SPECIAL STUDY

The EBRD's experience with policy dialogue in Ukraine

Case study – Financial institutions and the Local Currency and Capital Markets Development Strategic Initiative

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EBRD EVALUATION DEPARTMENT

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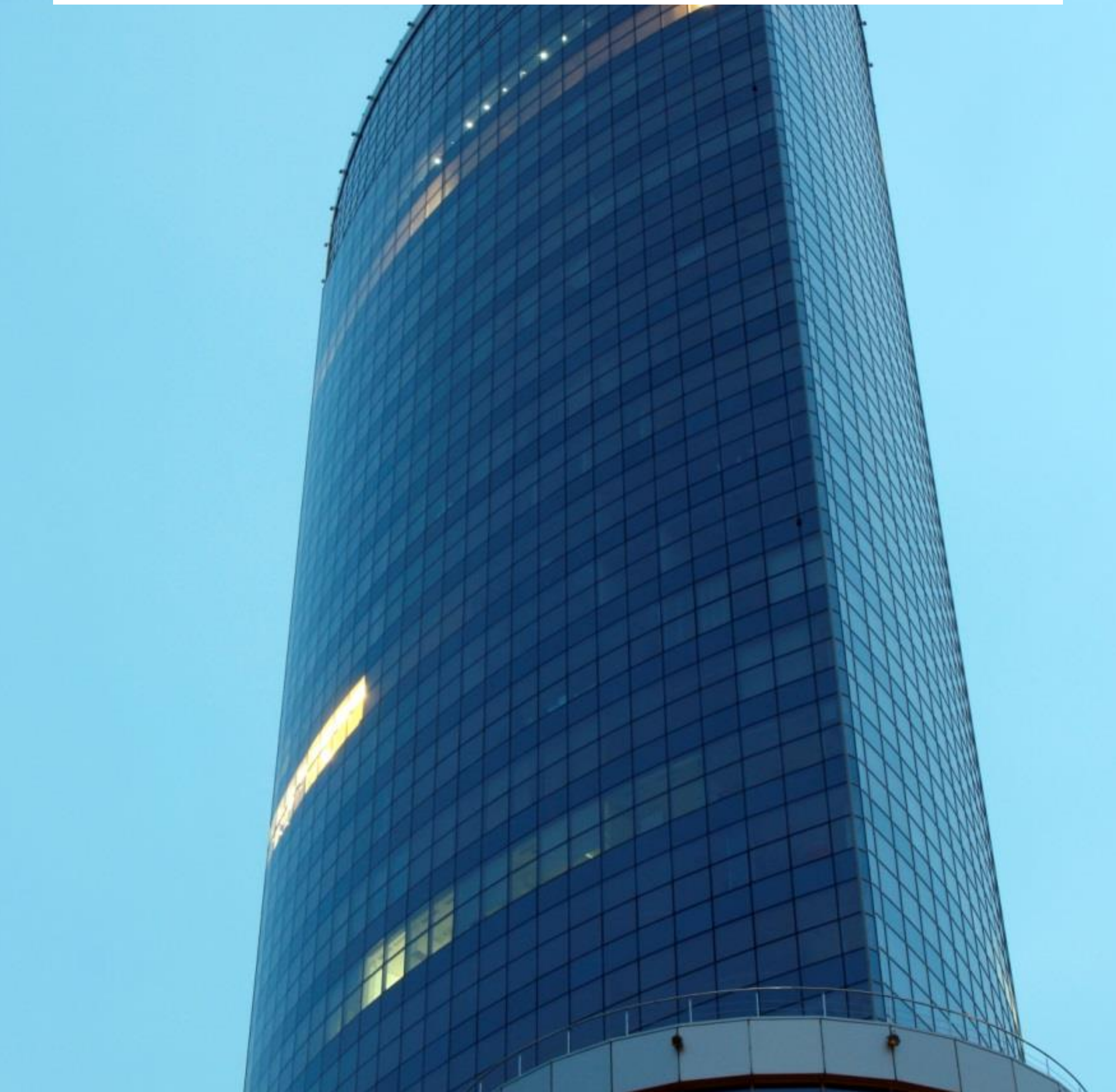

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Abbreviations

EBRD	European Bank for Reconstruction & Development
EvD	the EBRD Evaluation department
IFC	International Finance Corporation
IFI	international financial institution
IMF	International Monetary Fund
MEDT	Ministry of Economic Development and Trade
MFU	Ministry of Finance of Ukraine
MSME	micro, small and medium sized enterprises
NBU	National Bank of Ukraine

Defined terms

The EBRD's Local Currency and Capital Markets (LC2) Development Strategic Initiative	The LC2 initiative http://www.ebrd.com/pages/news/features/local_currency.shtml
National Bank of Ukraine (NBU)	Central government body established when Ukraine became independent in 1991 whose main objective is to keep stability of the national currency, hryvnia (UAH) as well as to achieve and keep the price stability in the country.
Ministry of Finance of Ukraine (MFU)	Key Government Ministry responsible for developing and implementing policies in financial, budgetary and fiscal spheres. Jointly with NBU it regulates the stock markets (including bonds issuance). The Ministry is an important EBRD's counterpart in the policy dialogue.
Ministry of Economic Development and Trade (MEDT)	Key Government agency responsible for macroeconomic policy as well as co-ordination of collaboration with IFIs, including EBRD. MEDT is one of the key partners in the process of preparing legislation and regulations for stock markets.
National Commission On Securities and Stock Market	Established in 1995, the Commission regulates and monitors the issuance and trading of the debt securities, including municipal securities but excluding sovereign bonds. It operates according to the Law on State Regulation of Securities Market and the Law on Securities and the Stock Exchange. It is subordinated to the President of Ukraine and accountable to the Parliament and the Cabinet of Ministers. The Commission is responsible for monitoring activities of asset management companies, underwriters, brokers and dealers. It is one of the key EBRD's stakeholders and specifically it is beneficiary of Legal Transition Team's technical cooperation project on developing legislation on derivatives.
State Commission on Regulation of Financial Services Markets	State agency created in 2002 that regulates and monitors activities of non-banking financial institutions – insurance companies and private pension funds. It is subordinated to the Cabinet of Ministers.
Parliament (Verkhovna Rada) of Ukraine, Committee of Financial and Banking Activities, other relevant committees	The Committee on Financial and Banking Activities is responsible for developing, amending and approving all legislation in the sphere of the financial and banking sector. It is a crucial subject of the legislative initiative which can submit new legal acts. It is one of the key EBRD's stakeholders in its legal work in the sector.

Vienna Initiative	The Vienna Initiative was established at the height of the global financial crisis of 2008/09 as a private-public sector platform to secure adequate capital and liquidity support by Western banking groups for their affiliates in central, eastern and south eastern Europe. The initiative was re-launched as “Vienna 2” in January 2012 in response to renewed risks for the region from the eurozone crisis. Its focus is now on fostering home and host authority coordination in support of stable cross-border banking and guarding against disorderly deleveraging. Western banking groups continue to play an important role in the Initiative, both by supporting the coordination efforts and doing their own part to avoid disorderly deleveraging.

Executive summary

In 2013 the EBRD Evaluation department (EvD), at the request of Board members and the President, conducted a study of the European Bank for Reconstruction and Development's (EBRD's) experience with policy dialogue in Ukraine. An early decision was taken to adopt a case study approach as the core evaluation methodology for the needed "rich picture" of qualitative information. Early consultations with EBRD policy actors identified ten possible cases of which five were selected using criteria to ensure their relevance to the Ukrainian context and other countries in which the EBRD operates. Some of these criteria included whether there was an international dimension beyond the interests of the EBRD and Ukraine, volume of operations, and degree of outcome success so far. The area of financial institutions and the EBRD's Local Currency and Capital Markets (LC2) Development Strategic Initiative ("LC2 initiative") emerged from this selection process as key topics for a case study. The LC2 initiative, launched in May 2010, aims to enhance the macroeconomic, regulatory and market framework to ensure long-term, sustainable and liquid local currency markets.

The largest sector of the EBRD's engagement in Ukraine is financial institutions – comprising around 25 per cent of all projects. Operations in this sector have a wide systemic effect and improve the capacity of the banks to lend to specific clients or sectors (for example, energy efficiency or micro and small and medium enterprises (MSMEs)), creating more opportunities for investment.

Despite the EBRD's high pre-financial crisis scale of operations, until 2008 there was almost no broader policy dialogue between the EBRD and authorities although there was tactical dialogue linked to operations aimed at facilitating legal, regulatory and institutional changes necessary for specific investment operations. The International Monetary Fund (IMF) and World Bank were seen as being responsible for strategic policy dialogue in the sector. However, the situation has changed dramatically in the aftermath of global financial crisis as Ukraine was one of the hardest hit countries.

Since the onset of the crisis, the EBRD has engaged in a much more sophisticated and complex dialogue in the financial sector covering legislation, institutional changes, opening new markets, creating new products, contributing to the establishment of more sophisticated and developed financial markets. Most of this policy dialogue is being led by teams in the EBRD Headquarters, particularly Treasury, the Office of the Chief Economist, Office of the General Counsel (including members of the financial team and Legal Transition Team), Banking's EBRD Financial Institutions team and recently the Local Currency and Capital Markets Development team. The Country Director and Resident Office bankers are engaged in dialogue in Ukraine on a daily basis, in close coordination with London staff who make regular visits to Kiev for consultations with the Government, National Bank and other agencies.

This case study mainly concentrates on post-crisis in-country policy dialogue related to the restructuring of Ukraine's banking sector and policy dialogue in relation to the LC2 initiative. Other aspects of engagement, for example various financial facilities and dialogue with regard to changes to the Budget Code to allow municipalities to borrow money from IFIs are not considered in detail (the latter is included in the Lviv regional case).

The EBRD is well-positioned for strategic advice to Ukrainian authorities on reforms in the financial sector. Its recommendations and advice are based on many years of investment experience in the country and in other countries in the region, which can offer successful models for specific policy measures (such as the Russian experience in introducing the LC2 initiative). This close link with the operational experience and extensive knowledge of the local market and trends of its development are big advantages that are acknowledged by Ukrainian counterparts.

Having "found its voice" in being part of policy-driven, pro-active or strategic dialogue, and been effective in so doing, the EBRD should not, in the view of this evaluation, revert to the pre-crisis situation of only engaging in transaction-related dialogue if it wishes to realise its potential to help Ukraine realise its transition potential.

Post-2008 policy dialogue with Ukrainian authorities became more structured and oriented towards specific goals. With bank-wide strategies for the financial sector, including the local currency and capital markets initiative, the international forum in Vienna, and clear country priorities (Ukraine country strategy 2011-2014), the EBRD is well set up for engagement to achieve positive results from policy dialogue.

