Financial Stability Council
Report on Activities
(April 2015 – March 2016)

KYIV 2016

Foreword of the Co-Chairs

It was a difficult year for our country, our economy and financial sector in particular. Military and political aggression and falling external demand threatened the nation from outside while the weak progress in overdue reforms remained the key domestic challenge.

Nevertheless, Ukraine achieved certain macroeconomic stabilization in the course of the year. Owing to coordinated and balanced actions of regulators, we have managed to launch a real transformation of domestic financial sector supported by introduction of new principles and rules. Financial Stability Council, which first met in April 2015, facilitated some of the achievements.

The Council became an extremely helpful platform for exchange of views and visions on systemic risks and situations in the financial sector as well as on measures to prevent crises. All market participants are longing for this dialogue.

The Council is only making its first steps. In prospect, it should grow into an efficient mechanism of crisis prevention and management. Cooperation and information exchange within the Council will run stronger and deeper.

It is very important for us that market participants, experts, general public learns more about the Council. Thus, following best international practices of existing interagency financial stability bodies, primarily in Europe, we also aim to maintain high transparency standards and offer you our first annual Council's Report.

CONTENT

1. Financial Stability Council

1.1 Background and international recommendations

The Financial Stability Council (Council hereinafter) was established in line with the Decree of the President of Ukraine “On Financial Stability Council” of 24 March 2015 #170/2015. The decision was preceded by the lengthy period of expert discussions, consultations with experts from the World Bank and other international institutions as well as in-depth research of best international practices on shaping financial stability committees or councils.

The key recommendations made by European Systemic Risk Board (ESRB), which were taken on board, were:

- Analysis, monitoring and mitigation of systemic risks to financial stability should the key tasks of such body.
- The interagency body should not compromise mandates of its member institutions.
- There should be adequate exchange of information (data) between the members.
- Central bank should play a leading role given its experience and mandate in promotion of financial stability.

While designing the Council we also had in mind best international practices on such procedural matters as principles of chairing and voting, frequency of meetings, rights of members, quorum, publications, etc. Most of the financial stability committees / councils publish press releases and/or annual reports.

Table 1. Working formats of interagency financial stability bodies in other countries

	Central Bank	Ministry of Finance / similar Ministry	Financial Supervision Authority	Deposit insurance authority	Securities and exchange authority	Other members	Regular meetings
Australia	√	√	√		√		quarterly
Austria	√	√	√			Fiscal Advisory Council	quarterly
Albania	√	√	√	√			quarterly
Bulgaria	√	√	√				quarterly
Croatia	√	√	√	√			twice a year
Cyprus	√	√			√	Authority for the Supervision and Development of Cooperative Societies, Insurance Companies Control Service	quarterly
Denmark	√	√	√			1 of each: Ministry of Economic Affairs and the Interior and Ministry of Business and Growth; 3 independent experts on financial matters	quarterly

	Central Bank	Ministry of Finance / similar Ministry	Financial Supervision Authority	Deposit insurance authority	Securities and exchange authority	Other members	Regular meetings
France	√	√	√			Chairman of the French Financial Markets Authority (AMF); Chairman of the French Accounting Standards Authority (ANC); 3 experts on finance and economy	quarterly
Germany	√	√	√			*Non-voting members:* Financial Market Stabilization Agency (FMSA)	quarterly
Italy	√	√			√		n/a
Latvia	√	√			√		twice a year
Mongolia	√	√	√				quarterly
Netherlands	√	√	√				twice a year
Poland	√	√	√	√			twice a year
Portugal	√				√	Chairman of the Portuguese Insurance Institute (ISP)	once in 2 months
Romania	√	√	√		√		twice a year
Serbia	√	√	√	√	√		quarterly
Spain	√	√			√	Directorate General of Insurance and Pension Plans	twice a year
Sweden	√	√	√			Director General of the Swedish National Debt Office	twice a year
USA	√	√		√	√	Comptroller of the Currency; Director of the Bureau of Consumer Financial Protection; Chairperson of the Commodity Futures Trading Commission; Director of the Federal Housing Finance Agency; Chairman of the National Credit Union Administration; independent member with insurance expertise. *Non-voting members*: Director of the Office of Financial Research; Director of the Federal Insurance Office; state insurance commissioner; state banking supervisor; state securities commissioner	quarterly

Note: √ - chair; √- chair on rotation/topical basis

The composition and number of members of interagency committees/councils varies from country to country depending on structure of domestic financial sector, framework and mandates of national regulators, local financial traditions and role of the state in economy.

There is a number of similarities between them:

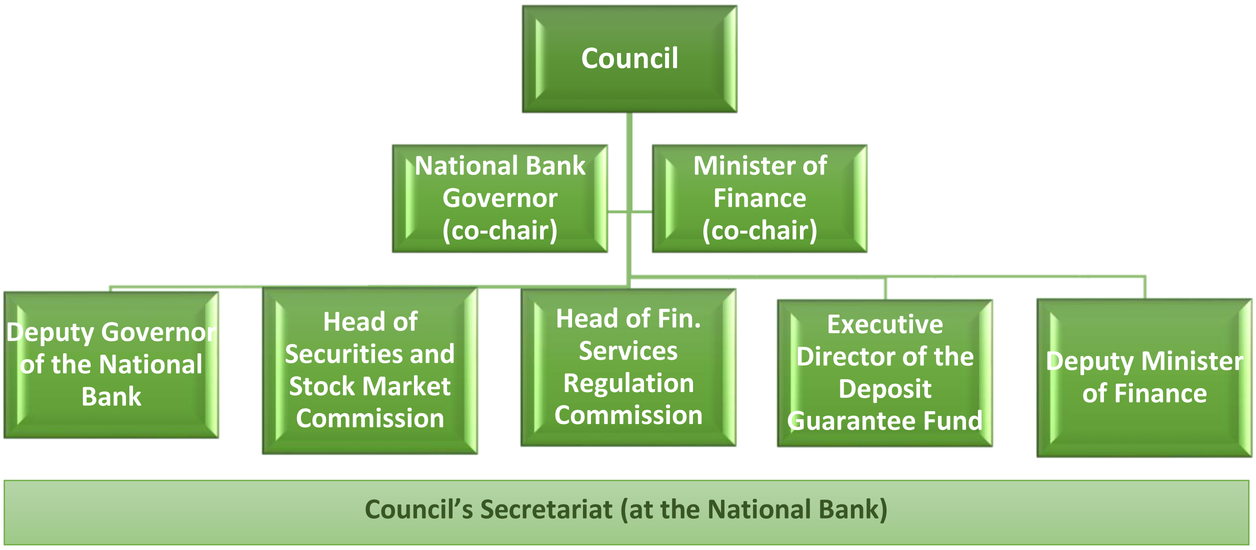
- All committees/councils observed include representatives from a ministry of finance (or authority alike, e.g. US Treasury), a central bank and financial supervision authority (if the central bank does not have mandate for financial sector supervision). Member institutions often include securities and exchange regulators and deposit guarantee funds (if there is one).
- Either the central bank governor or the Minister of Finance chairs the meetings (mostly in situations where central bank does not have mandate for supervision of banking / financial sector).

