukrainian securities market and to exit from it.

Stimulate the investments of Ukrainian people into domestic securities through establishing the tax rate on income from securities and transactions with them on the level with taxes on bank deposit interests;

Exempt services provided by professional securities market participants to the institutional investors from VAT and exempt from taxes the proceeds from issuing securities.

To encourage transactions with financial assets of foreign countries on the

Ukrainian stock exchanges it is necessary to create legal and organizational conditions for issuing and circulation of Ukrainian Depository Receipts.

5.5. Collective investment market

Assessment of the current situation

In Ukraine the collective investment market is represented by investment funds and asset management companies. This industry which plays an extremely important role in the majority of countries of the world in Ukraine is only at the initial stage of its development. At the beginning of 2008 in Ukraine 334 asset management companies operated and 834 investment funds functioned including 699 unit ones and 135 corporate ones. Almost 78% of the total number of CIIs fell on venture investment funds. In this case the total value of assets of collective investment institutes was equal to 40.8 billion UAH that was 5.8% of the total GDP volume of the country.

Problems

The problems which are common to the sphere of collective investment include the following: insignificant volumes of attraction of investment funds which make up only 14.5% of the funds attracted to the bank system; domination of quasi venture institutes among CIIs; low level of trust on the part of potential participants and investors; absence of an effective and transparent system of performance evaluation; a deficit of financial instruments attractive for investment and absence of real mechanisms of fund investment in foreign securities. The discriminatory (as compared to banking institution depositors) procedure of taxation of incomes of investment certificate owners is a substantial factor which restrains the development of the collective investment market.

The main directions of the state policy

Substantial improvement of the role of CIIs and AMCs in providing the real sector of the national economy with required investment resources should become a major task of the state policy in the development of the collective investment market in Ukraine.

The state policy associated with the development of the industry of collective investment should be directed at increasing the scale of CIIs activities with attraction of savings of households and investment resources of entrepreneurial structures, establishment of required legislative and organizational preconditions for more active participation of these institutions in financing priority branches of the national economy and implementation of innovation projects and state programs.

Key measures for development

To further develop the industry of collective investment it is required to prepare and take a number of the following measures:

- to improve the institutional component of the collective investment market by creating favorable organizational and legal conditions for substantial growth of the number of unit investment funds, filling venture fund operation with adequate

content, origination and effective operation of investment hedge funds, bond funds and direct investment funds on the market;

- to provide information transparency of CII operation, specifically, regarding the procedures of investment of funds, the amount of net assets, and fees of management of AMC's and their owners.

- to enable AMC's to have obligatory reserves of insurance companies in their management and manage investment and insurance funds of the companies which provide services on investment insurance;

- to provide continuous monitoring, ranking and rating of operation of investment funds and AMC's and publication of the results obtained by means of the mass media and Internet capabilities;

- to liberalize currency regulation in the sphere of CII operation, specifically, by cancelling unjustified restrictions on attraction of funds in foreign currency and making of investments in foreign securities;

- by 2010 to introduce prudential supervision over CII operation and financial accounting international standards, to provide valuation of net assets of AMC investment portfolios at market prices;

- by 2012 to complete introduction of the procedures of assessment of efficiency of domestic CII investment activities according to the rules defined by Global Investment Performance Standards (GIPS);

- to establish equal terms of taxation of incomes of CII securities owners and banking institution depositors;

- to introduce effective compensatory mechanisms of guaranteeing legitimate interests of unit investment fund depositors and corporate fund shareholders;

Ensuring CII efficiency is impossible without substantial growth of the number of natural persons and households which will carry out investment activities which needs better awareness of individuals of opportunities of investment of funds on the financial market using CIIs, of their rights and duties. In this respect it is required to develop and implement a target program which will provide for the measures for uncovering the reasons of low trust of the population to application of financial market instruments and CII capabilities for investment of savings, determination of a target audience to undertake measures aimed at attracting funds and explaining investment risks as well as a complex of information and training programs and materials intended for different target audiences.

5.6 Non-State Pension Services Market

Assessment of Current Situation

Currently in the field of non-state pension services of Ukraine the following entities operate: non-state pension funds, companies fulfilling functions of non-state pension funds administrators, banking institutions operating as pension assets custodians, as well as insurance companies specializing in life insurance and entitled to pay insurance benefits to NPF participants upon their reaching a certain age.

The domestic non-state pension services market is currently at its embryonic stage, however, it is developing rather rapidly. At the beginning of 2008 there were

99 non-state pension funds registered out of which only 66 funds were actually accumulating pension contributions. The number of licensed administrators was equal to 40. The total number of NPF participants over the last year increased by almost 45% and amounted around 279 ths. persons. NAV of NPFs has increased by a factor of 2.2 during this period; however it was equal only to UAH 278.5 Mio.