However, the need to quickly step up policy dialogue in response to the crisis meant that resources needed to be drawn from across the Bank and, in the absence of a designated leader and coordination mechanisms, some problems emerged. This evaluation considers that the EBRD EBRD Financial Institutions team should lead on country-level policy dialogue work in the sector in cooperation with other departments where specialised expertise exists resides.

Some areas of policy dialogue indicate that the process is not that smooth and that outcomes are difficult to achieve in the face of considerable resistance from local counterparts (in both the public and private sectors). Lessons from the EBRD's eight years of negotiation on the LC2 initiative in Ukraine are important and should be integrated in future initiatives. Apart from some objective factors and things that are outside the EBRD's influence (for example personnel changes), there are areas where the EBRD could have done better.

First, is a need for a more joined-up approach with like-minded organisations. The parallel dialogue performed by both the International Finance Corporation (IFC) and the EBRD with Ukrainian authorities on gaining permission for local currency operations was recognised by both parties as unfortunate and as one that caused many delays and complications to both. In Ukraine especially, when international financial institutions (IFIs) join forces and speak with one voice the authorities are more inclined to negotiate and compromise.

Second, the approach to dialogue is very important. Despite having in house expertise and ready availability of experienced and skilled consultants, the EBRD failed to formulate its proposals in more engaging way – where Ukrainian counterparts are offered options rather than ultimatums, and where thorough analytical work is done to address counter-arguments presented by opponents of the LC2 initiative. It is not clear whether in the earlier years the EBRD made any effort to understand the counter arguments that were influencing the key decision maker who was persistently blocking much needed reform.

The EBRD did not seem to consider the need to prepare the way for high-level meetings or to engage with mid-level specialists in addition to high-ranking officials. Some other cases of policy dialogue (for example in the sphere of budget code changes to allow municipal guarantee lending) demonstrated that a more flexible and empathetic approach, with a clear presentation of the pros and cons of options (including showing were the proposed approach has worked elsewhere to deliver tangible benefits) are more effective in convincing Ukrainian counterparts of the desirability of reforms and their adoption, albeit perhaps with some compromises on both sides.

The local currency experience also illustrates the EBRD should not assume that Ukrainian counterparts have equal knowledge and understanding of the issue. Creating equal access to information and knowledge should be one of the elements of the dialogue – a common vision of the solution cannot be achieved without common vision of the problem.

Coordination with other IFIs and donors should be an essential part of policy dialogue in the financial sector in general and the LC2 initiative specifically, due to its global significance and the level of complexity of Ukrainian problems. Coordination was traditionally good but some tensions started to emerge in the recent years when the EBRD left its "comfort zone" of transaction-related dialogue and entered the field of more systemic actions in the area of legislation and regulations. Tensions could be localised and supressed through careful planning and identifying niches for performing effective proactive policy dialogue most relevant to EBRD experience and expertise and that logically complements efforts of other institutions, especially the IMF and World Bank.

Tensions between the Banking department and other EBRD teams are more evident in financial sector policy dialogue than in others. Bankers lead on transaction-based dialogue that addresses concrete challenges facing current and potential clients. They believe the EBRD creates the greatest value and impact through this type of the dialogue. They are also making progress in intra-team coordination of policy dialogue through creation of a part-time position of policy co-ordinator.

Policy-driven, pro-active or strategic dialogue that is aimed at legal and regulatory changes of a more systemic nature is taking place directly between the EBRD's Office of the Chief Economist, Treasury, Office of the General Counsel and LC2 initiative teams (with logistical support from Resident Offices) and the National Bank of Ukraine (NBU), government agencies and parliament. The goal is to make financial markets more competitive, sustainable and mature. These EBRD teams are more distant from the Bank's transactions and sometimes they are seen by bankers and Ukrainian policy counterparts as lacking knowledge of the local context.

The almost unanimous impression of the stakeholders in the country that the EBRD's engagement in policy dialogue in the financial sector has not changed much over the last decade is due to policy-driven, pro-active or strategic dialogue not being mainstreamed into the work of the EBRD Financial Institutions team operating in the country.

The near total absence of a formal process for review, monitoring and evaluation reduces the likelihood of identifying the need for a new approach and making changes in a timely manner. It limits the extent to which existing knowledge and expertise can influence solutions to complex problems, and become a source of learning. Lack of review also contributes to the low visibility of policy dialogue work and the perception by staff that their work goes under-recognised and under-valued and it limits the EBRD's ability to explain its achievements through policy dialogue.

The motivation for engaging in policy dialogue should not be on the basis of extrinsic rewards – rather intrinsic motivation, recognition and rewards should be used.

Challenges from 2008 to the present – the policy problems to be addressed

- The Ukrainian financial system is still immature with strong dominance of banks over other types of financial institutions; money markets are facing many constrains related to strict policy of the NBU whose primary objective is to guarantee the stability of Hryvnia (UAH). Development of the equity market is restrained by various institutional, legal and regulatory factors.
- Governance mechanisms and the institutional environment is sound but independence of the NBU from the executive power is not as strong as it should be; factions in the government and various authorities in the financial sphere are complicating the process of policy planning and implementation.
- In the aftermath of the global financial crisis the biggest challenges to the banking sector are: i) a dramatic deleveraging due to limited access to international markets and exodus of foreign banks, ii) lack of internal resources, iii) significant dollarization of the economy, iv) a fragile liability base, and v) the legacy of non-performing loans.
- Lack of long term capital in local currency, undeveloped bonds market in UAH remains an issue. Until recently IFIs could not make deals in local currency and contribute to the development of the stock market due to resistance of the NBU, government and certain players at the banking market.

Overview and appraisal

Conception, planning and strategy		
Deciding to engage	Prior to the onset of the recent global financial and economic crisis, the EBRD Financial Institutions team focused on clients and transactions. Sector level policy dialogue was seen as the preserve of the IMF and the World Bank. This changed with the crisis. An exception to the EBRD's stepped-up engagement in response to the crisis is the long-running engagement (over a period of eight years) seeking a policy change to allow the Bank to operate and lend in local currency (the LC2 initiative). The decision to engage in financial sector policy dialogue had different motivations for the different segments. In large part the decision was led by clients' needs and the need to stabilise the financial system in which they operated. This prompted the EBRD to engage with the NBU over the challenges facing commercial banks in the crisis period with regard to their liquidity, standards of reporting, resilience and capacity to lend money. The policy dialogue surrounding the LC2 initiative was more proactive and deliberate. It was based on a thorough preliminary analysis and identification of key challenges. An initial needs assessment using technical assistance guided the policy dialogue process. The global financial crisis also led the EBRD to engage across its region of operations and its co-leadership of the Vienna Initiative has resulted in the EBRD engaging at a much higher level in the sector. This has led to Vienna II so it is unlikely that the EBRD will leave off this high-level engagement anytime soon. The EBRD was also instrumental in bringing Ukraine into the international platform with the aim of producing a positive effect on domestic policy decisions. The need for a coordinated approach to crisis-related policy dialogue with other institutions and donors active in the sector was clear and this also contributed to EBRD engagement in policy dialogue at the sector level. The EBRD's decision not to be part of the process of restructuring problem banks jointly with World Bank is a good example of deciding not to engage – the reasons for this decision were also clear.	👍👍[1] (clarity about why engaging or not engaging is essential)
Identifying the problems and their causes	Problems were clearly identified in the process of thorough reviews performed by various teams (such as the Legal Transition Team's Assessment of Commercial Laws in Ukraine and the LC2 initiative initial needs assessment), based on multiple meetings with key counterparts in the public and private sector, and consultations with the associations and other institutions. An advantage of initiating policy dialogue in response to a crisis is that consequences of problems and their underlying causes are clear. In other cases, this evaluation speaks of the need to "sell the problem before you can sell the solution" but this is not an issue in crisis response mode. There may however still be many disagreements about the underlying causes and what needs to be done about them. More generally, a crisis can make a government more generally receptive to reform although this has not been the case in Ukraine where the government remained opposed to significant reforms. The EBRD does not have the financial sector analytical resources of the IMF or the World Bank so even though it has stepped up its financial sector policy dialogue, the analysis of the problems remain mostly the work of others. That around eight years of effort was required to see a successful conclusion to the LC2 initiative raises the question as to whether the problem diagnosis in this area was sufficiently comprehensive. This evaluation concludes that it was not. In particular, it is considered that more consideration of the political economy dimension might have resulted in a strategy and set of tactics with a greater chance of success. As noted below, more effort to address legitimate concerns of Ukraine policy actors might have helped as well.	👍 (existence of good analytical underpinning)

1 The various elements of the policy process as reflected in the each case study are characterised as follows:

👎	=	not or only weakly demonstrated
👍👎	=	mixed performance
👍	=	possible good practice
👍👍	=	possible best practice

The word "possible" is used as practice should be guided by the context so the practices should not automatically be considered good and replicated without thinking about the context.

Selecting and validating the policy messages	In the financial sector there are two types of policy messages – tactical and strategic. Tactical policy dialogue relates to specific transactions – these require straightforward responses such as changes in government regulations and NBU instructions. Strategic policy messages are rooted in the EBRD's strategic priorities and transition objectives. The former have easier means of verification as are based on specific transactions. The latter are less clear (especially for local counterparts) and messages sometimes could be formulated in a way that is unacceptable. It is not to say that they are bad but their formulation, intonation of delivery and lack of alternatives or analysis of counter-arguments is clearly lacking in some cases, particularly for the LC2 initiative. The validation stage could be improved by testing the acceptability of the messages through engaging more with mid-level experts in key government agencies (the analyst and advisers to the decision-makers) to explain the motivation for the changes, demonstrate their benefits (and negative aspects and how those can be addressed), and to gather intelligence on the counter-arguments that will be presented to the EBRD at official meetings thereby allowing EBRD policy actors to be better prepared. Internal validation of the messages is also needed – are the policy prescriptions the "right" ones from among the alternatives available in terms of their ability to solve the problems without adverse or perverse effects; are they free from conflicts of interest – either real or perceived?	👍👎 (solutions also based on good analysis subject to further validation)
Clarity on results	There is considerable clarity and specificity on the outputs expected from policy dialogue. There is also clarity but less specificity as to expected outcomes and impacts. This evaluation shows that given the inherent capacity of well-intended policies to produce unintended negative consequences or even perverse results (the opposite of what was expected), it is important to operate on the basis of an explicit theory of change that plausibly links the EBRD's inputs and actions to the outputs desired, and those outputs to outcomes and impacts. Further, since policy is a political process and one that may be dominated by the economically powerful and politically connected, all embedded assumptions need to be made explicit and consideration given to their realism. Similarly, the risks to the theory of change working in practice need to be clearly identified, and their chances of occurring assessed. This up-front and ongoing assessment should be used to determining the strategy and tactics to be adopted.	👍👎 (clarity on expected results)
Strategy and tactics	As noted above, the EBRD significantly stepped up its policy dialogue in the sector in response to the 2008 global financial crisis. Responding to a crisis does not usually allow for a deliberative process of strategy development though work done in better times can be useful. Nonetheless, IFI coordination and the Vienna Initiative provided the basis for formulating and agreeing a crisis response strategy. One consequence of the EBRD's rapidly stepped up financial sector policy dialogue, both at the country and regional levels, was that the required expertise is spread across a number of departments so a joined-up approach was critical to ensure that those engaging in policy dialogue on behalf of the Bank did so speaking from a common script and in a coordinated manner. According to a number of those consulted within the EBRD and in-country this was not always the case. Notwithstanding this, the strategies adopted by the various teams that are engaged in policy dialogue have had an encouraging degree of success in producing planned outputs. However, the strategy needs to stretch beyond the delivery of outputs to consider the support needed for implementation and what else needs to be done to ensure that outputs lead to outcomes and impacts. A number of Ukraine policy dialogue counterparts expressed dissatisfaction and some confusion caused by different EBRD representatives meeting the same officials but delivering different messages. This evaluation holds the view that there are benefits to be had from a more explicit process of developing and monitoring strategy and tactics and adjusting these as necessary. A common theme running across all case studies is there are strong payoffs to be had from incorporating political economy considerations into the selection of strategy and tactics.	👍 (a more explicit and engaged process, taking account of political economy dimensions, for selecting strategy best able to produce intended outputs, outcomes and impacts would add value)