There are also examples of rotating chairs, either on regular basis (like in Romania, yearly) or depending on the subject of the meeting (in Poland the Minister of Finance presides at Financial Stability Committee meetings on crisis management while the National Bank Governor chairs meetings on macroprudential policy and crisis prevention).

1.2 Underlying principles of the Council

The tasks, mandate, composition and underlying principles of the Council are laid down in the Council's Statute approved by the President's Decree while the Council's Rules of Procedures stipulate practical procedural issues.

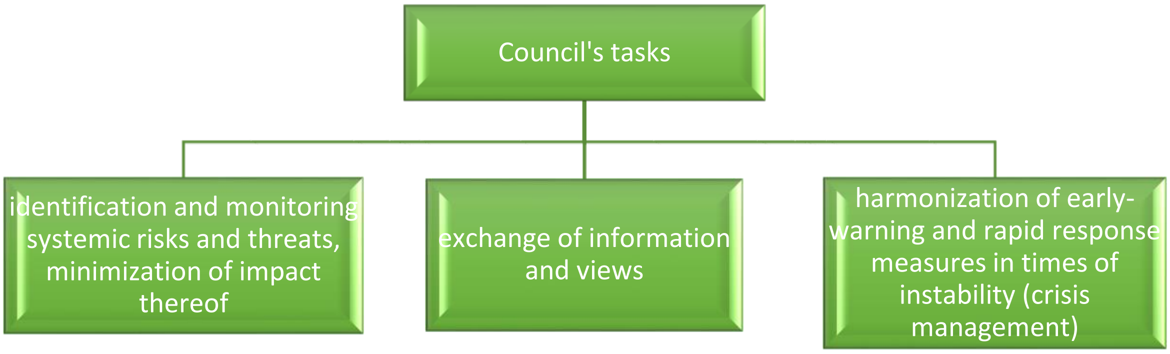
Chart 1. Council's Composition



The Council operates on the same principles as European financial stability committees/councils:

- The Council comprises heads of all financial sector regulators. This facilitates a more holistic understanding of internal processes and control over emerging systemic risks. The high level of representation allows making prompt and efficient decisions. The absence of political figures on the Council assists professional discussions and helps to minimize political influence upon decision-making.
- The Council builds its work as a discussion platform where everyone shares available information as well as his or her vision of emerging threats and ways to mitigate them.
- All decisions and agreements are recommendatory but follow "act or explain" principle.
- The Council publishes press releases on its meetings. This Report is the next step in communications with public on Council's objectives and results of its work.
- Meetings are held each quarter or more frequently if needed so.
- Secretariat provides information, analytical and administrative support for the Council. The Secretariat is a part of the Financial Stability Department of the National Bank.

Chart 2. Main tasks of the Council



Within the scope of its functions the Council:

- Identifies, analyzes, estimates and monitors current and potential threats and systemic risks for national financial system.
- Offers recommendations on mitigation of systemic risks that threaten financial stability.
- Develops efficient mechanisms for cooperation and coordination of measures on ensuring the stability of the national financial system.

On top of that, the Council's mandate includes detection of signs of unstable financial situation in banking system and situations that threaten stability of the financial system of Ukraine. This gives the National Bank the warrant to introduce (if necessary) temporary specific requirements and limitations for banks and banking operations, to extend anti-crisis measures etc.

The composition of the Council is the following.

Council's Co-Chairs:

Valeria **Gontareva**	–	Governor of the National Bank of Ukraine
Natalie **Jaresko** *(until 14.04.2016)*	–	Minister of Finance of Ukraine

Council Members:

Tymur **Khromaev**	–	Head of the National Securities and Stock Market Commission
Ihor **Pashko**	–	Head of the National Commission for the State Regulation of Financial Services Markets
Kostyantyn **Vorushylin**	–	Managing Director of the Individuals' Deposits Guarantee Fund
Oleksandr **Pysaruk** (*until 31.12.2015*)	–	First Deputy Governor of the National Bank of Ukraine

Yakiv **Smolii** (*since 29.01.2016*)	–	Deputy Governor of the National Bank of Ukraine
Artem **Shevalev** (*until 29.04.2016*)	–	Deputy Minister of Finance for European Integration

The National Bank Governor and the Minister of Finance are co-chairing the Council in turns on quarterly basis. Co-chairs' primary objective is moderation, and their votes have the same "weight" as a vote of any other Member of the Council. Any Member may initiate an extraordinary meeting of the Council; each of them has a right to include his or her separate opinion on issues discussed into the minutes.

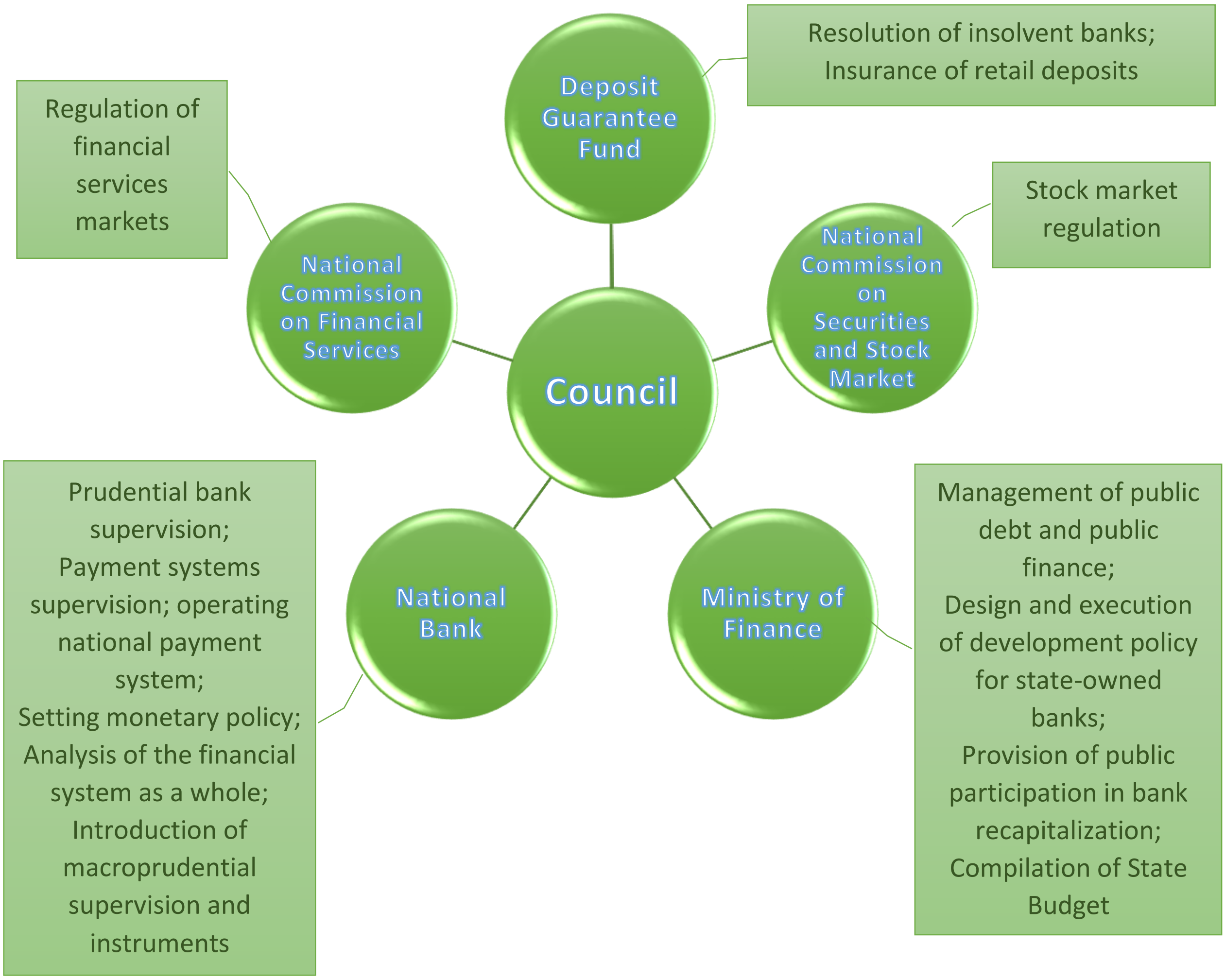
The Council meetings are quorate if at least five Members are present including at least one representative of the Bank and one from the Ministry of Finance. The decisions are taken by a qualified majority of votes; that is by four votes out of five Council Members present or by five votes out of six or seven Members present. The decisions are taken in an open voting. Each Member has one vote and votes personally.