Problems

To the most significant problems holding up the non-state pension services market development should be referred the following: the pension reform suspension in terms of implementing the mandatory accumulation pension system and personified record-keeping of its participants; insufficient tax incentives for the non-state pension provision development; the lack of reliable financial instruments for investment of pension funds money and unsubstantiated restrictions for investment of accumulated funds; insufficient transparency of NPFs and companies providing services to them; lack of trust to these institutions on behalf of potential NPF participants.

Main Directions of the State Policy

Further non-state pension provision development requires:

- Speeding up the introduction of the mandatory accumulation and occupational pension systems;
- Improving the quality of NPFs operation and of the operations of entities supporting the functioning of the operating NPFs;
- facilitating public education, information campaigns for employers', trade unions, associations of individuals and legal entities about NPFs advantages and advantages of their participation in the non-state pension provision system;
- improving the state supervision in this area;
- improving the legal and regulatory framework of the non-state pension provision system.

Key Measures for Development

For the sake of the accelerated introduction of the accumulation system of the mandatory State pension insurance and of the occupational pension system, it is necessary to develop and approve shortly the Concept for further implementation of the pension system in Ukraine, specifying the timeframe for the implementation of the above pension systems, specifying the mechanisms of pension funds accumulation, the age groups of the population to be eligible for non-State pension provision, and the amount of contributions. It is extremely important to ensure guarantees to protect the funds of the mandatory accumulation pension system against the possibility of their utilization to fund the current State budget deficit, service the sovereign debt, or closing the cash gaps. Pillar II is to be introduced no later than in 2010. The vitally important pre-requisite of successful introduction of the mandatory accumulation component is to be macro financial stability and a well-balanced financial strategy of a transition to Pillar II of the pension system,

and the introduction of a reliable exchange of individual pension contributions on the way from employers to NPFs.

To increase the NPFs efficiency and attractiveness of their services it is necessary first of all to take measures to expand the range of financial instruments insuring reliability and acceptable rate of return for investment of such institutions' assets.

The priority tasks in this field shall be the following: development of regulated and liquid securities market, new legislation drafting and improvement of the effective one regulating the creation of regulated commodity markets of (land, real estate, commercial infrastructure object, etc.), issue of securities (such as collateralized mortgage bonds, housing certificates and middle-term and long-term floating income government bonds) that could be used or specially designated for investment of pension funds.

In addition, measures should taken to eliminate artificial obstacles to investment of pension fund assets into foreign securities having an investment rating; to take into account in the State Privatization Program the need to transfer from fiscal to investment privatization and stock market support with its help; to ensure high quality rating of financial instruments according to the international standards and making relevant amendments to the effective legislation.

To ensure NPFs transparency and efficiency of NPFs and NPFs service providers' operation it is necessary to amend laws and regulations and to undertake the organizational measures aimed at the following:

- Acceleration of NPF market participants transfer to the international financial reporting standards;
- Improvement of the procedure for calculation of NPF NAV and implementation of the unified system of pension accumulations accounting based on the daily calculation and record-keeping of the unit value;
- Implementation of the system of NPFs financial condition public evaluation through adoption of respective regulations and PDS system implementation as well as regular disclosure of these data in mass media.

In addition, actions should be taken to implement the restrictions for investment of NPF assets into financial instruments of the NPF founders and persons affiliated to them; to specify the definition of "other" assets in which NPF assets can be invested (such assets could be only those whose value is clearly defined); to insure information disclosure about beneficial owners of NPFs, asset managers, administrators and custodians providing services to pension funds; to enhance the powers and liability of custodian-banks for compliance with the effective legislation when safe-keeping NPF assets and performing operations with financial instruments in which these assets are invested.

Special attention will be paid to improving taxation of transactions in the NPF system. In particular, it is required to undertake the following arrangements: to exempt NPF administration from VAT tax; to ensure that tax authorities meet the legislation requirements to include pension contributions into an individual income tax credit and ground the annual recalculation of these amounts; to establish equal

terms for taxation of pension funds benefits (lump sum benefits and defined period benefits); to improve taxation in the process of NPFs assets investment into the real-estate objects.

In order to improve public awareness of NPFs activities, it is necessary: 1) to ensure information campaigns are in place for educating the public, employers, trade unions, associations of individuals and legal entities on NPFs benefits and their participation in non-state pension provision; 2) explain the importance of including expenses for such purposes in state and local budgets, and financial plans of non-state pension provision participants; 3) inform the public of benefits non-state pension provision offers compared to other ways of long-term accumulation (insurance and bank products) and tell of the reliability of extra payments after NPF participants reach pension age; and 4) encourage more active work of the State Property Fund, oblast and local administrations, and explain what pension reform is about to the working people, especially employees of the state-owned and community-owned companies.