Carrying out the dialogue		
Main inputs provided by EBRD	*Investment operations in banking sector* In the aftermath of 2008 global financial crisis these reached a record level – operations were directed at supporting Ukrainian and international banks with Ukrainian subsidiaries. From 2008 to 2009, the EBRD invested € billion in Ukraine's banking sector. Technical cooperation projects and policy dialogue were mostly led by the Legal Transition Team, the Office of the Chief Economist, Treasury and Local Currency and Capital Markets Development teams on reform of Ukrainian legislation in the sphere of stock market and securities. Policy dialogue with the NBU and the Government over a period of eight years aimed at getting approval for the EBRD (and other institutions) to operate in local currency. Extensive use of examples from other countries in the region where local currency and capital markets development by IFIs had delivered strong results. Engaging Ukrainian authorities (since 2012), along with authorities of other central, eastern and south eastern European countries in the Vienna Initiative 2 aimed at supporting the recovery of European financial markets in the aftermath of global financial crisis. Close collaboration and coordination of actions with other IFIs active in the financial institution sector, especially the IMF, World Bank, IFC, as well as donors such as European Union. Participation in the activities of various high-level committees and councils established by the Government and Presidential Administration, business associations, including banking associations.	👍👍 (comprehensive and adequate quantum of resources)
Actors and roles	There two main strands of the EBRD's dialogue in the financial sector are led by different EBRD actors and involve different Ukrainian counterparts. Transactions-led dialogue is led by the EBRD Financial Institutions team in headquarters and the Resident Office with a strong role of the country director with inputs from the Office of the Chief Economist and Legal Transition Team as needed. Here, engagement with commercial banks and business associations is crucial. The main policy counterpart is the NBU. Policy-driven, pro-active or strategic dialogue is usually performed separately from transactions using stand-alone technical cooperation and international mechanisms. The EBRD's Office of the General Council, Treasury, Local Currency and Capital Markets Development team and Office of the Chief Economist are leading in the various aspects of this strand with the EBRD Financial Institutions team in Kiev only involved for operational needs during missions. Many more Ukrainian counterparts are involved, including Ministry of Finance, Ministry of Economic Development and Trade, parliament, and state agencies responsible for the stock market and financial services. Other institutions play crucial role as the EBRD was traditionally not involved in the strategic policy dialogue in the financial sector, which pre-crisis was seen as the preserve of IMF and World Bank. Agreements or sometimes disagreements amongst institutions can have significant effect on the final outcome.	👍👎 (multiple actors in EBRD, among government counterparts and the international community call for effective communication and coordination mechanisms)
Actions	Ukraine policy actors noted the high professionalism of the EBRD staff and consultants involved and high quality of documents produced, but rather too often their view was that the policy dialogue does not always deliver the desired result. These policy actors suggested that to improve the effectiveness of its policy dialogue in the sector, the EBRD should: (i) present options with the "pros" and "cons" of each identified rather than single solutions; the views of opponents should be acknowledged and persuasively addressed with counter arguments provided, which may be used by officials in briefing their decision-makers – policy analysis should acknowledge the different interests at play; (ii) adopt a more strategic approach of cultivating and working with allies – pre-meetings are very important to air and resolve issues and to ensure "no surprises" in the formal meeting in addition to giving time for decision-makers to receive briefing on the matters up for discussion and/or decision; and, most importantly, (ii) need to agree with the local counterparts on the problem before agreeing on the solution – in some cases, this requires "selling the problem before selling the solution." Generally, the EBRD's actions are perceived as having been direct – both in terms of the message ("cutting to the chase") and what some Ukrainian counterparts viewed as the somewhat limited range of policy actors engaged by	👍👎 (messages and actions need to be "smart" as well as technically sound – a political economy approach is needed that takes account of the local reality)

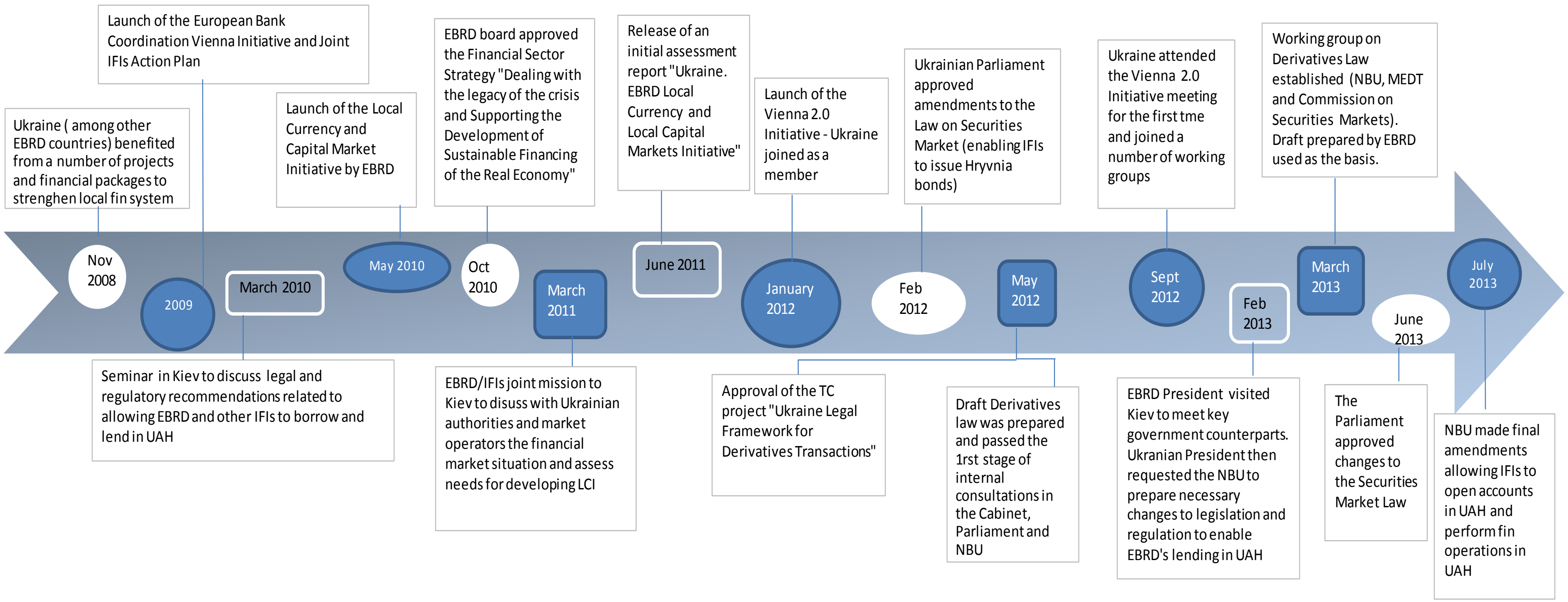
	the EBRD – in their view the EBRD sometimes takes a fairly straight line approach direct to the decision-maker whereas this may not always be the fastest way to the desired result as gaining allies along the way is very important.	
Coordinating	Internal and external coordination have strong points, which contributed to delivering high-quality outcomes in some areas. However, the EBRD's policy dialogue work in the sector is not as joined-up as it should be. Inter-team coordination appears challenging in the financial sector due to high complexity of issues, the multiple departments involved and mix of international and domestic, reactive and tactical and proactive and strategic dialogue. Further changes in the EBRD's policy pillar that are underway (including creation of VP Policy Group, appointment of Lead Regional Economist to be based in Kiev) will bring yet more changes to the structure and division of responsibilities, which need to be clearly explained both internally and externally. The successful experience of generating better intra-team coordination that exists within the EBRD Financial Institutions team (through the appointment of a part time policy coordinator) and generally well-coordinated actions with the Legal Transition Team could be extended further to Treasury, the Office of the Chief Economist, parts of Office of the General Counsel and local currency and capital markets team (though in the case of latter there are some recent steps that will ensure better coordination between financial institutions and local currency and capital markets teams through nomination of a dedicated liaison banker).	👎👍 (communication and coordination mechanisms need to be well-developed to avoid mixed messages, duplication of effort and overloading of in-country counterparts)
Flexibility and reaction to events	The EBRD's degree of flexibility is well illustrated by its response to the global economic crisis and grave consequences this had for the Ukrainian financial market and EBRD clients. The immediate and multi-dimensional response – coordinated with other institutions and the European Union – produced solid results and restored confidence in the financial sector. As the financial sector represents the channel for delivery of other investment operations in the country, the EBRD needs to ensure that its clients continue to pay attention to EBRD strategic priorities such as lending to MSMEs, and energy efficiency projects. There are some reasons to believe (including the fact that it took eight years to produce the desired result) that the EBRD demonstrated less flexibility and maybe insufficient creativity in its policy dialogue on the LC2 initiative and that the approach adopted caused some alienation of the counterparts, particularly key decision-makers. Of course, there were many other factors in play – personalities and political will being among the crucial – so it is not possible to attribute the long amount of time taken solely to a lack of flexibility on the EBRD's side. Nonetheless, the feedback from a number of Ukrainian counterparts (both inside and outside government) was quite straightforward saying that a lack of flexibility on the EBRD's part and its failure to engage a wider circle of allies to push for necessary reforms led to the delays.	👎👍 (flexibility to customise the approach to the context and to change it in response to a lack of success and/or changes in context is critical to success)
Results achieved		
Outputs and outcomes	<u>Outputs</u> – A new law on the securities market was approved in June 2013 and secondary legislation is in the process of development. This allows the EBRD to issue UAH bonds. – In July 2013, the NBU changed its regulations to allow the EBRD to open a bank account in UAH and to offer lending instruments in local currency. – A law on derivatives was prepared by the working group in close collaboration with the EBRD and consultants. It was agreed by government agencies and is due to be submitted to parliament. – Ukraine (represented by the NBU and Ministry of Economic Development and Trade) became a member of Vienna Initiative 2 and is benefiting from participation in a pan-European platform that facilitates exchange of ideas and co-ordination of actions between IFIs, central banks, regulatory bodies, banks with the large exposure in central and south eastern Europe. – Higher standards imposed in the banking sector after 2008 reduced the operational risks of the banks and improved their performance (relative to what it could have been without new measures). However, lending to domestic companies and households has not resumed due to protracted	

