

PROBLEMS OF FORMATION OF OPTIMAL MODEL OF GOVERNMENTAL REGULATION AND SUPERVISION IN THE FINANCIAL SECTOR OF UKRAINE IN THE CONTEXT OF CREDIT COOPERATION

Lecturer **Oleksandra OSADETS**

Chernivtsi National University Chernivtsi, Ukraine

AleksandraOsadets@rambler.ru

Dr.Sc., Professor **Natalia SHVETS**

Chernivtsi National University Chernivtsi, Ukraine

shvetzn@gmail.com

Abstract:

In the presented scientific practical research we considered and explored the role and problems of state regulation and supervision of the financial sector of Ukraine, in particular of credit unions because they are inalienable participants in the financial market.

In current conditions that have been established during the financial crisis, one of the most urgent problems is the effective functioning of the regulation and supervision of the financial sector. The crisis that negatively affected the activities of financial sector participants discovered the discrepancy of regulation and supervision of them, which caused the negative trend of development of financial market of Ukraine, as evidenced by official data of the National Commission, which performs state regulation in the sphere of financial services.

In the presented scientific practical research we identified the strengths and weaknesses of the modern system of state regulation and supervision in the financial sector of Ukraine, particularly in the sector of credit cooperation, and we formed suggestions on improving its model in the context of the concentration of regulatory and supervisory efforts in state financial regulators.

Key words: *financial sector; government regulation and supervision of the financial sector of Ukraine; Credit Union; model of state regulation and supervision in the financial sector of Ukraine; financial regulators.*

JEL classification: *G23, G230*

1. INTRODUCTION

The main purposes of regulation and supervision in the financial sector are to increase its functional efficiency, to promote healthy competition in it, to maintain market discipline, to ensure systemic stability of the sector and to protect the interests of financial services consumers. The decline of trust level in financial intermediaries, caused by their incapacity to fulfill their obligations, occasions a significant reduction in the number of active investors and as a result disorganizes the monetary sphere and increases social tension in the community. Since the credit unions in Ukraine are major participants in the financial sector, that has been proven by us in scientific works: "Credit unions on the financial services market", "Place and role of credit unions in the structure of financial services markets of Ukraine", "Problematic aspects of activity of credit unions in Ukraine", then all of the above directly concerns the regulation and supervision of credit unions in Ukraine. And therefore the effective functioning of the regulation system and supervision of the financial sector, which largely depends on how distinctly the tasks of regulation and supervision organs are defined and how correctly these tasks are interpreted and realized by them, is currently standing in the front row of problems which require an immediate solution. That is why in the presented scientific and practical research we will discover the strengths and weaknesses of the modern system of governmental regulation and supervision in the financial sector of Ukraine, particularly in the credit cooperation sector, and also we will analyze generated proposals on improving its models in the context of the concentration of regulatory and supervisory efforts in two state financial regulators.

Scientific use of the formulated scientific problem is reflected in the works of such national scholars as N. Versal, R. Kotsovska, O. Lutsyshyn and etc. However, these researches don't give the definitive solution, so singling problems and formation on their basis suggestions on rising the efficiency of state regulation and supervision of the financial sector of Ukraine in the context of credit cooperation is defined by us as an important task of the authorial scientific and practical research.

2. CONTENT

Global crisis phenomena have negatively affected the activities of the financial sector of Ukraine: the solvency has deteriorated significantly and the liquidity of financial institutions has been broken, which was mainly caused by state regulation and supervision of this sector of the domestic economy. This financial crisis has detected the disparity of regulation and supervision of the financial sector to modern requirements and identified narrow spaces of this field around the world and especially in our country. Regulative and supervisory authority of the financial sector of leading countries are currently analyzing the consequences and errors, which have been revealed as a result of the crisis phenomena, and produce their own recommendations of resistance to them. These recommendations may be partially adapted to Ukrainian realities in the process of building a modern national system of effective state regulation and supervision of the national financial sector.

Responsibilities for regulation and supervision in the national financial sector are distributed as follows: the National Bank of Ukraine provides regulation and supervision of banking institutions; the activity of non-bank financial institutions is controlled by the National Commission, which provides state regulation in the sphere of financial services markets, and functioning of which will be the subject of our research; the National Commission on Securities and Stock Market provides control of the activity of the securities market.

The legal framework of regulation and supervision of financial sector in Ukraine, in particular the credit unions, is represented by fairly extensive list of legislative acts. The laws that are directly related to regulation and supervision of credit unions in Ukraine are The Law of Ukraine "On Financial Services and State Regulation of Financial Markets", "On Credit unions", "On Principles of State Regulatory Policy in Economic Activity". However, despite the presence of the appropriate legislative framework, there are many outstanding issues and vectors which require the immediate solution and improvement in order to increase efficiency of regulation and supervision in the financial sector of Ukraine, particularly in the direction of implementation the provisions of Association Agreement between Ukraine and the European Union.