Strengthening state supervision of private pension provision entities requires the following actions:

- introduce consolidated supervision to allow regulators track transactions with related entities within financial groups that deal with NPFs' assets;
- develop and implement the system for exchanging information among bodies performing state control and supervision in the non-state pension provision sector through the implementation of an integrated system for information exchange;
- improve inspection of NPFs' operation in order to strengthen risk assessment and discover violations of investment restrictions in investing pension assets in a timely manner;
- strengthen institutional capacity of state regulators in the supervision of non-state pension provision system; expansion of FSR and SSMSC powers in obtaining information on beneficial owners of financial institutions.

In the meantime, it is necessary to take actions to improve legal framework of non-state pension provision. In the first place, it is necessary to facilitate the enactment of some bills that amend and complement properly some laws of Ukraine, in particular, the Laws on Non-State Pension Provision, On Mandatory State Pension Insurance, On Financial Services and State Regulation of Financial Services Markets, On Conducting Experiment in Housing Construction On the Basis of KyivMiskBud Holding, in order to improve and harmonize the entire legislation related to non-state pension provision.

5.7. Leasing services market

Assessment of the current situation

In the countries with a developed economy a share of leasing in investments in fixed assets reaches 15 -30 %. In Ukraine despite the fact that for the last three years the pace of leasing development increased and its share in investments in fixed assets in 2007 reached 8% the domestic leasing branch is represented mainly by passenger

car transport. Leasing of production fixed-capital assets, machines and equipment for agriculture, the medical branch, housing and utilities, education and science, etc., is underdeveloped.

According to expert estimate at least 100 billion UAH may be invested through leasing mechanisms in Ukraine, however, as of the beginning of 2008 the actual volume of the leasing market was equal to 14 billion UAH.

Problems

The most urgent problems which restrain the development of leasing in Ukraine are:

- imperfection of legal support that is manifested in existence of legal components of leasing activities and the lack of proper regulation of some of them.
- shortcomings of the tax policy. VAT treatment of leasing activities is discriminatory as compared to banking in spite of the fact that financial leasing as well as bank crediting is a financial service and lessor incur more risks than banks. The current tax legislation does not stimulate the development of the investment leasing mechanism – there is incompliance of the periods of tax depreciation of the subjects of leasing with the duration of the periods of their value-added use, especially, regarding leasing assets which belong to group 3 of fixed assets. Fiscal restraints regarding charging the funds spent for insurance of leasing assets to gross expenditure increase substantially the risks of lessors (the latter being fixed assets owners transfer them in long-continued use by lessees).
- absence of long-term sources of financing replacement of fixed assets at on-budget institutions of the branches of social infrastructure (medicine, communal facilities, education and science).
- insufficient number of skilled personnel in the sphere of leasing and low awareness of the matters of leasing among representatives of small and medium business.
- limited long-term financial resources on the domestic market of Ukraine.

The main directions of the State policy

The state policy regarding the market of leasing services should be aimed at making financial leasing an important instrument of technical reequipping of enterprises, the development of agriculture, housing and utilities as well as small and medium business.

In view of the above the main directions of the state policy in the area of the development of financial leasing should become as follows:

- improvement of civil and financial legislation on leasing, integration of the national legislation into international one.
- development of the leasing infrastructure and its more active use by market participants.
- creation of conditions for introducing a mechanism of refinancing of leasing agreement portfolio.
- training of leasing specialists in educational establishments.
- broadening options of using an investment leasing mechanism for replacement of fixed assets by on-budget institutions of the branches of social infrastructure

(medicine, housing and utilities, education and science).

- creation of conditions for growing of financial stability of lessees, an increase in their capitalization, introduction of up-to-date risk management systems by leasing companies.

Key measures for developing the leasing services market

The following is required to develop the leasing services market:

To improve common and special legislation on leasing, specifically, to eliminate irrelevances and contradictions between norms of the Civil and Commercial Codes of Ukraine and other laws of Ukraine. To amend the Law of Ukraine “On financial leasing” with the purpose of improvement of the mechanism of performing financial leasing operations, protection of the rights and interests of the parties to leasing agreement.

To amend the Law of Ukraine “On corporate income tax” with the purpose of bringing its norms in compliance with norms of civil legislation. To introduce a mechanism of the investment-oriented policy of tax depreciation for production fixed assets (group 3 of fixed assets) when receiving it in financial leasing. To lift restrictions regarding charging the cost of insurance of leasing subjects to gross expenditure. To eliminate redundant taxation of non-residents who engage in leasing activities in Ukraine.