The Council may invite representatives of authorities, international financial organizations, civil organizations, enterprises as well as leading foreign and national scientists and independent experts to participate at meetings without voting rights. This way the Council can take into account views of different target groups while making decisions that matter for financial stability. The Council can also set up working groups to look into specific matters.

In order to ensure the proper exchange of information and interagency coordination at working level the Council established a Technical Group that works under the Executive Secretary. It comprises representatives from member institutions (authorities). The Executive Secretary of the Council is *ex officio* the Director of the Financial Stability Department of the National Bank.

In spite of the fact that the National Bank has wider mandate in the area of financial stability (as stipulated in the Law on the Bank), all member organizations contribute to promotion of financial stability within their competences and authority.

Chart 3. Division of competences within the Council



Council's working format gives footing for effective exchange of information, risk assessment and coordination of actions in different segments of the interlinked financial system. This allows minimizing the chances that negative trends will emerge undetected and turn into a full-blown systemic crisis.

2. Key issues considered by the Financial Stability Council

The Council first met on 27 April 2015. Through the year that passed the Council has met six times, including two extraordinary meetings. The latter were required for urgent consideration of issues that posed risks for financial system.

2.1 Systemic risks: the overview

The National Bank presented an overview of risks to stability of Ukrainian financial system at each Council meeting.

Table 2. Evolution of systemic risks

	Q2 2015	Q3 2015	Q4 2015	Q1 2016
Global economy	↗	↗	↗	→
External demand	↗	↗	↗	→
Economic conditions	→	↘	↘	→
Public finance	→	↗	↗	↗
FX market	→	↘	↗	↗
Geopolitics	→	↘	→	↗

Note:
Evaluation of key sources of risk through the quarter and prospects for the next quarter.
Arrows up – higher risks; arrows down – lower risks.

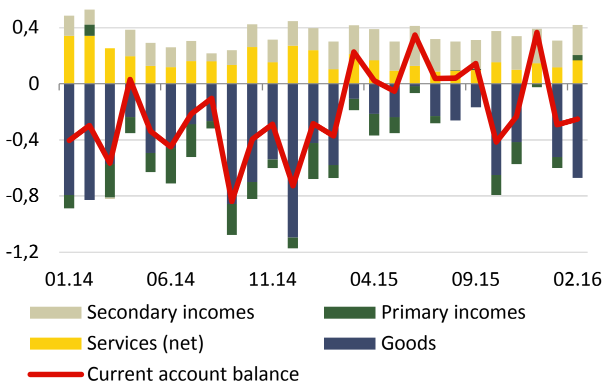
Global economy: through the year the global financial markets were turbulent – there were several episodes of falling stock markets and depreciating emerging market currencies. Global economic recovery is sluggish, mostly because of slowing Chinese economy.

External demand: slower global growth was reflected in falling demand and prices on commodities including main Ukrainian exports. Russian trade impediments was an extra negative factor for Ukrainian exports. External conditions became more favorable in February-March 2016

Public finance: assessments were dominated by uncertainties on public debt restructuring (first half of 2015), 2016 Budget approval, fiscal reform and its outcomes.

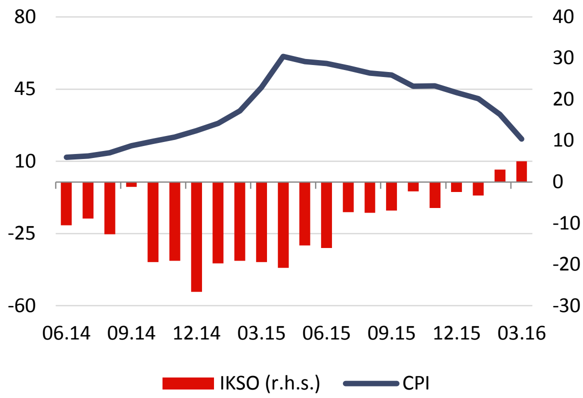
Economic conditions: risks were diminishing against the background of gradual reversal of negative GDP trend, slowing inflationary processes. Yet first signs of macroeconomic stabilization are still fragile.

Figure 1. Ukraine's current account, USD bln.



Source: National Bank of Ukraine

Figure 2. Ukraine's IKSO and CPI[1] (y-o-y), %



Source: National Bank of Ukraine

FX market: the market was under pressure from low exports proceeds. Episodes of stability occurred primarily due to the National Banks' administrative measures. A pause in cooperation with IMF since August 2015 added to negative expectations.

Geopolitics: after a period of relative stabilization after Minsk agreements, the fighting on the East of Ukraine intensified again since early 2016. Continued Russian aggression establishes an atmosphere of uncertainty and shapes negative business and household expectations.

Council's position. The Council in the course of its meetings repeatedly detected risks to and volatility of Ukrainian financial markets - and FX market in particular. With regard to this, the Council noted signs of unstable financial situation in the banking sector and conditions that threaten national financial stability. That provided grounds for retaining some of administrative limitations on FX market.