	problems with non-performing loans and asset recovery. – <u>Outcomes</u> – The Ukrainian financial sector is affected by the global crisis but not as severely as it would have been without financial packages offered by the EBRD and other institutions to some Ukrainian banks (and the NBU in case of the IMF and the World Bank). – A legal framework is largely in place for development of a mature stock market with clear rules and regulations. – The capacity of key decision makers and mid-level managers in key partner institutions is enhanced. – Ukrainian client banks of the EBRD have improved their performance, and have enhanced their capacity to work with the target clients such as MSMEs, and with specific credit products, such as loans for energy efficiency and renewable energy projects. – New local currency facilities for MSMEs, energy efficiency and municipal infrastructure sectors are expected to be launched in the near future with potentially high demand from local clients. – Increased learning from wider international experience by Ukrainian authorities, in particular the NBU, through their engagement in international platforms like Vienna Initiative 2. – The EBRD became one of the significant players in the financial sector of Ukraine despite many restraints for operations in banking sector associated with strict integrity principles and rules of engagement.	
Supporting policy adoption and implementation	To date, the emphasis on policy dialogue has necessarily been on getting policies, legislation and regulation in place, so the issue of supporting policy implementation has not really arisen. The EBRD has however supported policy implementation by the NBU to build a banking system that is based on modern international standards and also by providing support to a number of commercial and state-owned banks to improve their standards of reporting, accountability and asset management. Although acknowledging the importance of the less visible but vital fine-tuning of legislation and development of secondary legislation, one EBRD interviewee noted there is certain degree of fatigue or unwillingness by government counterparts in this area developing because it is not so visible and high profile as the preparation and passage of new or amended laws or regulations.	👎👍 (evidence of other cases and more widely, stress the importance of supporting the implementation of recently adopted policy to fine tune it as necessary, assist with preparing secondary legislation, and to lessen the chance of reversals, capture by anti-reform elements)
Evidence of learning	The evaluation did not find much evidence of structured learning in the financial sector policy dialogue – either in terms of experience leading to changes in the approach or in terms of knowledge being captured for future use by the same or other teams (the recent appointment of a policy coordinator in the EBRD Financial Institutions team may help to address this gap). Policy dialogue in the local currency area appears to have proceeded for many years without any success and or changes to the approach, which may be symptomatic of a lack of learning. However, in 2011 and 2012 the EBRD launched a bank-wide initiative, created a specialist team, organised a needs assessment mission, and formulated a country-specific strategy. This along with separate visits by the EBRD's president and senior vice-president and a change of personnel in the NBU can probably be credited for the recent success.	👎👍 (learning from the experience should be the basis for flexibility to adjust or change strategy and tactics; learning should also be captured in a useable form, shared and used)

Reviewing, monitoring, reporting and evaluation		
Reviewing	No formal process of reviewing progress was apparent although informal reviews almost certainly took place and regular coordination meetings with other IFIs and with the team concerned. Because there are some issues with the extent to which EBRD policy dialogue is coordinated across departments, this includes review, monitoring and reporting. There can be a danger with policy dialogue that those delivering it can get “too close to the action” such that important contextual matters or vital details might be overlooked – for this reason, including an independent but informed person in the review process can add value.	👎 (regular or periodic formal reviews of progress involving informed persons from both within and outside the Bank [importantly including political economy expertise] have been shown to be important contributors to success)
Monitoring	In common with other cases there appears to be little formal monitoring of selected indicators as a means of tracking progress.	👎 (identifying a set of relevant indicators and monitoring these against a baseline provide a basis for tracking progress in the sector and the contribution of policy dialogue to this)
Reporting	Like in all other areas studied by this evaluation, reporting on policy dialogue activities is significantly less developed than reporting on transactions. In fact, formal reporting is largely non-existent. This causes problems in coordinating the efforts of different teams. Lack of documented evidence of the dialogue was an obstacle for the current evaluation study but it is significantly more damaging obstacle for EBRD teams that are engaged in the dialogue on a regular basis. Also unlike in some other cases storytelling in the financial institutions sector is less prominent possibly due to the specifics of the sector and the multitude of actors involved.	👎 (formal and informal reporting are important for the purpose of review, communicating results or lack of them, and learning – given the nature of policy dialogue, the emphasis should be on story telling for learning purposes while reporting against quantitative targets has a role but can be less relevant)
Evaluation	As with all cases, the benefits of periodic evaluation were never considered. Policy dialogue is rarely mentioned in self-evaluations (Operations Performance Assessments). EvD sometimes covers policy dialogue as part of sector evaluations.	👎 (periodic evaluation of policy dialogue initiatives provides for a useful independent assessment and it can be an important way for capturing learning)

Resourcing and rewards		
Sufficiency of resources and skills available	As the amount and scope of policy dialogue in the financial sector increased greatly as a result of the global financial and economic crisis, EBRD staff resources were generally sufficient for the task. However, they were scattered over a number of departments, a number of which operated semi-independently as coordination and communication mechanisms were not in place. At the early stage of policy dialogue on the LC2 initiative there was a lack of in-house expertise. Initial outsourcing was a workable solution but when the scale of this increased an in-house team was created. In common with other sectors, there is an absence of experience with the political economy – given the highly political nature of policy dialogue in this sector (determining who gets what and when) these skills are sorely needed to help guide strategy and tactics for each policy dialogue initiative. There is no absolute shortage of funding, though a lack of predictability in obtaining technical cooperation funding could be problematic (because of the frequent need to engage over a long period of time) though it has not been a problem to date. Use of the Shareholders' Special Fund has allowed more flexibility and predictability. When considering the future requirements for staff resources and technical cooperation funds for policy dialogue in the financial sector, one must take a view on whether, as the crisis response winds down, the EBRD will reduce its policy-driven, pro-active or strategic dialogue and revert back to the situation that existed pre-crisis of modest involvement in policy dialogue and then mostly only transaction-related. It is the view of this evaluation that the situation should not revert to that which existed pre-crisis. As the largest sector of the EBRD's business, the financial sector's contribution to delivering transition impact is not likely to be realised without an effective policy dialogue component. This evaluation also finds that the EBRD Financial Institutions team needs to exercise leadership – the recent appointment of a policy dialogue coordinator is a useful, though small, first step in this direction.	👎👍 (resources need to sufficient in terms of amount and quality – where these are scattered, there needs to be good communication and coordination; both technical and political economy skills are needed for effective policy dialogue)
Incentives and rewards	As in other sectors, incentives for performing policy dialogue are largely absent for bankers despite the fact that it often consumes a large proportion of their time and effort, especially at higher levels of hierarchy. Policy dialogue does not lend itself to numeric targets or incorporation in scorecards – the latter because of the frequent time lag between effort and reward.	👎 (incentives and rewards for policy dialogue are needed but these of necessity should be largely intrinsic rather than extrinsic – increasing the visibility of policy dialogue work is a good start)

Timeline of key events



1. Introduction

This case study analyses the process of policy dialogue between the EBRD and Ukrainian authorities in the financial sector and in implementing Bank's LC2 initiative in Ukraine. The timeframe for this study is from 2008 to 2013 and it is focused on the post-crisis period of engagement, although some earlier reference points are used to present the dialogue in perspective.

The reason for choosing this timeframe is that the EBRD's engagement in policy dialogue in the financial sector has become more prominent in the aftermath of the global financial crisis that hit Ukraine particularly hard. Although the change in the intensity of the dialogue might not always be dramatically visible to outsiders, it is fair to say that a considerably larger amount of resources and expertise has been deployed by the Bank in Ukraine over the last five years. The EBRD is supporting Ukrainian authorities in designing and implementing much-needed reforms in the financial (and in particular the banking) sector and in expanding money markets and financial markets operations in local currency (hryvnia, UAH) in order to provide necessary resources for investments and growth.

Post-crisis priorities and activities in the Ukrainian financial sector are in line with the Bank's sector strategy (approved in October 2010) for the entire EBRD region, which suffered a lot from the global crisis. Like many other countries in central, eastern and south eastern Europe, Ukraine is currently facing a double challenge. On the one hand Ukrainian financial institutions (which are dominated by banks as other players on the financial market are not that advanced) are experiencing constraints in attracting foreign funding either at open markets or through parent banks largely based in Western European countries that are heavily affected by Euro crisis. On the other hand there is continuous and deepening deficit of the internal financial resources due to a systemic crisis in the Ukrainian economy. Responses to the crisis that require substantial changes to the policies in financial and banking sectors are now being formulated in the framework of prominent policy initiatives of the EBRD, such as the Vienna Initiative launched in 2009 (upgraded to Vienna 2 in 2012), and the Local Currency and Capital Market Development Initiative (LC2) established in 2011. The Ukrainian response to the crisis, which was quite coherent and effective between 2008 and 2010, is now lacking a strategic approach and there are no clear high-level priorities for stabilising the system that is facing the second stage of the recession.

This case study will analyse the context of the policy dialogue, the process of the dialogue, key actors and their actions, roles and responsibilities. It then looks at the outcomes and impacts of the policy dialogue on the financial markets and governance system in Ukraine.

2. Context of the dialogue

Knowledge of the underlying context in which policy dialogue is taking place is crucial for planning its strategy, approach, resources needed and a range of instruments for engagement. The deeper the knowledge the more fine-tuned the policy dialogue is and the higher the chances are of positive outcomes and long-term sustainable effect of the changes. The EBRD has an extensive range of analytical reports and other documents and through the Resident Office and its staff it has regular access to key players in the sphere, meaning its knowledge of the local situation is up-to-date. The combination of first-class analyses of the global trends and the active participation in various global frameworks and fora, places the EBRD in a good strategic position for providing relevant advice and consultancy to Ukrainian authorities and market operators.

For this case study the following three elements of the context are crucial to consider:

(i) the global perspective on the situation in Ukrainian financial markets; ;

(ii) Ukraine's national legislation, regulations and institutional framework;

(iii) The EBRD's strategy and approach to engagement with Ukrainian counterparts in the sector of financial services, stock market and the LC2 initiative.