To amend the Law of Ukraine “On VAT” aimed, first of all, at regulation of the matter of interest and fee taxation paid as part of a leasing payment in case of financial leasing.

To amend the Law of Ukraine “On financial services and state regulation of the market of financial services” which will provide for improvement of regulation of activities of leasing market participants.

To develop legislation on establishment of non-budget local special-purpose funds intended for long-term (3-5 years) financing of replacement of fixed assets in the branches of social infrastructure (public health, housing and utilities) by investment mechanisms other than purchase.

To bring the State classifier of Ukraine “Classification of fixed assets” (Classification of fixed assets ДК 013-97) in the sphere of leasing in compliance with the effective legislative acts with the purpose of regulating the process of ascribing fixed assets to certain groups and providing economically feasible charging depreciation charges on them.

To complete the procedure of joining UNIDRUA Conventions “On international factoring” and “On international financial leasing”.

To ratify UNIDRUA Convention “On international rights to mobile equipment” and Kyoto Convention “On simplification and harmonization of customs procedures”.

To join UNCITRAL Convention “On assigning receivables in international trade”.

To develop mechanisms of refinancing leasing agreement portfolios, specifically, through the procedures of their sale and securitization (standardization of leasing agreements with further issue of securities on security of packages of standardized

leasing agreements), application of leasing in state investment projects.

To develop standard provisions on organizational structure of leasing companies, management of their risks as well as other matters aimed at enhancing financial stability and efficiency of activities of domestic lessees.

To organize training of leasing specialists at higher educational establishments and postgraduate education institutions on the basis of agreements concluded with enterprises, institutions, organizations and natural persons.

To develop guidelines on leasing accounting, computation of annuity leasing payments.

To develop academic and research commentary to Ukraine's legislation on leasing and establish a consultative center for potential and current leasing market participants, first of all, representatives of small and medium business.

5.8 Support to New Institutions, Financial Instruments and Services

5.8.1. Development of the institutional component of the financial market

Assessment of the current situation. Discreteness and fragmentation of the financial market development resulted in the deformation of its institutional component. As a result of this some market institutions started to look in some way like their foreign analogs, the activity of others turned out to be considerably deformed, and some institutions which are extremely important for a market are absent until now.

Key measures

To change such a status it is required to take the following measures:

- to create an opportunity of operation of universal non-banking institutions, specified legislatively, which will comprehensively engage in investment activities – dealer, underwriting and customer's asset management, and have the right to off-exchange operations (mainly to initial securities placement), financial consulting, securities lending using REPO operations and other types of services associated with investment;
- to promote origination of specialized investment banks which will provide services on organization of initial public offering (IPO) of issues of equity securities on stock exchanges or other trading systems to investors and other subjects of investment activities; underwriting of securities or other financial instruments; securities crediting of businesses with their buy-back; hedging of the investment risk of indirect participants of the investment market and commodity producers by concluding term contracts on regulated markets of financial instruments or those of commodity and raw material resources; performance of operations with financial instruments of the monetary market on the instructions of customers which are based on exchange rates, interests, financial term agreements; fund and securities management under agreements with natural and legal persons;
- to create preconditions for operation of investment hedge funds in Ukraine

whose assets should be formed exclusively at the expense of the founders' money, be invested for protection of capital of the latter in financial instruments and real assets and money value of investments thereof will not depend on liquidity and other indicators of the financial market condition;

- to provide a legal framework for operation of trust partnerships which will provide natural and legal persons with the services regarding the subject of trust management which may be real and/or financial assets, using contractual or corporate form of investment;
- to introduce on the financial market activities of specialized information and analytical institutions (agencies) on information disclosure which will evaluate available and potential asset investment objects, financial and other liabilities, their financial condition, profits and losses, securities ownership rights, other financial instruments, their current value on the market, possible risks in case of investment in real or financial assets existing on the market and which (institutions) bear responsibility for authenticity of the information published or provided by them for publication;
- to provide normal functioning of investment consultants on the market that may be represented by both legal entities and entrepreneurs – legal entities whose exclusive or priority type of activities is giving consultations to investors, including professional ones, regarding investment objects, the investment strategy in different segments of the financial market and asset management methods;
- to introduce standard requirements for financial institutions which are intermediaries in organized trading in derivative financial instruments;
- introduce common requirements for financial institutions acting as intermediaries in the regulated trading of derivatives of financial instruments;
- develop legal, organizational and economic foundations for the creation and operation of land investment funds in Ukraine that would accumulate, based on land title and/or under long-term lease contracts, land plots (stakes) of individual participants of such funds.

5.8.2 Development of financial instruments and non-banking financial services

Assessment of the current situation

Currently in Ukraine the lack of attractive financial instruments and a rather narrow range of financial services are observed that is conditioned, on the one hand, by a low general level of the development of the financial market, and on the other hand, by continuous growth of the investment potential of domestic investors, first of all, institutional ones and the population.