The negative statistics on the number of excluded financial institutions from the State Register proves the presence of significant problems in the regulation and supervision of non-banking financial sector in Ukraine (see table 1).

According to data presented in the Chart 1, we can establish fairly large share of excluded non-bank financial institutions of certain types from the register in their total number, the highest border reaches almost 9%, that, along with other factors, may mean low efficiency of state regulation and supervision of their activities.

Also we may observe untimeliness and incompleteness of obligations fulfillment to customers by credit unions, the increase of financial institutions unprofitability. The main reasons of this are:

- risky placement of insurance reserves (a significant share of insurance reserves is located in unlisted securities);
- activities on the brink of of profitability.

In the conditions of financial economic crisis, financial sector state regulatory and supervision authorities of Ukraine were not ready to operate in extreme conditions, in particular to take stringent regulatory measures such as the initiation of temporary administrations imposition of sanctions on owners of financial institutions and others. The delayed application of enforcement measures of the regulation and supervision authorities worsened further the difficult financial situation of non-bank institutions of Ukraine. The lack of efficiency of application regulatory and

supervisory measures only deepened the impact of problems with solvency and liquidity of financial institutions.

An important factor that primarily affects the status of state regulation and supervision of the financial sector of Ukraine is the practical absence of responsibility for the situation in the financial markets relevant regulatory and supervisory bodies and their officials. Thus, according to the current Regulation "On the National Commission for State regulation in the sphere of Financial Services Markets" from 23.11.2011, the National Committee of Financial Services has no duties, but only tasks, powers and rights and actually assumes no liability for its activities in the financial services markets. This is the fundamental factor, in the first place, that brings destructive elements in the existing system of state regulation and supervision of national financial institutions.

Table 1. State of the State Register of financial institutions of Ukraine in 2014*

Financial institutions	As at 31.12. 2012	As at 31.12. 2013	Changes in 2014		As at 31.12. 2014	Share of excl. fin. inst. from the reg. in the total number, %
			Inputed information	Excluded information		
Insurance companies	352	345	9	29	325	8,92
Credit unions	617	624	6	41	589	6,96
Not state pension funds	94	81	0	5	76	6,58
Pawnshops	473	479	19	21	477	4,4
Financial companies	312	377	52	14	415	3,37

* Compiled by the author on the official data of the National Commission that provides state regulation of Financial Services Markets

In addition, quite often taking some tough measures of influence to certain financial institutions affects the interests of certain private and political forces, which take care of the issues of independence of regulatory and supervisory authorities, especially in the financial sector of Ukraine. Public Officials, having their own interest, don't want to abandon the indirect impact on the financial sector of Ukraine. The reasons for this phenomenon lie primarily in the insufficient institutional independence of authorities of regulation and supervision for financial services, particularly this directly concerns National Commission, which performs state regulation in the sphere of Financial Services Markets. Institutional independence must be ensured by the following basic tenets: transparency and openness of decision-making, governance of regulative and supervisory authority should have guarantees against unreasonable dismissal, and experts committee should exist in the authority structure. For the latter, the possibility of establishing Expert Advisory Board as part of the National Committee of Financial Services is provided by current Regulation (point 14). As for the other, then there is a significant basis for the possibility of unlawful pressure on the organ of regulation and supervision in order to take appropriate decisions. The proof of this can be the change in the management structure of National Committee of Financial Services during the crisis phenomena.

Many financial institutions problems, including insolvency and bankruptcy of credit unions in Ukraine, are the result of imperfections in licensing requirements. In addition, improvidence of regulative and supervisory authorities in the financial sector caused the insufficiency of approaches focused on risk, particularly in the supervision of local credit unions. It should be noted that today legal framework which will govern the functioning mechanism of risk management system in non-banking financial institutions of Ukraine is almost absent. And the necessity of forming much

smaller authorized capitals by credit unions in comparison with banking institutions, and less normative pressure from regulative and supervisory authorities causes more risky inflow of financial capital to credit unions of Ukraine.

Considering mentioned issues underlying the current system of state regulation and supervision of the financial sector of Ukraine we examine the following options for their solutions:

- 1) further development of existing megaregulators;
- 2) creation of a separate megaregulator;
- 3) creation of megaregulator at the National Bank of Ukraine;
- 4) the introduction of two separate authorities of regulation and supervision.

The advantages and disadvantages of each of these models we represent in the table 2.