2.1 Ukrainian financial markets in the global context

After years of dynamic growth in the mid-2000s Ukraine faced a severe decline which in 2009 reached 15 per cent of GDP. In the following two years growth picked up. However due to negative trends at international commodity markets (especially steel and chemicals) and the inability of the government to implement significant systemic reforms, the second wave of crisis came back in 2012. The Ukrainian economy was in recession from the third quarter of 2012 with growth reaching only 0.2 per cent that year. According to the EBRD, in 2013 Ukraine's GDP dropped by 0.8 per cent and growth forecast for 2014 was reduced to 1.5 per cent.[2]

According to the EBRD 2011 to 2014 Ukraine Strategy:

> "Ukraine's highly dollarised financial sector continues to suffer from post-crisis de-leveraging, reliance on short-term funding as well as the long-standing governance problems. The role of the state in the sector has increased during the crisis as state owned institutions received significant capital injections and several banks were nationalised. State ownership may reduce the sector's long-term efficiency and, ultimately, hamper economic growth potential. The non-banking sector is in the nascent stages of development and local currency capital markets remain largely underdeveloped."

Ukraine received one of the largest financial packages from IMF after the recent crisis which is equal to US$16.4 billion.[3] Ukraine also received a substantial rescue package from the World Bank (around US$5 billion), the EU, the EBRD, the EIB and some other institutions primarily aimed at supporting ailing banking system. Ukrainian authorities had to perform significant reforms in the macroeconomic, fiscal and financial spheres in order to accommodate the conditions of the rescue loans. According to the IMF:

> "The banking system was stabilised and recapitalised, and several banking and crisis resolution laws and reforms were completed. The sovereign regained access to international markets and foreign exchange reserves were rebuilt. These efforts strengthened Ukraine's resilience to external and macro-financial shocks and its performance relative to peers, and reduced perceptions of risk"[4]

According to Ukrainian counterparts, a large part of the IMF and other institutions' recommendations were sound and useful for Ukraine, however some of them were inadequate for the Ukrainian context. It should be noted that the IMF stand-by arrangement was suspended in 2011. There are still many structural changes that need to be implemented in order for the Ukrainian economy to enter the period of dynamic and sustainable economic growth.

2 For more detailed analysis of macroeconomic situation in Ukraine please refer to the main report of the evaluation study.

3 IMF provided initial stand-by arrangement in 2008 which in 2010 was restructures into new stand-by arrangement for the total amount of US$ 15.4 billion for 29 months of which only US$ 3 billion were disbursed in two tranches in 2010. From 2011 onwards the Ukrainian Government could not commit to previously scheduled reforms and the arrangement was suspended.

4 Ukraine Article IV Report 2012, IMF

The Transition Report 2013 characterises Ukraine's financial sector in the following way:

> "Despite recent reforms, the financial sector continues to be affected by post-crisis deleveraging and policy-induced money market volatility. Key recent reforms include the transformation of the Deposit Guarantee Fund from a pay-out institution into a fully-fledged bank resolution agency at the end of 2012, and the completion of the transition of commercial bank accounts to IFRS standards on 1 January 2013. In June 2013 the parliament adopted legislation permitting IFIs to issue hryvnia bonds, and the central bank liberalised the use of hryvnia accounts by such institutions. In order to unblock credit activity the government also announced the creation of a state development bank, charged with providing project-related financing to other banks. Several large and medium-sized European banks sold their subsidiaries in Ukraine to local owners. The withdrawal of foreign banks and cheap external funding contributed to greater uncertainty about the future of interest rates and banks' access to external capital markets."[5]

Continuous efforts of the NBU to keep the UAH exchange rate at the level significantly above its real value has been expensive and drained Ukraine's foreign exchange reserves. In January 2014 Ukraine's foreign exchange reserves reached US$20.4 billion up from US$18.9 billion in November 2013. The growth is due to a US$3 billion raised from placing external sovereign bonds in the framework of Russian financial aid package totalling US$15 billion.[6] This level is still lower than the average level of foreign exchange reserves – US$23.2 million in the period from 2003 until 2013.[7] Credit activity remains very weak, as real interest rates in the national currency are about 20 per cent and the NBU continues to expand control over the movement of capital.

Foreign banks that invested intensively in the Ukrainian financial system from 2006 to 2008 are leaving Ukraine. It should be noted that between 2006 and 2008, nearly 42 per cent of the US$26 billion foreign direct investment in Ukraine went to the financial sector. During the crisis in 2009 and 2010 European banks invested over UAH 17 billion (about €1.7 billion) of new share capital in the Ukrainian banking sector, which was 67 per cent more than what the owners of local banks invested.[8]

The share of western European banks has dropped from 35 per cent in 2009 to 22 per cent in 2012 (see Annex 1). According to some market operators even more banks are keen to leave the market due to pressure of new regulatory requirements for the levels of capitalisation (Basel III) and in the preparation to stress tests by the European Banking Authority. However for some banks costs of exiting the market are too high to sustain.

More data and trends of the development of Ukrainian financial system are presented in Annex 1 of this case study.

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5 EBRD Transition Report 2013

6 Ukraine and Russia signed the bailout deal on 17 December 2013 after the Ukrainian leadership reverted from its previous commitment to sign an Association Agreement with the European Union at Vilnius summit in November 2013. Russia agreed to invest US$15 billion in Ukraine's sovereign debt and to reduce price of gas by 30 per cent (temporary measure, simultaneously requiring two-fold increase in the minimum level of gas purchase).

7 In Ukraine foreign exchange reserves are the foreign assets held or controlled by the country central bank. The reserves are made of gold or a specific currency; they can also be special drawing rights and marketable securities denominated in foreign currencies like treasury bills, government bonds, corporate bonds and equities and foreign currency loans. Foreign exchange reserves reached all-time maximum of US$38.3 billion in April 2011 and a record low of US$4.6 billion in January 2003.

8 NBU statistics, The Ukrainian Week analysis

2.2 Ukrainian legislation, regulations and institutional framework

Over the last 15 years, Ukraine developed a comprehensive institutional framework, adopted some key legislation and regulations that govern the functioning of the financial sector. Among key legislation acts are: the Law on Banks and Banking Activities (2000); the Law on Securities and the Stock Market (2006); the Law on State Regulation of Securities Market (1996); the Budget Code (2010); and regulations and instructions by NBU, MFU, National Commission On Securities and Stock Market, State Commission on Regulation of Financial Services Markets. The draft Derivatives Law has been prepared with the support of the EBRD and other IFIs (see below) and is currently in the process of approval by the government and parliament.

During over 20 years of its operation in the country, the EBRD worked closely with key government institutions and legislature in the financial sphere such as NBU, MFU, Parliament and the National Commission on Securities and Stock Market.

According to the analysis of the legal and regulatory framework in Ukraine's capital markets made by the Legal Transition Team in 2011, Ukraine has achieved good progress in this sphere. However there are significant handicaps that should be addressed for the money and stock markets to reach a more mature stage of development.

After a joint IFI mission to Ukraine in March 2011 which included the EBRD, the EBRD identified a list of six main areas that require changes and improvement in order to create beneficiary conditions for positive dynamics of development on Ukrainian financial markets (the list is not exhaustive). These areas are:

i) strengthening of the macroeconomic stability and monetary policy;

ii) foreign exchange market liberalisation;

iii) money market development;

iv) strengthening the liability base of the banking sector;

v) promoting the reduction of non-performing loans to help restore lending;

vi) improving the sustainability of the pension system

Besides sector specific challenges the financial system like all other spheres and perhaps even more so, suffers from a number of serious structural problems that are difficult to overcome in the short term. Among them are: (1) a weak rule of law and protection of creditor rights, (2) only modest efficiency of the judicial system, (3) feeble corporate governance and (4) endemic corruption. Also the transparency of credit-worthiness of potential borrowers is low. The credit bureau's infrastructure is inadequate to the needs of the market.[9]

9 Stephan Barisitz, Ulrich Gunter, Mathias Lahnsteiner "Ukrainian Banks Face Heightened Uncertainty and Challenges"/ Financial Stability Report 23, June 2012

2.3 The EBRD's strategy and tactics of engagement in the sector

Activities in the financial sector of Ukraine are defined by the Bank's priorities that currently are stipulated by the EBRD's Financial Sector Strategy (approved in October 2010) and Ukraine Country Strategy for 2011 to 2014 (approved in 2011).

According to Ukraine Country Strategy for 2011 to 2014 the EBRD's key priorities in financial sector include:

- providing the banking sector with targeted long-term loan and equity funding together with technical assistance;
- strengthening governance in financial sector;
- diversifying long-term funding sources; and
- supporting local currency lending to the extent possible.

In the previous country strategy (2007 to 2010), the EBRD's plans for policy dialogue were concentrated on: (1) developing strategies for two state-owned banks (Ukreximbank, Savings Bank); and (2) developing local currency financing instruments based on the approach used in Russia and other countries.[10]

The lending mechanisms are presented by individual loans to the banks and a range of financial facilities – aimed at supporting Ukraine's MSME sector, energy efficiency and renewables energy projects, and trade facilitation.

The EBRD's approach in this sector has changed significantly as a result of the profound crisis in Ukraine's banking and financial sectors. The EBRD was one of the most critical partners that helped Ukraine in the aftermath of the global financial sector. Ukraine was among the countries that suffered the most and required a significant amount of resources, advice and technical consultations for developing and implementing effective reform in the financial sector , in particular in the banking sector. The Bank was able to swiftly adjust its work in country and focused its crisis package for Ukraine on providing an extensive support programme to the banking sector that had expanded rapidly in between 2007 and 2008. This sector was among the most affected sectors of the national economy as it was negatively affected by weak internal governance and controls, large scale foreign currency lending to unhedged borrowers and a poor institutional and regulatory environment.[11]

In coordination with strategic investors and regulators, the Bank invested over €1 billion in Ukraine's financial sector from 2008 to 2009, including over €600 million to support the capital base of banks. The extent and speed at which the Bank engaged in a difficult period was considered a significant success that helped to save the Ukrainian banking sector from a systemic crisis, complementing support from other IFIs.

In the area of domestic capital market development and associated long-term credit lines provided to banks, the EBRD has achieved success, albeit after many years of negotiations.

During the 2008 to 2009 crisis period, the Bank's policy dialogue in Ukraine focused on the stabilisation of the financial sector.[12] The Bank engaged with the NBU and other partner institutions on the regulatory response to the financial crisis and co-organized round table discussions with the authorities, representatives of the leading foreign banks represented in Ukraine and IFIs with a view to ensuring

10 Ukraine country Strategy 2007-2010, EBRD
11 Ukraine country strategy 2011-2014, EBRD
12 This sub-chapter is largely based on Ukraine's country Strategy 2011-2014 and 2007-2010

continued commitment of the bank groups to their Ukrainian subsidiaries. The Bank also offered technical assistance to a large group of medium sized banks to ensure they would comply with the requirement to undertake their balance sheet diagnostics.