Principal directions of the state policy and key measures

To develop existing and introduction of new financial instruments and non-banking financial services it is required to make steps in the following directions:

- to considerably improve investment attractiveness of shares and bonds of Ukrainian issuers. In this case special attention should be paid to strict adherence to corporate governance standards, introduction of clear and effective procedures of protection of the rights of minority shareholders, enhancement of information transparency of operation of JSCs and issuers of corporate bonds, improvement of legislation on taxation of incomes from securities. Fulfillment of these tasks, in particular, and first of all, requires urgent approval of the Law of Ukraine “On joint stock companies”;

- to promote further development of the debt liabilities market. Within the framework of this direction it is required to take measures regarding origination of new types of government bonds (with a floating coupon rate, nominated in foreign currency and long-term special purpose “pension” and “housing” bonds) as well as new market money instruments, so-called commercial securities. Origination of commercial securities which represent short-term liabilities with a fixed income will facilitate minimization of expenses and time for debt servicing when financing current assets of entrepreneurial structures. Commercial securities which combine the best features of bonds (unlike corporate bonds they are non-equity securities that reduces considerably the time spent for issue registration and provides advantages in choosing terms of circulation) and promissory notes (unlike promissory notes they are issued according to standard rules, have a centralized system of record keeping and may circulate on an organized market) should be adequately distributed.

- to stimulate development of the market of securities derivatives and financial instruments. Within the framework of this direction it is required to take measures aimed at origination and formation of the market of Ukrainian depository receipts, debt liabilities securities derivatives, instruments of hedging interest and currency risks, foreign economic contract derivative instruments. Origination of debt liabilities derivatives, bonds of an individual issuer or a group of issuers, credits or credit lines will make it possible to refinance debt liabilities that will contribute to enhancing liquidity of the market of debt securities and volumes of crediting enterprises of the real sector of the national economy.

Development of the market of instruments of hedging interest and currency risks will contribute to reducing the risks of not only institutional investors, but also the enterprises – participants of export-import operations. Origination of underlying derivative contract instruments for export-import commodities will facilitate reducing the risks of price fluctuations in foreign trade operations.

Approval of the Law of Ukraine “On derivative financial instruments” is an important step in the direction of development of the market of derivative financial instruments. In addition, to provide risk control on the market of derivative financial instruments it is required to develop and approve regulatory acts which should: identify requirements to assets which may be underlying for derivative financial instruments; to create mechanisms of protection of the interests of participants of this market; to identify requirements to participants of the market of derivative financial instruments, to the system of management of the risks of the operations with derivative financial instruments, to record keeping of such instruments and other requirements. It is necessary, first of all, to provide conditions for effective use of derivative financial instruments and term contracts in order to form market pricing of

the commodities which are the most important for the domestic economy (grain, metals, fuel).

It is also required to develop the services on asset securitization. To do this it is necessary to take measures required for approval of the Law of Ukraine “On securitization” stipulating in it a definition of the types of assets which may be used for securitization; requirements to the issuers of securities issued in the course of securitization; a list of the right of claim which can be used for securitization; restrictions on a possibility to recognize assignment of the right of claim invalid; the mechanisms of improvement of securities credit quality, etc.

It is also required to make steps which would contribute to origination of such types of non-banking financial services, which are new for Ukraine, as mandatory medical insurance and investment insurance on the domestic market. For this purpose it is well worth preparing a legislative framework by approving the Law of Ukraine “On mandatory medical insurance” and introducing corresponding changes to the Law “On insurance”.

Introduction and development of investment insurance in Ukraine should take place with taking into account of the world experience, in particular, requirements of EU Directives on life insurance and stipulate: creating an proper regulatory and legal framework, the systems of management and financial accounting, availability of the procedures of regulation of investment and insurance business; operation of the effective securities market and the immovable property market; existence of preferential tax treatment for operations and incomes obtained within the framework of the program of investment insurance.

6. Regulation and Oversight in the Financial Sector

Current status.

The current system of Ukraine financial sector regulation is scattered, costly and non-efficient. Its major impediment is that it is not in line with the modern requirements, specifically, it fails to comply with the principle of uniformity. Yet a characteristic feature of the current situation in financial markets development is universality of financial institutions, diversification of their services, and concentration of financial services provision at multi-industrial corporations and conglomerates. Besides, Ukraine lacks a single set of requirements to investment activities of financial institutions and has different regimes of taxation of similar financial operations and services.

Low effectiveness of regulation in the financial sector is due to insufficient cooperation of the State regulators with professional market participants of the financial markets, their SROs, and associations of financial services consumers. Under such circumstances, transition to the modern regulation model requires major and in-depth reforms of the current system of financial market regulation in Ukraine.