[1] IKSO – index of key sectors output; CPI – consumer price index

2.2. Restructuring of sovereign debt

Restructuring of the sovereign debt was the only effective way out of the problem of excessive debt burden for Ukraine. It helped to avoid declaration of default. As an outcome of intensive work, the Government managed to reach an agreement with the Ad Hoc Committee of Creditors on terms of exchange of its sovereign and state-guaranteed debt, which are generally in line with the IMF Program:

Goal №1

CURRENT ACCOUNT IMPROVEMENT

Saving on external debt repayments of public sector totaling USD 15.3 bln. for the period of IMF Program implementation

Goal №2

SUSTAINABILITY OF DEBT SERVICE

Ensuring that the proportion of public and state-guaranteed debt is not higher than 71% GDP by 2020

Goal №3

ABILITY TO PAY

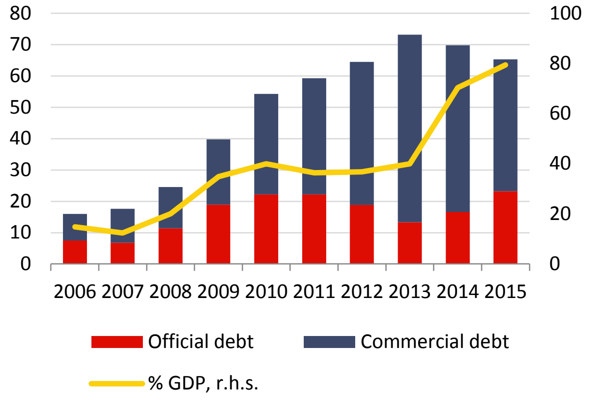
Limiting general needs for Budget financing debt service operations to 10% GDP on average (12% GDP at maximum) for 2019-2025

Joint efforts of Ukrainian authorities ensured successful completion of debt restructuring for most of Ukraine's external commercial debt. USD 19.1 bln. out of total USD 22.2 bln. has been already exchanged. The rest is primarily made up by USD 3 bln. of Eurobonds, which Russia refuses to restructure on common terms. A moratorium was introduced on repayments on these bonds.

Creditors agreed for a 20% haircut (around USD 3 bln.) in an exchange for value recovery instrument (VRI). Repayment of principal of USD 8.5 bln. was rescheduled to period after 2018. This brought down the debt pressure on Ukrainian economy in the short run and thus allowed to secure macroeconomic stability and to preserve international reserves.

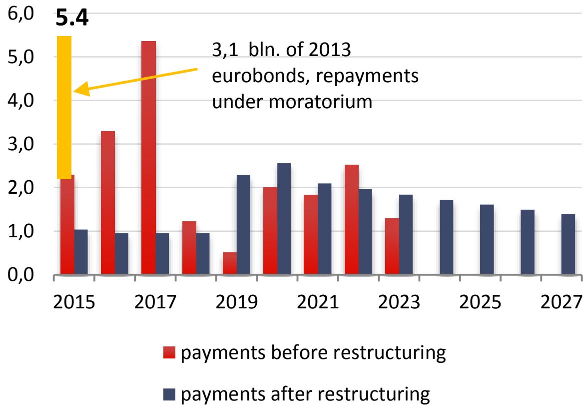
On the whole, the public and state-guaranteed debt in dollar equivalent was reduced by the end of 2015 by 6.2% to USD 65.5 bln. or around 80% GDP, in line with trajectory of gradual reduction of the debt burden.

Figure 3. Public and state-guaranteed debt in breakdown to creditors, USD bln. in equivalent



Sources: Ministry of Finance, National Bank

Figure 4. Public payments on public and guaranteed liabilities restructured in 2015, USD bln.



Source: Ministry of Finance

Moreover, due to the successful restructuring, Ukraine's sovereign credit ratings were upgraded by S&P, Fitch and Moody's credit agencies from in-default levels to B-, CCC and Caa3 respectively, where they currently remain.

Council's position. The Council considered public debt restructuring on several occasions as a precondition for resolution of several problems in financial sector. Council Members welcomed restructuring agreement reached by the Ministry of Finance as a substantial input into financial stability. They also supported single terms for Eurobonds exchange for all creditors including the so-called "Russian debt".

2.3. Cooperation with international donors

Ukraine's cooperation with international donors who were ready to offer financing on preferential terms facilitated reforms in banking, public finance, energy sector, state-owned enterprises and fighting the corruption. The total amount of financial support provided for Ukraine by international donors in the course of 2015 and first quarter of 2016 reached USD 11.7 bln. (around 13% GDP).

Table 3. Key Ukraine's international donors, total amount of their financing in 2015 and Q1 2016

International donors	Existing programs/ financing agreements	Raised funds		Undrawn commitments
Key creditors				
IMF	**USD 17.5 bln.** (Extended Fund Facility - EFF, 11.03.2015, 4 years)	**USD 4.9 bln.** (I tranche, March 2015) **USD 1.7 bln.** (II tranche, August 2015)	o/w: **USD 2.63 bln.** (for State Budget), **USD 3.9 bln.** (for rebuilding of international reserves)	**USD 11 bln.**
World Bank	**USD 1.02 bln.** (Social Security Nets Modernization Project of Ukraine, Second development policy loan, Second Programmatic Financial Sector Development Policy Loan)	**USD 20 mln.** (July 2015) **USD 500 mln.** (August 2015) **USD 500 mln.** (September 2015)	for State Budget	-
EU	**EUR 1.8 bln.** (III macrofinancial assistance, 22.05.2015)	**EUR 600 mln.** (I tranche, July 2015)	for State Budget	**EUR 1.2 bln.**
		EUR 250 mln. (IV tranche, I macrofinancial assistance, April 2015)	for State Budget	-
Other donors whose support is linked to cooperation with IFOs				
Japan	**USD 331 mln.** (under joint project with World Bank "Second development policy loan")	**USD 331 mln.** (March 2016)	for State Budget	-
USA	**USD 2 bln.** (loan guarantees as part of a comprehensive international financial package)	**USD 1 bln.** (May 2015)	for State Budget	**USD 1 bln.**