Table 2. Advantages and disadvantages of various models of further development of state regulation and supervision in the financial sector of Ukraine *

Development model	Advantages	Disadvantages
Further development of existing megaregulators	<ul style="list-style-type: none"> • absence of changes in the legal framework; • absence of financing necessity of changes in the organizational structure; • absence of transition period risk. 	<ul style="list-style-type: none"> • difficulties of implementing consolidated supervision; • low level of coordination of actions of regulation and supervision authorities; • increase of the burden on the State budget; • absence of a unified database of financial institutions; • absence of a unified approach to regulation and supervision of financial institutions; • low protection level of rights of investors and consumers of financial services; • absence of macroprudential supervision.
Creation of a separate megaregulator	<ul style="list-style-type: none"> • fixing of responsibility for policy development of the financial sector; • implementation of consolidated supervision of financial institutions; • creation of a unified database of financial institutions; • unification and reduction of reporting; • more efficient use of resources; • elaboration of a unified approach to regulation and supervision of financial institutions. 	<ul style="list-style-type: none"> • the risk of megaregulator bureaucracy increase; • increase of the burden on the state budget on financing the development of legislation and organizational change; • risk of transition period; • increase of the burden on the state budget for maintenance of the regulator; • absence of macroprudential supervision; • low rights protection level of investors and consumers of financial services;
Creation of megaregulator at the National Bank of Ukraine	<ul style="list-style-type: none"> • fixing of responsibility for policy development of the financial sector; • absence of transition period risk for the banking sector; • implementation of consolidated supervision of financial institutions; 	<ul style="list-style-type: none"> • risk of transition period for the banking sector; • the risk of megaregulator bureaucracy increase; • risk of erroneous representation on providing the NBU refinancing of non-bank financial institutions;

Development model	Advantages	Disadvantages
	<ul style="list-style-type: none"> • creation of a unified database of financial institutions; • unification and reduction of reporting; • elaboration of a unified approach to regulation and supervision of financial institutions; • implementation of macroprudential supervision; • more efficient use of resources; • increase of professional level of employees of regulatory authority and financial institutions based on NBU; • reduce of the burden on the State budget. 	<ul style="list-style-type: none"> • increase of the burden on the state budget for funding the development of legislation and organizational change; • low rights protection level of investors and consumers of financial services;
Introduction of two separate authorities of regulation and supervision	<ul style="list-style-type: none"> • consolidation of responsibility for policy development of the financial sector; • absence of the transition period risk for the banking sector; • introduction of consolidated supervision of financial institutions; • creating a single database of financial institutions; • unification and reduction of reporting; • development of a unified approach to regulation and supervision of financial institutions; • implementation of macro-prudential supervision; • no risk of increasing bureaucracy of megaregulator; • increase of professional level of employees and regulatory authority of financial institutions on the basis of National Bank; • increase of the protection level of rights of investors and consumers of financial services. 	<ul style="list-style-type: none"> • risk of transition period for the non-bank financial institutions; • risk of coordination the activities of regulatory and supervisory authorities; • increase of the burden on the state budget for funding the development of legislation and organizational change.

*Compiled by the author on the basis of research of the National Bank of Ukraine

3. CONCLUSIONS

Considering presented in the table advantages and disadvantages of possible models of public regulation and supervision in the financial sector of Ukraine and relying on the development tendencies of credit cooperatives market we want to emphasize the following. In modern conditions of urgent need to reform the current system of state regulation and supervision of the domestic financial sector as for us the best option is to introduce two separate financial regulators, namely: the state regulator of the banking sector, and a separate regulator in the non-bank financial sector. The introduction of this model, in our view, will minimize the disadvantages of reform at the same time significantly increasing the efficiency of state regulation and supervision in the financial sector of Ukraine in the context of the implementation of the consolidated financial regulation and

supervision. Creating a single database of financial institutions, unification of approaches to regulation, supervision and reporting of financial institutions, the implementation of macro-prudential supervision will significantly improve the protection of rights of investors and consumers of financial services in the country.

REFERENCES

1. Consultations of the National Bank of Ukraine on improving the efficiency of regulation and supervision of the financial sector in Ukraine [electronic resource] - 2010. -- www.bank.gov.ua/doccatalog/document?id=84101
2. Kotsovska R.R. Main directions of reforming Ukrainian credit cooperation system/R.R. Kotsovska// Journal of the University of Banking of the National Bank of Ukraine.- №2(20),2014.-P. 187-190.
3. Krylova, N. Nikonova M. Features of credit cooperatives in Ukraine // Journal of NBU.- 2013.-№ 7.- p. 34-39.
4. Regulation "On the National Commission for State Regulation of Financial Services Markets": [electronic resource] : <http://zakon2.rada.gov.ua/laws/show/1070/2011>
5. The law project of Ukraine "On amendments to certain legislative acts of Ukraine on reforming and development of a national credit cooperation system " [Electronic resource].- Access mode: <http://nfp.gov.ua/news/205.html?PrinVersion>