More recently, the Bank's main policy dialogue has concentrated on:

- best practices on fiscal decentralization and debt management by the local authorities with the view to enabling commercially oriented municipal projects;
- policies needed to develop capital markets, reduce dollarisation and other issues related to the Bank's potential hryvnia lending operations;
- challenges in the area of public sector governance facing Ukraine's corporate and financial sectors.

The Local Currency Local Capital Market Development Initiative ("LC2 initiative") launched by the EBRD in 2010 is responding to the realisation that broader local currency capital market development is necessary, and can be a desirable end result in itself. In this initiative it is not just the individual operations that matter, but also our ability to contribute to changes in the broader institutional and macroeconomic environment through policy dialogue and through operations that catalyse market development. A coherent programme of investment in bonds could have a similar catalytic effect in furthering the strategic objective of financial market development.[13] The EBRD's LC2 initiative has country specific strategic plans for engagement. The Ukraine element was launched in 2011 after thorough initial needs assessment exercise (see below).

The EBRD together with a group of like-minded IFIs and the EU launched Vienna initiative in 2009 which brought together government agencies, regulators and private sector operators at financial markets of European countries and beyond, creating platform for the dialogue and finding solutions for the common problems. Ukraine became a member of Vienna Initiative in 2012 after its second stage was launched. The membership is highly valued by Ukrainian authorities and it created an additional channel of communication and influence over the necessity of performing crucial reform in Ukraine's banking and financial sectors. Co-ordination amongst institutions in the framework of Vienna Initiative allows them to speak in one voice over crucial issues – traditionally a significant factor of influence on Ukrainian counterparts.

3. Policy process

A detailed timeline of policy dialogue in the financial sector and LC2 initiative is presented in Annex 2 to this document.

Policy dialogue in the financial sector has been ongoing for many years and constitutes an important part of the EBRD's engagement with Ukrainian authorities. For this study, initially the evaluation team was looking at the distinction between pre-crisis and post-crisis dynamics of the policy dialogue. However many EBRD colleagues and Ukrainian counterparts from the public, private and international sectors didn't agree with this assumption. Policy dialogue has become more intensive and multifaceted, with more legal and regulatory work that involved various parts of the EBRD. It also involved more stand-alone technical cooperation and advice linked to significant financial packages (such as the energy efficiency and climate change initiative). Most of the interlocutors noted however that the EBRD's position in policy dialogue has not changed dramatically in the post-2008 period.

13 Use of Bonds in EBRD Operations Paper, March 2011 – by Treasury, OCE and Banking

One reason for this conclusion may be that ongoing dialogue is not immediately visible or directly linked to the current transactions – the latter factor is considered by bankers as crucial for the EBRD's success in the country. The work that is being performed in the sphere of legislation and regulations is "proactive" and forward-looking, opening new avenues for EBRD business activities and re-invigorating the system in general. As noted by some EBRD colleagues, the Bank has to carefully separate its functions as a consultant and as a banker in this sector in order to avoid a conflict of interests. Through reforms that are currently being finalised (see below) the EBRD and other IFIs are contributing towards the creation of universally available and beneficial conditions for Ukraine's money and stock markets, from which the EBRD also can gain in the future.

Through the financial sector and LC2 initiative the EBRD is pursuing a "strategic" policy dialogue that is aimed at creating a legal, regulatory and institutional framework to enhance Ukraine's money and financial markets. Recognising the challenges of the local financial system the Bank is carefully identifying and pursuing the areas of the dialogue that would bring a positive effect to the critical elements of the system. A great effort is being invested in the dialogue with regard to de-dollarisation of Ukrainian economy in general and financial system in particular by allowing local currency operations to IFIs which are active in country. It is mostly teams from EBRD Headquarters– the Office of the Chief Economist, Treasury, the Legal Transition Team and the local currency team – that are leading this type of policy dialogue.

There is also "tactical" or "reactive" policy dialogue that is usually linked to the ongoing operations and is concentrating on assisting existing clients in complying with national legislation and regulatory requirements, that changed significantly in the aftermath of crisis. Assistance through a number of technical cooperation projects is provided to modernise banking standards and practices in certain areas, such as MSME financing and energy efficiency/renewable energy projects which must comply with IFRS standards compulsory for all Ukrainian banks from January 2013. The financial institutions banking team is leading on this type of the dialogue.

3.1 Conception, planning and strategy

In the financial sector policy dialogue is often launched on the basis of a combination of two things – opportunity and the commitment of the client. A good knowledge of the clients, their challenges and advantages is crucial for prioritising the policy dialogue. Carrying out policy dialogue in a conductive environment with the support of market operators and regulators is much easier and bears more sustainable long-term results. "Doing policy dialogue in the vacuum is not wise" commented one of the interviewees.

Launch of the dialogue in the financial sector was prompted in several ways:

i) opportunities for future business (LC2 initiative);

ii) needs of the existing clients (non-performing loans legislation and regulations);

iii) Ukraine's obligations (legal and regulatory framework for financial markets).

During the pre-crisis period, Ukraine's financial sector was developing very dynamically with lots of mergers and acquisitions by international banking groups. In that period the EBRD was engaging with Ukrainian authorities more or less on an ad-hoc basis, when the needs arose to resolve transaction-related issues. The EBRD recognised the strategic role of the World Bank in policy dialogue in this sector and co-ordinated its efforts with the World Bank and other institutions. Traditionally, there was also a large amount of funding available for technical cooperation and policy dialogue from other international institutions and donors, especially the European Union. The EBRD's focus was on commercial banks and contacts with the NBU, and on increased transparency and liquidity of financial markets – for example through the introduction of the KievPrime rate jointly with Thomson Reuters (see Box below).

However, the 2008 crisis changed the market and the EBRD's approach to policy dialogue. In the course of forming a financial rescue package for Ukraine major IFIs identified areas of policy and the regulatory environment that need substantial reforms in order to return the market to the stability and sustainable growth. From then on the EBRD's role in policy dialogue became more prominent. Some efforts were made in the framework of Vienna initiative launched in 2009 to help central, eastern and south eastern European countries to mitigate negative consequences of the deleveraging caused by Western European banks. Ukraine was not included in the group of member countries until 2012 when Vienna II was launched. Ukraine, as a country with a significant number of foreign banks (a lot of those from EU countries) and a dependence on international financial markets, had to be integrated in the forum that brings together national banks, commercial banks and regulators from "donor" and "recipient" countries

Multilateral meetings of IFIs, donors and Ukrainian authorities in late 2008 were aimed at finding immediate solutions for restoring stability on a quickly deteriorating market. However more strategic issues were identified – reforms in the areas long neglected by the government and the NBU were needed in order to rebuild a financial sector that is more resilient and based on new fundamental principles.

From 2008 to 2009 the EBRD launched a range or recapitalisations and subordinated loans in order to help local banks to address short-term liquidity problems. At the same time dialogue with the NBU became more systemic as along with "operational" issues of client banks that had to be addressed jointly with the NBU and other critical issues outside the transactions zone were identified. From 2011 the EBRD launched a more systemic dialogue with regards to the LC2 initiative which was based on a thorough initial assessment of the situation and the formulation of key challenges to be addressed in future policy dialogue. A mission to Ukraine, conducted jointly with other IFIs in March 2011 and the publishing of the Initial Needs Assessment Report for the Ukraine LC2 initiative in June started a process that ensured the formulation of objectives that are both realistic and in congruence with the strategic plans of Ukrainian authorities that were extensively consulted during the mission. As mentioned above, six key areas of actions were identified:

i) strengthening of the macroeconomic stability and monetary policy;

ii) foreign exchange market liberalisation;

iii) money market development;

iv) strengthen the liability base of the banking sector;

v) promote the reduction of non-performing loans to help restore lending;

vi) improve the sustainability of the pension system.

The EBRD local currency team is leading on this work jointly with Treasury, the Office of the Chief Economist, the Legal Transition Team and EBRD Financial Institutions teams. A former EBRD Ukraine director is now leading the local currency team. Since 2013 one of Resident Office financial institutions bankers has been responsible for liaising with the local currency team on a regular basis, which should contribute to greater co-ordination between two teams and two types of policy dialogue (see below). It should be noted however that there is an uneasy feeling among bankers with respect to the growing role of "policy" teams in the EBRD and their take on policy dialogue that is far from the real transactions and has the potential for increasing bureaucracy in the bank. Outsourcing some policy functions could be a better option, some believe, although this brings a challenge relating to the ownership of decisions and institutional memory.

Launching policy dialogue in the recent years also saw some tensions with IFIs, for example the International Monetary Fund and the World Bank, which traditionally see policy dialogue in the financial sphere as its "zone of operation". More articulated position of the EBRD is causing some unease among IFI partners who are not seeing real change in the bank's contribution to policy dialogue. The way to overcome this might be to concentrate on very specific areas of intervention and to have specific clients (existing or prospect) who can contribute in the short- to medium-term perspective from the legal and regulatory changes.

Another option for opening the dialogue is joining other organisations who share the EBRD's position on certain issues. Joining forces with two national bank associations, FLIFI, EBA, ACC and Domestic and Foreign Investors Advisory Council under the president of Ukraine, on issues such as non-performing loans, is important for building critical mass of pressure and speaking in one voice. This usually attracts more attention from authorities and leads to concrete changes.

3.2 Carrying out policy dialogue

Topics of EBRD's policy dialogue within the financial sector in Ukraine

As described in Chapter 2.3, the EBRD has a wide range of investment and technical cooperation operations in Ukraine that are accompanied by continuous and multifaceted policy dialogue.[14] The EBRD's efforts are largely concentrated in:

- strengthening resilience of the banking system (through individual loans to banks and financial facilities for smaller loans);
- strengthening its transparency and predictability (earlier work on creating a KievPrime reference rate for inter-bank lending – see box below);
- strengthening stock markets through transparent and efficient legal framework (technical cooperation on derivatives law);
- strengthening money markets through de-dollarisation (LC2 initiative),
- enhancing financial market supervision and regulation jointly with other IFIs and donors (for example Vienna II).

Stakeholders with whom the EBRD works

The EBRD is working with a range of stakeholders in Ukraine that first of all include Ukrainian authorities (see Chapter 2.2. for more details), other IFIs, clients (commercial and state banks), associations and lobby groups. Figure 1 below lists the key stakeholders in various spheres, including different EBRD departments that are engaged in various aspects of policy dialogue.

14 There are also other initiatives that are being supported by the EBRD through technical cooperation via other IFIs such as the Black Sea Development Bank and EIB.

Box 1: The launch of an independent reference rate, KievPrime

In November 2007 the EBRD jointly with Thomson Reuters launched KievPrime - an independent reference rate calculated daily by Reuters based on offered inter-bank deposit rates in UAH as quoted by leading participants in the Ukrainian money market. Nine local commercial banks initially selected by the EBRD (and slightly changed since then) contributing reference rates. KievPrime is calculated for overnight, one week, one-, two- and three-month tenors, and since 2012 for six- and twelve-months tenors which are provided by the contributor banks daily at 12pm. The index was an important stepping stone in the development of Ukraine's local market that contributes to increase market liquidity and pave the way for the issuance of floating rate bonds and loans denominated in UAH.