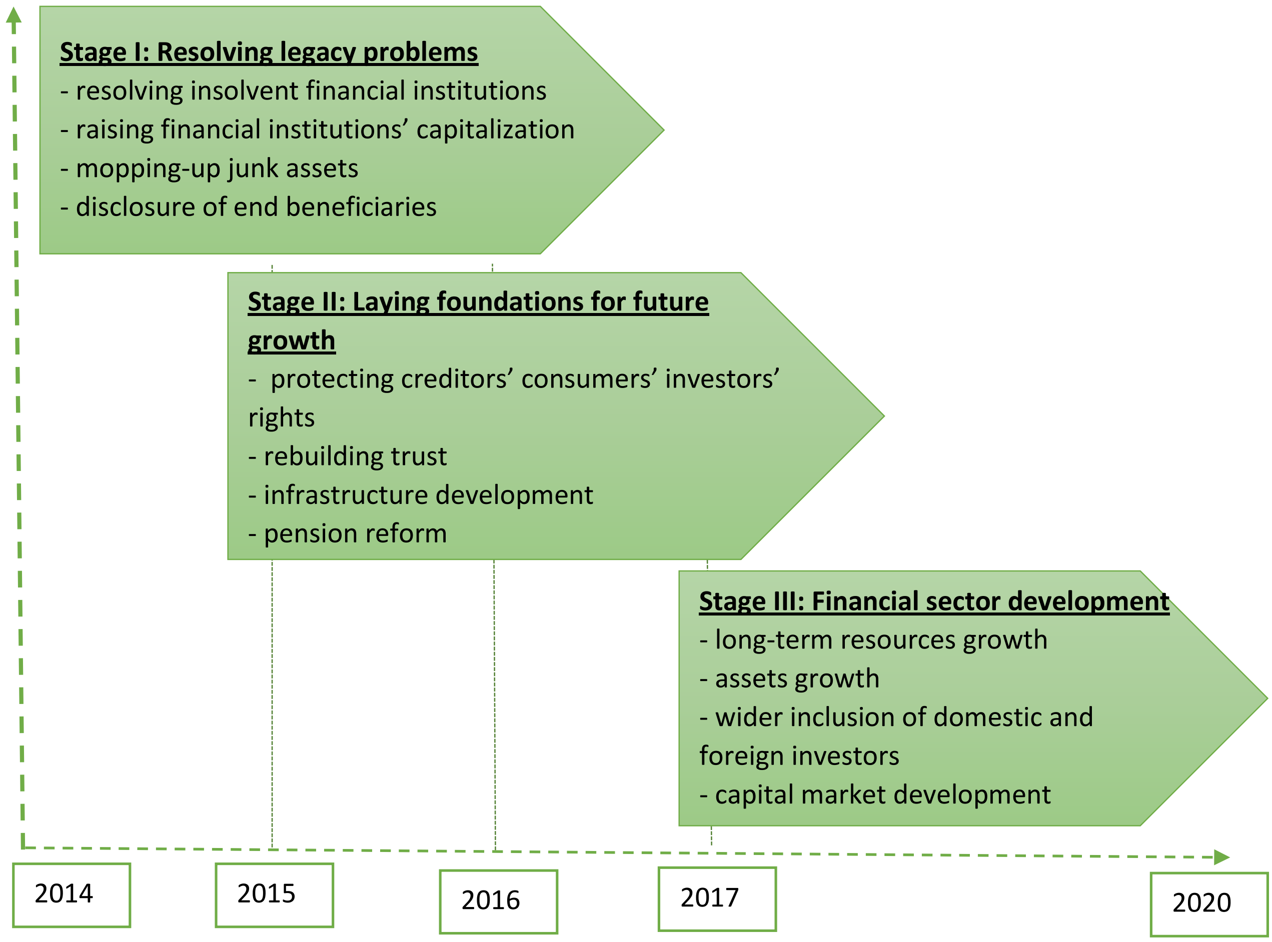
One of the key elements of Government's plan to stabilize Ukrainian economy and renew its growth starting from 2016 is the 4-year IMF program of USD 17.5 billion. Raising finance from other sources in amount to USD 7.2 bln. directly depends on successful restoration of cooperation with the IMF.

Council's position. Cooperation with IMF and fulfillment of the Memorandum terms is the necessary precondition for ensuring financial stability. Council Members underline the importance of adaption by the parliament of laws and taking other necessary steps to restore political stability in the country as well as to renew cooperation with IMF and other international donors.

2.4 Financial sector clean-up

At the Stage I of Comprehensive Program of the Ukrainian Financial Sector Development up to 2020 the efforts of regulators are primarily directed at resolution of legacy problems, which were piling up for years in the financial system. This first of all includes resolution of insolvent financial organizations, mopping-up junk assets on the stock market, establishment of level playing field and increasing transparency for all participants.

Chart 4. Stages of transformation in financial sector



The clean up is effected:

- from insolvent market participants – through enhanced supervision and/or enhanced prudential requirements as well declaring participants insolvent; revocation of licenses / permissions for certain operations;
- from inefficient financial instruments on stock market – through new listing requirements and applying more balanced and stricter criteria for detection of fictitious securities' issuers;
- from "doubtful" participants – through enhanced requirements on ownership structure and its disclosure; from manipulators – through higher responsibility and granting mandate for investigation.

Table 4. Results of the financial sector clean-up

	Element of Stage I	Results
	resolution of insolvent financial institutions	No. of banks: -47[2] No. of non-banking financial institutions: -104[3] No. of licenses for provision of financial services: -529[4] No. of licenses for professional stock market participants: -181[5]
	enhanced capitalization of financial institutions	Recapitalization schedules for top banks approved upon stress tests[6]. Enhanced requirements for minimum bank capital (to UAH 120 mln. – from 17.06.2016, to UAH 200 mln. – from 11.07.2017, to UAH 300 mln. – from 11.07.2018, to UAH 400 mln. – from 11.07.2019, to UAH 450 mln. – from 11.07.2020, to UAH 500 mln. – from 11.07.2024)[7]. Enhanced requirements to asset quality of insurers, circa 160 insurance companies will have to reallocate assets into safer instruments. Enhanced financial requirements to operations and quality criteria for management systems for credit unions.
	mopping-up junk assets	In 2015: 20 issuers detected with evidence of fictitious nature. Circulation of securities of 98 issuers stopped. 106 participants sued for market manipulation.
	disclosure of end beneficiaries	Ownership structure disclosed for 44 solvent banks[8]. Measures taken to enhance responsibility of bank's related parties[9]. Enhanced requirements for ownership structure for stock market participants.

The clean-up stage for banking sector will be over this year. Now begins the stage of reloading and laying foundations for future financial sector growth. It will require further enhanced coordination of regulators' actions.

Council's position. Council Members supported coordination of actions between financial regulators in cleaning up of different segments of financial sector. In particular, this refers to scheme and captive banks, insolvent banks and junk securities.

[2] Licenses recalled between 01.01.2015 and 01.04.2016.
[3] Of which 81 in 2015, 23 – in January – February 2016.
[4] Of which 527 in 2015, 2 – in January – February 2016.
[5] Through 2015.
[6] Four banks did not need additional capital according to stress-test results.
[7] Refined schedule introduced by the National Bank regulation of 07.04.2016 # 242.
[8] http://www.bank.gov.ua/control/uk/publish/article?art_id=22502427&cat_id=22502426 ; some of them have already brought ownership structure in line with requirements, for others procedure is on-going.
[9] Law of Ukraine of 02.03.2015 # 218-VIII «On amendments to certain legal acts of Ukraine on responsibility of related persons».