Key directions of the State policy

The development of regulation and surveillance of the domestic financial sector needs taking into account the new approaches and key components of the

ongoing global regulation reforms, which envision:

- unification of the regulation procedures;
- introduction of risk-based supervision and standardized risk management procedures;
- stronger control over owners and management of financial institutions;
- concentration and integration of regulatory functions, their embodiment in a single State authority;
- more active participation of the professional market participants associations in resolving problems impeding the financial market development, including attracting their resources to fund the regulatory authorities operations;
- ability and willingness of the national regulators to collaborate effectively with international financial organizations and associations; and
- strengthening anti-money laundering efforts.

Given the above, the reform of regulation and oversight of the financial market of Ukraine is to be conducted in three major areas:

- 1) through the unification of the rules and procedures of State regulations of the financial market, with gradual concentration of the regulatory functions in a single regulatory authority;
- 2) secondly, separation of supervisory functions from the regulatory functions and introduction of the prudential oversight system in all key segments of the financial market;
- 3) a significant enhancement of the role of professional market participants' SROs and their closer links with industry regulators and, subsequently, with the single State regulator; and
- 4) significant improvement in funding the State regulators, transferring the burden of this funding on market fees.

Key development measures

Unification of State regulation and oversight

It is necessary to unify the regulatory requirements to investment activities of financial institutions, primarily in collective investment. One needs to proceed from the fact that there is no principal difference between the operations of collective investment institutions (such as asset management companies, investment and private pension funds, and insurance companies) in the area of assets investment (in the presence of certain specificity of raising capital). Simultaneously, the requirements to placing the funds accumulated by these institutions, as determined in the legislation and in the regulation, including regulations of different industries, are significantly different. To overcome lack of uniformity of the legal norms regulating operations of different investment institutions, the most important strategic task in the area of financial market regulation should be the implementation of uniform requirements and standards of investment for all forms of collective investment institutions. To fulfill this problem, we need approve the relevant decisions, which are to form the

foundation of the regulatory framework that will introduce common standards of investment activities for all financial market participants operating in the area of collective institution, with due regard to the special features of their operations.

Concentration of State regulation functions

Under the current circumstances, the issue of a single center to regulate the financial market becomes even more pressing. At the same time, resolving this matter is to happen taking into account the realities of the State regulation system in place now, including the need to review the effective legislation and preserving the current authorities of the National Bank of Ukraine, which are related directly to the macro economic regulation tasks and to the implementation of the monetary policy.

The idea of a mega regulator in the financial market of Ukraine is to be implemented on a step-by-step basis, primarily through unification of requirements and standards of financial market operations, and the creation of the relevant legislative pre-requisites for consolidation of State regulation functions, which is to be completed by 2015.

In 2008, we need to commence the unification of requirements to investment activities of financial institutions, trust management of assets, and tax regimes for similar financial operations and services. Thereafter, it is necessary to introduce uniform approaches to risk management at financial institutions operating in various segments of the financial market. These approaches are to be based on the Basel Accord Principles being already implemented in the banking industry. These principles are to be expanded on the other professional financial market participants, such as asset management companies, insurers as credit unions, taking into account the specifics of their operations, customers, and transaction types.

The mega regulator of the financial market is to carry out its functions as a collegiate body of State power, with a special status, and with a special procedure of appointing and terminating top executives, and with a flexible funding system, including through funds of professional market participants.

Introduction of the prudential oversight system

In order to ensure a sustainable and reliable financial market as an integral system, it is necessary to develop and carry out organizational and legal measures to develop the prudential oversight system for surveillance of professional participants in all its segments, which will permit forecast and prevent both the operating risks of individual financial institutions, and the systemic risks of the market as a whole.

In terms of individual participants of the financial market, the task of the supervisory authority will be to evaluate the liquidity risk inherent in a financial institution, in order to prevent potential consequences of insolvency, as well as to reduce operating risks through implementing effective procedures to control transactions.

Introduction of prudential oversight in the financial market involves also the supervisory body applying effective measures (both preventive and compulsory ones) to those who violate the prudential norms and standards. These measures, on the one hand, are to make market participants comply with the prudential norms and, on the

other hand, to act as a supervisory impact tool for recalcitrant companies.

To this end, measures are to be undertaken to harmonize the methods and rules of oversight over non-bank financial institutions, which, on the whole, is in line with the European standards. Specifically, Directive 2004/39/EC states that measures to identify own funds of lending institutions are to be the basis to identify own funds of all the other categories of financial institutions.