Figure 1: Stakeholders in policy dialogue for financial institutions and local currency lending

Ukrainian authorities	Banks and their associations	EBRD	IFIs/donors
NBU	Banks clients	Financial Institutions	IMF
Ministry of Finance	Association of Ukrainian Banks (AUB)	Treasury	WB
Ministry of Economic Development and Trade	Independent Association of Ukrainian Banks (IAUB)	OCE	IFC
National Commission On Securities and Stock Market – market regulator	Forum for Leading Financial Institutions (FLIFI)	OGC (including Finance Team and LTT)	EU
State Commission on Regulation of Financial Services Markets	American Chamber of Commerce (ACC) - Banking Committee	LC2	EIB
Parliament of Ukraine (sector committees) – legislature	European Business Association (EBA)		
Presidential Administration	Domestic and Foreign Investors Advisory Council under President of Ukraine (DFIAC)		

It was noted by some stakeholders that there are significant rifts between various Ukrainian authorities and sometimes open rivalries. Battling for the sphere of influence different institutions are using different tactics, often undermining each other's achievements. The Minister, Head of Commission on Securities and Stock Market, and the head of profile Parliament committee could represent antagonistic interest groups – they try to compromise each other's actions, block legal initiatives or sabotage implementation. IFIs and donors are among victims of such battles – open or hidden. It is worth remembering about strong connections between large economic groups (oligarchs) and government agencies where members of parliament and even ministers are openly lobbying for the interests of specific groups. Knowledge of such political "geography" and power struggles should help in identifying potential allies and opponents and to develop relevant strategies for collaboration and counteraction. Experience with derivatives law preparation is a good illustration of acknowledging various centres of influence and building a strategy of engagement that integrates this knowledge. Changes in personalities that represent different economic interests also played a positive role in achieving regulatory success for the LC2 initiative

Non-governmental counterparts

The non-governmental network of counterparts is quite diverse and antagonistic. There is no single strong banking association – three key networks are competing and have various degree of "closeness" to the NBU or to large international investors. Their influence is also fluid. While ABU was a top lobbyist three to five years ago now it is IAUB (with close links to the NBU) that has greater leverage on the banking community. FLIFI might face challenges in the nearest future as the number of foreign banks (its members) is going down very rapidly and accordingly the weight of influence is reducing. It leads to some more "concessional behaviour" towards the EBRD comparing to earlier years when strength of lobby groups was greater. ACC and EBA represent interests of large and medium (the latter) companies but have antagonistic positions. DFIAC, despite having high status, is largely useless and used as a photo opportunity by the president of Ukraine.

Inter departmental cooperation within the EBRD

As for internal dynamics of relationships, there is a significant amount of inter-departmental cooperation as various parts of the Bank are involved in the different components of policy dialogue and technical advice in the financial sector, especially in the local currency initiative. As the issues are quite complex and some negotiations are going on for a long period of time several departments are playing various functions.

The financial institutions banking team is in the core of the business in the area and is the primary contact point for on the ground daily dialogue conducted with Ukrainian counterparts. It manages technical cooperation projects associated with concrete investment operations, especially those related to financial facilities for participating banks (see table 3 below).

The local currency and capital markets development team, Treasury, legal transition team, financial legal team and the office of the chief economist represent the "policy" side of the dialogue. This is largely based on stand-alone technical cooperation projects and ongoing dialogue with specialised agencies, the NBU and other IFIs with regard to reform of the standards of Ukraine's financial system to make it more transparent, efficient, liquid and profitable. The local currency and capital markets development team, first assembled in 2011 and then transformed into an official part of the finance vice presidency, forms the core of this co-ordination effort.[15]

The Office of the Chief Economist (especially the Director for Country Strategy and Policy) is leading on policy dialogue related to developing the capacity of the Ukrainian banks, in particular recapitalisation, stress testing, review of the banking system and specific banks. This work is being implemented largely in the framework of Vienna Initiative 2 which Ukraine joined in 2012. The EBRD also provided resources for third party audit in certain banks to ensure transparency and compliance with international standards that positively affected investment ratings of those specific banks. The NBU was initially very grateful for this specific support.

15 There was an interesting insight from some interviewees that initially the LC2 initiative experienced a real deficit of in-house expertise and some outsourcing was done. However it became apparent that it negatively affects the capacity of the Bank to effectively implement the goals of the initiative so a dedicated department was created and fully staffed with experts.

The Legal Transition Team leads the implementation of the technical cooperation project funded by the EBRD's Shareholders Special Fund "Ukraine Legal Framework for Derivatives Transactions" (budget of €250,640) which was approved on 31 May 2012. This project is being implemented jointly with the World Bank, the IFC and the IMF together with some law firms. The EBRD's Treasury is also taking part in this activity. In the framework of the project, the EBRD assists the Working Group of Ukrainian authorities in preparing legal provisions which will introduce a number of amendments and additions to the existing legislation, thereby providing for validity and enforceability of derivative transactions in Ukraine. A draft Law was prepared and passed first stage of internal consultations in the government, parliament and the NBU. In June 2013, the draft law was published on MEDT website for public consultations.

Coordination with other IFIs

It should be noted that the EBRD and IMF experienced some tensions in the process of implementing this project. In particular there were some disagreements about the draft law prepared with the support of the EBRD and others. The International Monetary Fund came up with another version and there were some disputes observed by Ukrainian counterparts, which is usually quite destructive for the "common cause". However the EBRD managed to convince partners that its version of the law is what Ukraine really needs and it was accepted as a basis for further refinement. At the moment (January 2014) there is no final decision on the derivatives law.

Strengths of the EBRD approach

EBRD bankers highlighted the greatest strength of EBRD policy dialogue which distinguishes it from other advisors – it is "project-based" and largely driven by transactions. When talking to the NBU or other Ukrainian authorities the EBRD has much more credibility as its position, advice and recommendations are based on solid and diversified experience of working on Ukrainian financial markets (which are dominated by the banking sector).

Limitations and opportunities

Though the EBRD should be careful not to generalise on the basis of a single case, transaction-based policy dialogue (however important and unique) should refer to the macro trends in the country's economy, political and institutional environment, which is fluid and rigid at the same time.

Also direct involvement in the sector potentially creates a conflict of interest in the sphere of policy reforms as any advice and suggestion could be interpreted as potential lobbying of Bank's own interests. In a way, the eight year struggle to get the NBU on board with the LC2 initiative was a result of strong believe in Bank's plans to profit from the entrance into the hryvnia market without long-term considerations of its stability ("short term speculator" term was used by some).

Positions of other EBRD teams are different as a more systemic approach to policy dialogue is recognised as necessary. Consultations in relation to legal and regulatory changes on financial and money markets need to be comprehensive and take into account the EBRD's experience from work in other countries in a similar context, and to introduce international best practices and latest innovations that are being used globally. Including Ukraine in international clubs such as the Vienna Initiative 2 could bring greater benefits in achieving progress in "tactical" transaction-based dialogue as there would be a greater understanding of the international context and the needs for reform. There is clearly a scope for bringing these two components of the policy dialogue closer.

EBRD financial facilities in Ukraine

Figure 2 below presents a number of financial facilities launched by the EBRD in Ukraine to support specific sectors of commercial lending. Through a number of local banks, the Bank provides loans to smaller companies. The investment component is accompanied by technical cooperation that is usually aimed at building the capacity of local banks to work in specific segments of the market (either with MSME or on energy efficiency). In-house expertise allows banks to expand their product range and attract more clients.

Figure 2: Some EBRD financial facilities in Ukraine's financial sector

Date	Project[16]	Participating banks	EBRD finance	TC associated	TC Amount and Donor
08-Jun-12	Ukraine Sustainable Energy Financing Facility (USEFF)	RBA and others	US$100 million	Project aimed at addressing acute needs for sustainable energy investments	€3.5 million Austrian Ministry of Finance
14-Dec 2004	Ukraine MSME Lending Framework	FW-SEB bank Kreditprombank Forum RBA Kredobank Rodovid Megabank	US$200 million	Implementation of MSME lending schemes with emphasis on product diversification	€2.25 million from EU TACIS for MSE finance €3 million form the EU IPF 2004 for MSE finance €2 million from Dutch Government for Rural and Agriculture MSE finance €3 million from the EU IPF 2004 programme for SME finance
15-Sep-06	UKEEP - Energy Efficiency Programme for Banks in Ukraine	Ukreximbank Kreditprombank Forum Megabank	€100 million	Credit lines to Participating Banks for on-lending to private sector companies for industrial energy efficiency and renewable energy projects	Project consultant – €1 million Energy efficiency experts – €1 million Market demand study –€ 97,400

Tactical policy dialogue often involves tri-lateral meetings between the EBRD, its client and the NBU in order to address some specific challenges faced by the Bank. This dialogue is performed by the EBRD's EBRD Financial Institutions team (based in Headquarters and the Resident Office) with significant support from Country Director and Headquarters management.

Client experiences with engagement

Partners from Raiffeisen Bank Aval provided quite a detailed account of their engagement in transaction-driven policy dialogue. It is multifaceted and includes negotiations over application of new standards and procedures in the post-crisis period, launch of innovative risk-sharing financial facilities (leasing scheme jointly with John Deere in agribusiness sector), and attempts to influence changes in inefficient legislation and regulation with regard to for example, non-performing loans. The latter issue was the subject of other individual meetings and meetings with banking associations and the Ministry of Taxes and Duties (and

16 These data comes from Project summary documents- www.ebrd.com. The figures are not final since the project could have been expanded afterwards.

other agencies). Non-performing loans constitute almost 30 per cent of the total portfolio of loans in Ukraine (16 per cent according to the NBU methodology of calculation) but triple-losses related to their disposal are making them non-liquid and respectively preclude banks from engaging in new credit operations.

Actors and activities

Below we consider the process of strategic policy dialogue which is mainly performed by the policy teams of the bank (the Office of the Chief Economist, the Office of the General Counsel, Treasury, LC2 initiative team) with the support of EBRD Financial Institutions team bankers in Headquarters and the Kiev Resident Office. Activities associated with the LC2 initiative in Ukraine include:

- Amendment of the NBU Instructions allowing the EBRD to operate its accounts in UAH freely (done in June 2013) and amendment of the Securities market Law, which enables IFIs to issues local bonds (approved in June 2013 by Parliament);
- Secondary legislation is being developed by the National Securities and Stock Market Commission to enable practical instruments of local currency lending for IFIs;
- Law on derivatives (sponsored by the EBRD) - to be submitted to the parliament shortly

Joining forces with other IFIs

The World Bank proposed that the EBRD join the initiative of saving three ailing banks that were nationalised in 2009 and are currently are being restructured with the objective of future privatisation. The EBRD refused this offer and is looking at the current state of the banks in question to decide if it was a right decision to make. Despite the assurance of World Bank colleagues that it did not affect the initiative and relationships between the two IFIs it could however reinforce the World Bank's (and IMF) existing assertion that they are leading on policy dialogue in the financial sector and that the EBRD's role and influence are not strategic.