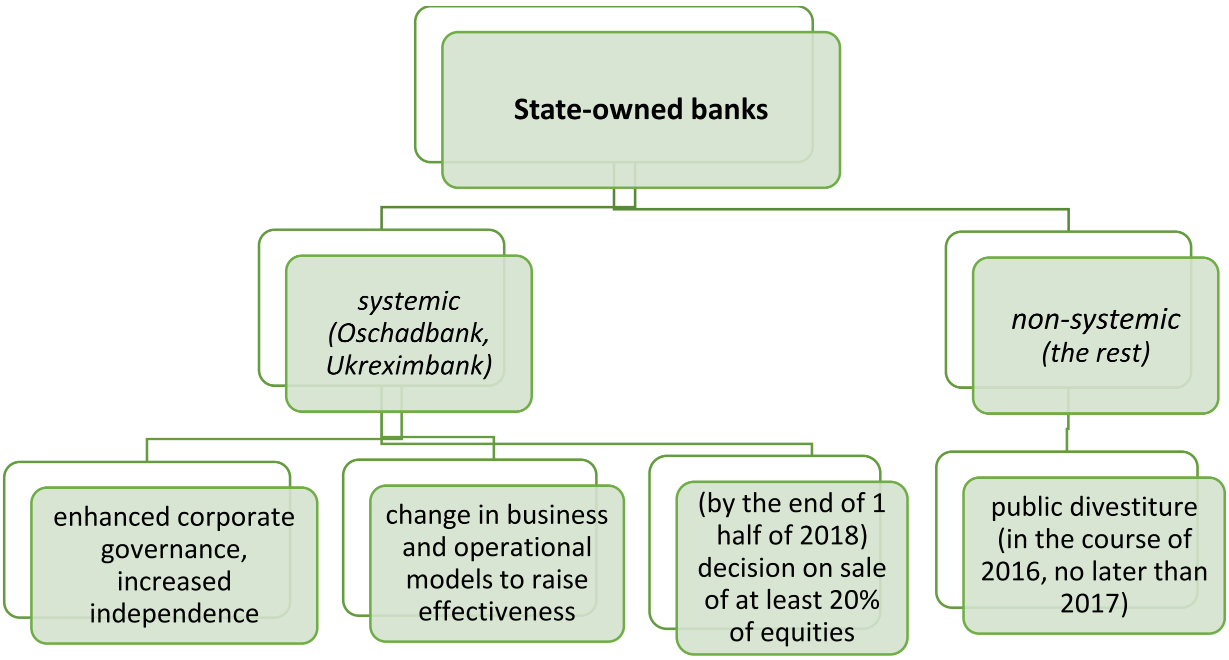
2.5 Development strategy for state-owned banks

The Cabinet of Ministers at its meeting on 11 February 2016 approved "The Guidelines of the strategic reform of the state-owned banks" (hereafter referred to as "Strategy") developed by the Ministry of Finance with active support from the National Bank, international financial institutions and expert community.

The key tasks of the Strategy is the fundamental revision of principals and mechanisms of corporate governance at the state-owned banks with regard to the OECD recommendations and establishment of management system isolated from political influence for state-owned banks. This will ensure stable functioning of the banks, better operational results and highest appreciation from potential investors.

As of today, the share of state-owned banks in the Ukrainian banking sector[10] is around 26%. Depending on their importance for the financial system, the banks are divided into systemic (Oschadbank and Ukreximbank) and non-systemic (the rest).

Chart 5. Key elements of reform strategy for state-owned banks.



Achievement of efficiency and governance transparency goals for systemic state-owned banks requires substantial rebuilding of business models and introduction of new management mechanisms. The further development of the banks will focus on:

- maximum concentration on target client segments, satisfaction of full range of demand for financial services by clients and thus maximization of net incomes;
- reform of operational models.

[10] http://www.bank.gov.ua/control/uk/publish/category?cat_id=64097

Substantive attention was paid to bringing corporate governance at the state-owned banks to international standards, including setting up independent supervisory boards on competitive basis and establishing dedicated committees at supervisory boards. With regard to that, the Government approved a new order of selection of members of supervisory boards for state-owned banks (regulation of the Cabinet of Ministers of 11.02.2016 # 97).

Council's position. The Council reviewed the draft Strategy prior to its adoption. Council Members unanimously stressed the need to upgrade corporate governance at the state-owned banks to the OECD standards and to reconsider business models and strategic targets for the banks. The State has to shift to commercial basis while operating its investments for the good of taxpayers and to divest the capital from non-systemic banks. The approved Strategy reflected the Council's recommendations.

2.6 Enhancing capacity of National Commission for Securities and Stock Exchanges

In 2015-2016 the National Commission for Securities and Stock Exchanges drafted several bills that should allow it to join the International Organization of Securities Commissions (hereinafter IOSCO). This should provide for adequate exchange of information and will bring regulation of national financial market closer to best international practices.

The Commission represents Ukraine at IOSCO and is its member since 1996. Yet the Commission still did not join the IOSCO Memorandum due to a number of drawbacks of domestic legislation, inter alia concerning the powers and status of the Commission.

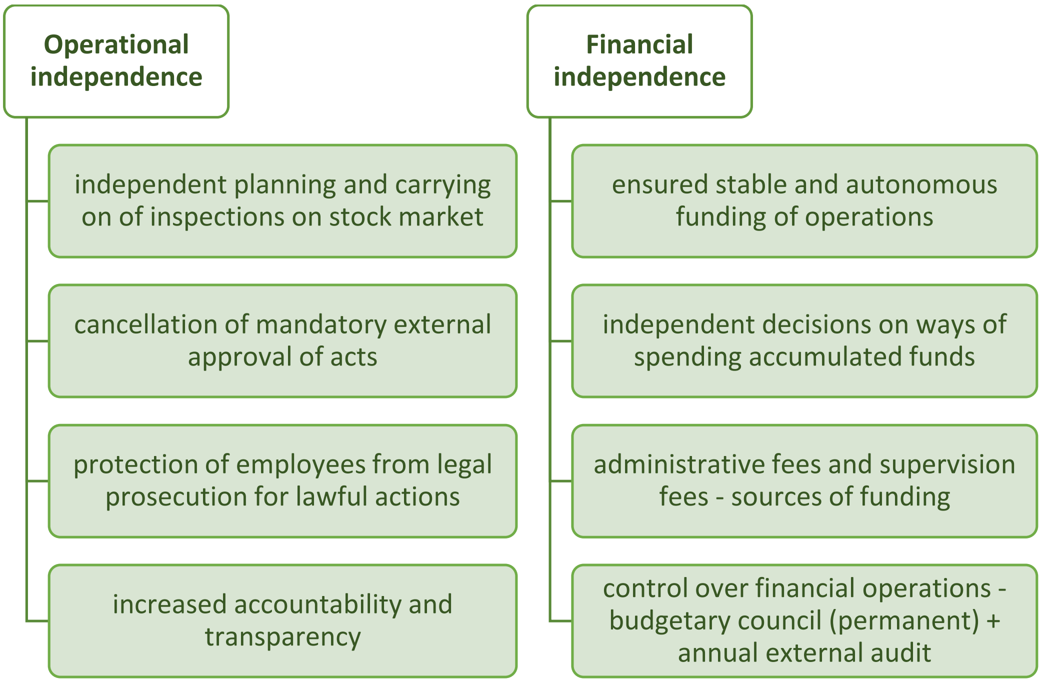
After acceding to the mentioned Memorandum the Commission will:

- have right to request foreign regulators to investigate the involvement of individuals and legal entities into infringements on stock market;
- be recognized by international community as such that has all necessary rights to investigate infringements on stock market.

Chart 6. Powers the Commission needs to join the IOSCO Memorandum

18.02.2016 IOSCO adopted a resolution on inclusion of the Commission to Appendix “B” of the IOSCO Memorandum. This means that Ukraine was recognized as nation, which is ready to accede the Memorandum should the stock market regulator be reformed. In the nearest future, we expect the President of Ukraine to submit necessary legal acts, which enhance the Commissions capacity, to the parliament.

Chart 7. Ways to enhance the Commission's independence



Another issue that the Commission is working on is stock market infrastructure development in line with the IOSCO principles. The infrastructure is fragmented today and mostly does not meet these principles. This determines high risks within the system, absence of fair pricing, impossibility to develop a range of instruments and market segments.