It is necessary to introduce uniform requirements for all market participants to calculate own capital, in keeping with the international standards, and to set requirements for professional market participants to calculate their capital on a daily basis. It is also necessary to review the minimal capital requirements, gradually raising the minimal capital, at the same time trying to keep in business those market participants with low minimal capital and limited number of operations that they conduct.

For the purpose of creating the function of the risk-based prudential oversight system (during the period up to 2015), it is necessary to bring the capital adequacy requirements closer to the level of international standards. Development is expected of the risk-based capital adequacy requirements, with the whole approach to capital adequacy calculation being more risk sensitive and conducive to closing the gap between the regulatory and economic capital.

To introduce internationally accepted requirements to capital adequacy calculation, it is necessary to improve the accounting system of professional securities market participants and that of insurance companies, so as to make sure all supervision data are available.

Modern methods of risk evaluation are to be introduced that are based on international modules and on active use of rating assessments.

It is necessary to complement the regulatory practices by the pro rata principle of prudential oversight, which implies the need to apply the surveillance requirements to individual professional participants of the financial market, depending on their size, segment of operations, the nature of transactions they perform, and their risk exposure.

By 2012, measures are to be implemented that are sufficient for all market participants to convert to exclusively electronic filings of supervisory data and reporting to the State supervisory authority.

By 2015, work is to be completed on the harmonization of regulations on financial institution bankruptcy, including the introduction of temporary external administration to stave off bankruptcy.

The operations of the institute of temporary external administration, as a supervision measure, is to apply not only to banks, but also to asset management companies, insurance companies, credit unions, corporate investment funds, stock exchanges, depositories, trusts and non-State pension funds.

Self-regulation development

The numerical expansion and qualitative complication of the financial market give rise to an objective need to develop the function of self-regulation, which means, in the one hand, strengthening the role and involvement of market operators in the market's further development, and, on the other hand, the need to improve the

efficiency of SROs interaction with the State regulators.

Lifting the self-regulation role in the financial market is to happen in several directions. Firstly, delegation of certain regulatory powers, under the regulator's control, to SROs as they are getting stronger. Secondly, the rules and regulations to be developed by SROs are to complement and specify the norms of State regulation. Thirdly, it is necessary to stimulate SROs, so that they set forth more stringent requirements to professional market participants.

To strengthen the SRO role and the role of professional associations in the financial market, it is necessary perform the following measures:

Delineation of SRO and professional organizations' status, their rights and obligations through development and passage of the relevant legislation specifying the requirements to the SRO principles and standards;

Delegation to SROs and professional associations of powers to oversee fair competition, by means, among other things, developing and implementing professional ethics codes;

Delegation to SROs and professional associations of powers of enforcement, including a ban on operations in the marketplace;

Encouraging the creation at SROs of insurance and guarantee funds that will give additional protection to investors and consumers of financial services.

SROs and professional associations should not duplicate the functions of the financial market regulator. Just the opposite, membership in associations and compliance with their requirements is to make the life of financial institutions easier and to get rid of excessive attention from the State regulator;

This is possible, with highly qualified experts working at SROs, incorruptible and with unblemished reputation;

They should not lobby the interests of individual financial institutions or groups, therefore there should be effective mechanisms in place to clarify the interests of all member organizations;

It is worth assigning significant powers to SROs to collect and analyze the reports of financial market participants. It is also worth assigning to SROs the function of analyzing this reporting, generalizing the contents of reports and disclosing information in accordance with the rules established by the regulator.

It is professional association and SROs that are to represent the consolidated interests of financial agents vis-à-vis the financial market regulator.

Moreover, it is necessary to develop and provide state support to public organizations uniting financial services consumers; encourage and promote in all ways the dialogue of such public associations and associations of stock market professional participants, state regulators engaged in law-making, approval of legislation and enforcement; and the consolidation of efforts in further development of the national financial market. For this purpose, it is worth amending respectively the Civil Code of Ukraine regarding such newly introduced aspects, in particular, specify more clearly the status of SROs of professional participants and initiative associations of financial services consumers.

Enhanced counteraction of laundering illegal gains

Regulation and supervision of financial institutions in the area of preventing

laundering of illegal income and financing terrorism will be improved taking into account international standards, experience and practices in application of the relevant legislation.

For this purpose, action will be taken for banks and non-bank institutions to introduce systems of financial monitoring based on ensuring that risks are discovered, evaluated and managed effectively, as specified by *Know Your Customer* Basel Committee standards for banks supervision.

In the meantime, supervision will be strengthened over the results of internal control procedures introduced by financial institutions to prevent laundering of illegal income and financing terrorism, including by way of ensuring specialization of inspectors and introduction, alongside inspections, the system of distant control of how effectively institutions perform financial monitoring.

Another important element of policy aimed at preventing the use of a financial system to launder illegal income and finance terrorism will be ensuring transparency in the operation of financial institutions, keeping individuals that do not have perfect business reputation from managing or owning significant stakes in banks, insurance companies and other financial institutions, and preventing attraction to the capitals of financial and lending institutions of funds whose source is impossible to discover.

7. Ways of integration into the world financial arena

Integration of the national financial sector into the international financial arena is critical to the social and economic development of Ukraine. Therefore, it must flow in line with the conceptual basis specified by the state.

Ukraine's entrance into the global financial system must provide for the best consideration of national interests, current trends and today's trends in the development of financial markets. Financial institutions will operate following the rules of the WTO, Basel Agreements and European terms for provision of financial services, set forth by the relevant EU Directives.

In the meantime, note that Ukraine's integration into the global financial arena not only opens new opportunities for the development of the financial sector. It also brings forth potential threats the most significant of which is lost control over the financial system and missed opportunity to support the development of strategically important sectors of the national economy, hence the loss of economic sovereignty of the state.

In order to prevent this, set forth a limit in the law for the share of foreign capital in Ukrainian banking system and other segments of the domestic financial market. Such share may not exceed 50%.

Specify additional requirements for economic standards of operation of foreign bank and insurance companies' affiliates, in order to avoid large-scale speculation on the Ukrainian capital market.

Develop and implement state programs for supporting competitiveness of the national financial institutions.

In order to avoid and prevent shifts of trading and settlement of securities by Ukrainian issuers to off-shore zones and to other foreign markets, introduce a

well-balanced economic policy of incentives (registration, regulatory, tax policy) for issuers, investors and professional participants of the stock market.

Fully eliminate the possibility of using Ukraine's financial system to launder illegally gained funds, and penetrating into Ukraine's financial sector of capital of financially unstable foreign legal entities with doubtful business reputation. The state must establish tough criteria for authorizing foreign banks, insurance companies and infrastructure institutions of the stock market, such as stock exchanges, depositories, and clearing houses, to open their affiliates in Ukraine.

In order to prevent possible complications and violations in the supervision of affiliates of foreign financial institutions, sign relevant inter-government treaties setting forth obligations of supervising authorities in jurisdictions of parent companies to properly supervise their affiliates on the territory of Ukraine and exchange information with the relevant regulators of Ukraine.

State regulators shall develop a comprehensive set of actions to regulate access of foreign financial institutions to Ukraine's financial market, in order to effectively use their investment potential and eliminate adverse impact on the development of the national financial system.

The regime of access for foreign capital to the domestic financial sector is to expand the range and improve the quality of financial services and to ensure its dynamic and sovereign development.

An important pre-requisite for Ukraine to enter the international financial space is development and implementation of the Concept of Ukraine integration into the world financial system. When developing this Concept, it is necessary to generalize and take into account as much as possible the record of transition economies that have already passed this road.

8. Expected results

It is expected that the measures envisioned by this Strategy will lay down the grounds for an accelerated development of the financial market as compared to the growth rate of the Gross Domestic Product. Raising the level of development of the financial market in 2015 is characterized by the following data:

- the share of the bank system assets will be equal in size to Ukraine GDP;
- the ratio of the total net asset value of investment funds and accumulations of non-State pension funds to GDP will reach 10%;
- the value of corporate bonds outstanding to GDP will be about 15%;
- the value of annual issues of municipal bonds will increase six fold to reach UAH 1 billion;
- the ratio of insurance premiums to GDP will be 8%;
- equity market capitalization in 2015 will be 90% of GDP;

As a result of implementing these measures under this Concept, the financial market will sustain qualitative changes.

Most of domestic companies will get access to the capital market. There will be a significant increase in the number of IPOs performed by the companies in the securities market. The total volume of trades on the regulated market in value terms

will exceed 50% of the total securities trades.

There will be a marked expansion of the range of financial instruments and services provided by financial institutions to individuals and businesses. The share of life insurance products in the total number of insurance services will be at least 30%, including about half this volume being investment insurance.

There will be comfortable environment for securities transactions, including those performed by individuals, reliable record keeping of assets and their custody. Most of Ukrainian company assets will be traded inside Ukraine.

A speedier development is expected of collective investment institutions. Among financial market investors, the share of individuals and funds will increase orientated to long term investment.

By 2015, a single State regulator is to emerge in Ukraine, whose supervisory functions will be separated from the regulatory functions, and a system of prudential oversight will be implemented in all the market segments.

There will be a significant reduction in the total investor losses due to violation of their rights and lawful interests.

It is expected that raising capital by domestic companies through placement of stocks and bonds in the domestic financial market in 2015 will constitute at least 25% of the total capital investment by big and medium companies. Taking into account their borrowings from domestic banks and abroad, this indicator will rise to reach 40%.