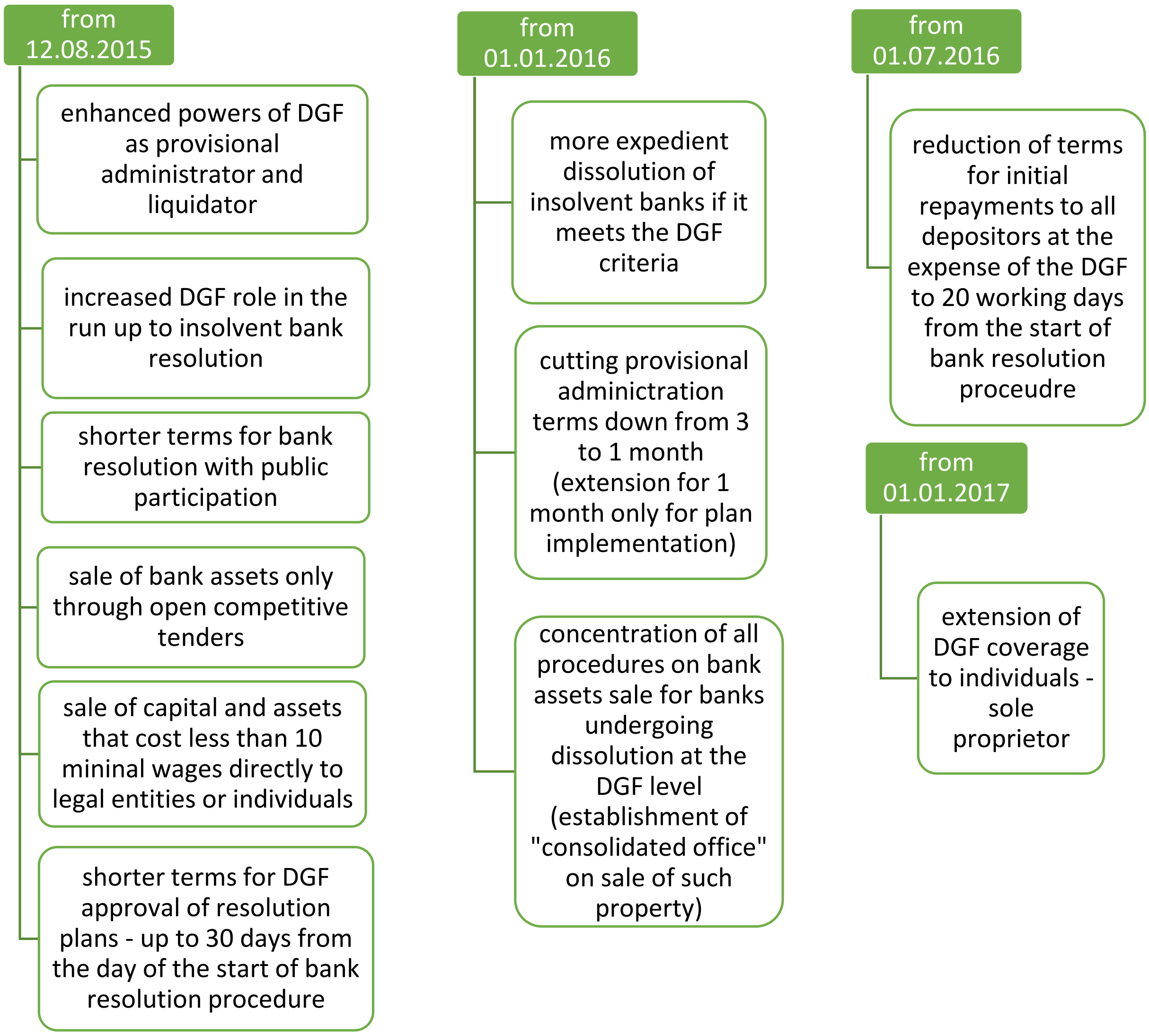
According to the international experience and BIS recommendations in particular, IOSCO principles for financial market infrastructure, EU Directives, world best practices, the decisions aimed at improvement of stock market infrastructure shall include higher requirements to capital and operational activities of market participants, consolidation of infrastructure elements, building up IT systems, increasing safety of settlements.

Council's position. Council Members supported the Commission steps on building up the stock market infrastructure in accordance with best international practices as well as enhancement of Commission's capacity. The latter includes development of draft legal acts, which, once adopted, will allow adhering to IOSCO Memorandum.

2.7 Enhancing capacity of the Deposit Guarantee Fund

The Retail Deposit Guarantee Fund (the DGF) together with the National Bank and the Ministry of Finance and with support from international experts developed a draft Law of Ukraine “On amendments to certain legal acts of Ukraine on improvement of retail deposit guarantee system and resolution of insolvent banks”. The Law was adopted in July and came into force in August 2015.

Chart 8. Key stipulations and stages of implementation of the law



In order to implement the provisions of the Law the DGF is undergoing a gradual organizational transformation. The latter envisages reinforcement of certain existing as well as establishment of new units within the DGF (e.g. on sale of assets, legal support, investigation and fight against corruption, consumer rights protection and financial literacy), the increase of staff. This should allow laying off a part of staff in insolvent banks and should lead to cutting losses at such banks.

2015 was a considerable challenge for the Fund both financially and organizationally. In 2015 alone, the DGF spent UAH 50.3 billion on repayments to depositors in insolvent banks (comparing to UAH 70.8 billion in total for the whole time of the Fund existence). To cover these expenses the DGF had to borrow in the course of the year from the National Bank (loans amounting to UAH 9.95 bln.) and Ministry of Finance (UAH 41.5 bln.).

Council's position. The Council backed up measures to enhance the institutional capacity and efficiency of the DGF. It also supported (at the meeting in July 2015) a suggestion to ensure funding for Fund totaling to UAH 21.5 billion for August-December 2015.

2.8 Reforms in audit

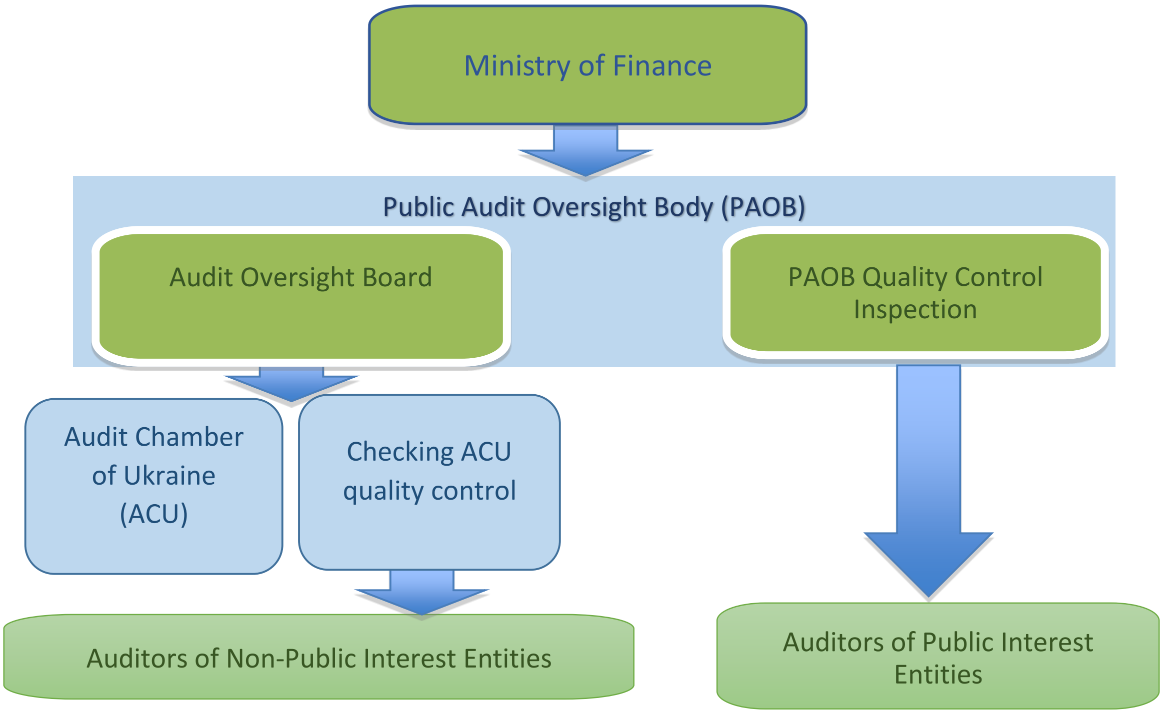
The system of audit inspections, which have existed in Ukraine until recently, did not detect serious problems in operations of many banks that were later declared insolvent. Audit have not become an instrument for unbiased, professional and independent verification of financial reports of banks and other financial institutions. Among the reasons behind this were conflicts of interests and problems of oversight over auditors.

The ministry of Finance initiated reforms in audit in accordance with European and global standards including introduction of independent oversight over audit.

The new system of independent audit in Ukraine shall include:

- establishment of two-level system of oversight and increase in public oversight role;
- division between audit of public[11] and non-public interest entities;
- increased transparency of auditing, setting up of a single register of auditors;
- providing incentives for continuous education for auditors.

Chart 9. Changes in auditors' oversight



30.03.2016 the Government approved a draft Law "On the audit of financial reporting and audit profession". It aims at improvement of the quality of audit services in Ukraine,

[11] Public interest entities – public joint-stock companies and issuers of listed securities, banks, insurance companies, private pension funds, other licensed institutions and enterprises that are large in accordance with the Law.

lowering auditing companies costs related to education and certification in different regulatory authorities.

Adoption of the Law shall allow on general:

- gaining investors' trust in financial reports of Ukrainian companies including state-owned enterprises;
- restoring citizens' trust in Ukrainian banks and insurance companies;
- pave the way for Ukrainian auditors to European markets.

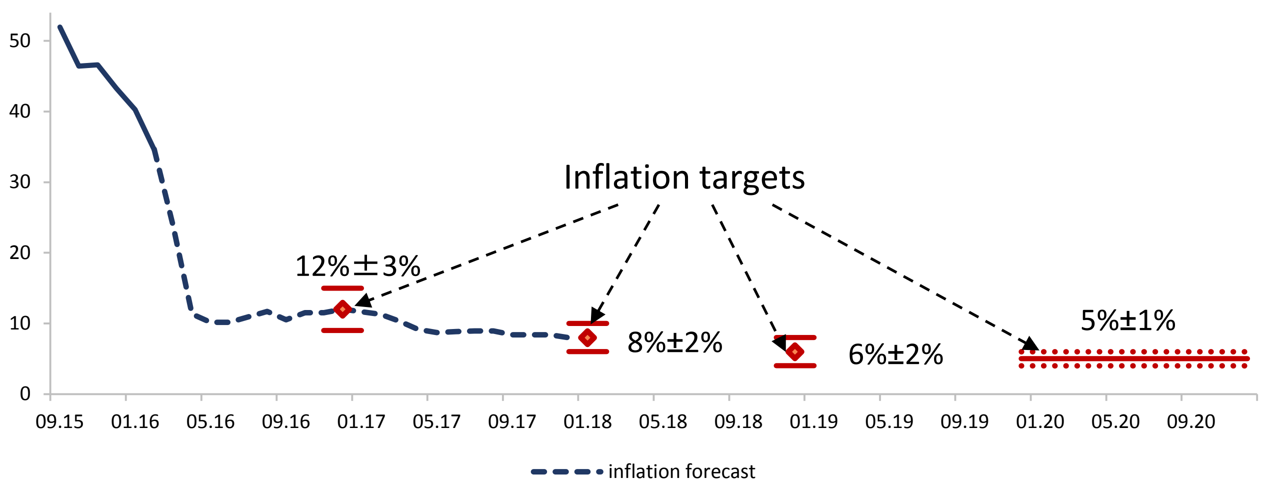
Council's position. Council Members recommended introducing the public oversight system over auditors in accordance with the EU directives in order to enhance control over service quality provided by auditors of Public Interest Entities. There shall also be stricter liability for infringements and abuses in auditing.

2.9 Cooperation between the National Bank and the Government on ensuring price stability

In 2015, the National Bank continued preparatory work on introduction of inflation targeting regime (IT hereinafter) and declared its intention to achieve in the next few years quantitative inflation targets, including 12% by the end of 2016.

Inflation is inseparably linked to all economic processes in the country. The National Bank as an independent institution primarily seeks to ensure price stability. Coordination between the National Bank's monetary policy and the Government's economic policy is needed to support price stability and the Council's works continuously facilitate such coordination. The Council discussed at its meetings such matters as budget execution and situation on the FX market, key parameters of future fiscal and debt policy.

Figure 5. Inflation targets of the National Bank



Source: National Bank

Successful implementation of the monetary policy under IT regime is impossible in the presence of fiscal domination. This factor faded away in 2016 owing to more balanced fiscal policy. Efficient governmental management in the area of finance allows the National Bank not to be involved in financing of public expenditure. In this regard, the mutual understanding reached between the Ministry of Finance and the National Bank regarding information exchange and better planning of expenses from the Single Treasury Account was very important.

The Ministry of Finance-led public debt restructuring was an important achievement. It a provided for a significant reduction in pressure on balance of payments and facilitated stabilization on FX market. This in turn helped the National Bank to replenish its international reserves during the periods of excessive foreign currency supply on the market.

Construction of the yield curve for state securities should also boost efficiency of the monetary policy. Market participants will thus have information on yields on securities with different maturities and will be in a better position in terms of planning of financial investment. In this regard, the Council discussed return of the Ministry of Finance to the primary market of domestic government bonds, which took place in 2016.

Council's position. Close coordination of efforts of the National Bank and the Government and ensuring necessary preconditions is a pledge of successful transition to inflation targeting. In particular, the Council supported elimination of fiscal dominance and better planning of expenses from, the Single Treasury Account.

The Report was prepared by the Secretariat of the Financial Stability Council. Official data and information from the National Bank, the Ministry of Finance, the National Commission on Securities and Stock Market, the National Commission on Regulation of Financial Services and the Deposit Guarantee Fund was used.