The EBRD's Treasury, Office of the General Counsel and recently the LC2 team led the initiative which allowed the EBRD and other IFIs working in Ukraine to perform investment operations in local currency. After eight years of intensive dialogue, Ukrainian authorities finally amended key legislation and regulations that opened the way to the LC2 initiative.

Work was conducted in parallel with the IFC which chose to focus purely on money lending rather than issuing bonds and lending in UAH like the EBRD. The IFC received the NBU's permission for such operations in 2011 however did not use it as it included conditions – cap on end-user interest rate – that were commercially nonviable. In conversations with the EBRD, IFC colleagues noted that it was a mistake to "diverge" on this important issue and that both the IFC and the EBRD could achieve a positive outcome faster and on better conditions (than IFC currently has) if they joined their forces.

Limitations of the EBRD approach

Remarks from EBRD staff and other stakeholders in the sector included the point that the EBRD's approach to LC2 initiative negotiations was consistent but inflexible. It lacked clear explanations about all "pros" and "cons", accessible information that could be delivered to crucial counterparts. Also the EBRD did not engage with critical mass of like-minded partners that would articulate joint position more clearly. The EBRD's attempts to build alliances, were found to be ineffective and potential partners did not consider them as very serious.

Relations with the central bank

The key Ukrainian counterpart in negotiations – the NBU – is a challenging partner. It is an institution of high professional standing with a strong understanding of its own importance. Despite the EBRD having "excellent" relations with the management and mid-level specialists, and ability to meet and discuss issues upon request, the NBU's top-level management was traditionally inaccessible and fully dismissed creating any chance for the EBRD or other institutions to infringe the monopoly of the NBU on operations in local currency.[17] Some private market operators fuelled this phobia to their own advantage, being worried about potential competition. However personalities at the top of the NBU were always decisive in the dialogue. With the arrival of a new team in 2012 (from state Ukreximbank that has long history of relations with the EBRD) relations between the EBRD and the NBU improved considerably and in summer 2013 the long-standing issue of the LC2 initiative was resolved.

Relations with the government

One might suspect that the "activeness" of Ukrainian authorities increased since the EBRD's President Suma Chakrabarti's visit to Kiev in February 2013. During this visit, some challenging issues were discussed with the President, Prime Minister and other high-level officials, including corruption and the rapidly deteriorating business climate in Ukraine that undermines any plans for future investments. While not offering "concessions" in other areas, in June 2013 Ukrainian authorities announced a breakthrough in LC2 initiative negotiations at the time when international isolation of the country's leadership started to escalate. Political will following top-level contacts between the EBRD President and President of Ukraine enabled necessary changes in legislation and regulation. It is difficult to underestimate the necessity of political will for progress in financial sector reforms (as in any other sector).

Coordination of interest groups

The process of assistance in preparation of the derivatives law during 2011 to 2014 by the Office of the General Counsel suffers from different challenges related to fragmentation of influence groups in the sector and related to IFI co-ordination. Due to the current delicate stage of the dialogue, the evaluation team did not meet with key local stakeholders and thus the range of opinions is not complete. However multiple delays and complications in the MFU, Commission, and Parliament were related to power struggle between different economic groups and open conflict with the IMF over the version of the draft law that should be adopted by the Government. The lesson from this experience is to co-ordinate efforts not only with the country teams in Washington and Kiev but also with specialist teams (such as the EBRD's Office of the Secretary General) to avoid unnecessary tensions and potentially jeopardising of the crucial regulatory reform due to the divergence in recommendations.

3.3 Achieving results

The EBRD achieved significant positive results in the financial sector through a crisis response package and further individual transactions with banks that were aimed at improving their health standards and liquidity. An important observation made by some counterparts reflects that the impact of EBRD operations goes beyond direct economic effects – it also encompasses ethical and cultural changes in client banks. It is important to use this qualitative change as an illustration of successful transformations stimulated by EBRD investments and TC packages. Sharing more accessible stories with a wider

17 Evaluation team was told that in 20 years of EBRD's operations in Ukraine it had only 3 meetings with the Chairman of NBU.

audience will help not only to increase the awareness about EBRD achievements, but also to comprehend the potential gains that are missed by many who do not engage in challenging but much-needed reforms (such as reforms contributing to raising productivity, profitability and ultimately investment attractiveness of specific companies and sectors).

Results in local currency and legislative work are less straightforward and in many cases are still to be achieved. This case presents an extremely interesting and useful example of the dynamics of relationships between the EBRD and Ukrainian authorities that deserves more detailed insight.

The main question which many counterparts were asking is “Why did it take the EBRD so long?” There is of course no simple answer to this question and the motivation of Ukrainian counterparts is complicated and multifaceted. Motivation is also dynamic and subject to many “undercurrent” events and personalities that remain largely hidden from the eyes of the public and international actors. And while it is not our intention to allocate roles and responsibilities, in this particular case it is extremely useful to reflect on the perceptions and assessments of the process of the dialogue expressed by various Ukrainian and international counterparts who were involved in the matter.

One of the arguments was that the EBRD failed to acknowledge for quite a long time the strength of opinion amongst Ukrainian counterparts about the potential impacts of IFIs on the markets in Ukraine. Many phobias, sometimes objective and sometimes artificially overplayed by certain market operators who oppose potential competition on the market, were known to the EBRD. However no visible attempts were made to neutralise those phobias and to present strong cases with counter-arguments and explanations as to why the negative scenarios are not plausible. According to some Ukrainian counterparts who have been engaged in the process for some time, there was a lack of empathy and understanding of the complexity of the situation which adversely affected the EBRD’s ability to compromise on some elements to achieve “a greater good”. This was a very interesting observation, which could be summed up in the phrase “before selling the solution you need to sell the problem”. Selling the problem in case of the LC2 initiative was not obvious and for a long time Ukrainian counterparts were able to neglect the problem.

There is of course a great role of political will and personality. New NBU management aware of the EBRD’s and other IFIs’ strategies and approaches, the quality of their investments and strict adherence to regulations, had a dramatic impact on the dynamics of policy dialogue. However the change was not immediate and it took a while for the NBU to adopt a resolution that allowed the EBRD and other IFIs to begin operations in local currency.

According to some stakeholders, despite the EBRD’s high quality staff and documentation, the effect of policy dialogue was often limited. A reason might be the “traditional” approach of IFIs to delivering the policy messages – very direct and prescriptive. However this approach might work well in the situation when there is the same level of understanding of the issue on both sides. In reality the culture and interests of Ukraine civil servants tend to be quite different and a direct and prescriptive approach to dialogue will not change the opinion of those opposed to the policy advice.

Some interviewees noted that the EBRD’s (and other IFIs’) policy analyses often do not identify the different interests at play – who was for and who was against. Like in some other policy areas, for the LC2 initiative only one “solution” was presented. At its meetings with NBU management, EBRD staff would present the advantages of letting the EBRD and other IFIs operate in local currency ignoring the disadvantages, despite the fact that EBRD staff always knew there was a strong opposition to the idea from NBU leadership and some market operators. In the future, the EBRD needs to do a better job in addressing the opponent’s views in its documents and in providing counter arguments. An explanation of why the views of opponents are wrong needs to be included in the EBRD's documents because after the meeting, the decision-maker will hear the counter arguments from his staff who will provide specific data and analysis about the damaging effects of the proposed changes. If the EBRD wants to prevail it needs to provide rebuttal to the counter arguments to the decision-maker.

Another observation from multiple counterparts was that the EBRD needs to work more closely with its allies or would-be allies. The EBRD is currently an active member of several important investment and economic advisory bodies for the Government and the President, a member of business associations and observer at sector banking associations. However, it needs to complement this activity with a consistent information campaign to explain its position and views. Indeed, giving publicity to views that are critical of the government's current policy position is problematic for investors who always want a strong relationship with the government. Despite this, it is still possible to do a balanced information campaign outlining the positive and negative factors of decision. This is important in order to gain allies.

The practical elements of the EBRD's engagement in the policy dialogue that could be improved include:

- more evidence-based policy recommendations;
- enhanced synergy from different initiatives;
- thorough technical preparations for high level meetings will ensure higher success;
- to be more active and creative – the EBRD should analyse the performance of its huge portfolio and come up with the ideas as for developing specific sectors. It can create role models that many will learn about and potentially follow;
- more public events or coordination actions with other leading banks and financial sector players with EBRD experts talking to a broader range of actors about specific issues that are meaningful for Ukraine;
- to be more vocal about the issues it believes are important – it should be more active in building coalitions with other international actors working in the country.

3.4 Reviewing, reporting and evaluation

3.4.1 Lack of documentation leading to a fragmented approach

It was acknowledged by EBRD staff that policy dialogue is not a very well documented area, and it is especially evident regarding activities carried out by the Resident Office team. The importance of informal relationships is difficult to overestimate and Resident Office staff members are doing extremely well on this front. In some sectors lack of documentation of dialogue does not cause major negative effects on operations. However in the financial sector and local currency area where so many different teams are engaged in inter-connected issues, poor documentation standards might cause some overlaps and gaps, incoherence of communications with the local counterparts and might potentially damage the EBRD's reputation suggesting that "one hand does not know what the other is doing".

3.4.2 Benefits of cross departmental policy team coordination for learning and use of transactions as examples

Review of the priorities and actions is performed within a strategic timeframe – for both the country strategy and sector strategy. There are also specific initiatives such as the Vienna Initiative and LC2 initiative that have their own timeframe and evaluation mechanisms. As they are led by EBRD policy teams (the Office of the Chief Economist, the Office of the General Counsel, LC2 team and Treasury) and are not directly linked to transactions, there could be some “lost moments” from lack of cross-reading and learning lessons from each other. Supporting high-level international dialogue with practical examples from “live” transactions will add value. Additionally, bankers will benefit from the achievements of high-level dialogue which produces a new piece of legislation or new regulation. Currently there is a certain degree of alienation between bankers and policy specialists. Overcoming this will benefit both groups and the EBRD as a whole.

3.5 Resourcing

3.5.1 Adequacy of resources

Resources for policy dialogue in the financial sector are adequate however additional resources would facilitate more dialogue. The EBRD is using a combination of internal expertise and external consultants, especially when the gap in internal capacity needs to be filled. These two approaches have their own advantages and disadvantages.

3.5.2 Funding of technical cooperation initiatives

In-house staff can provide high quality specialised skills but if a very specific piece of advice is urgently required then external consultants are the best option. Consultants represent a very flexible and high-quality source of expertise. However their availability is very much dependent on the availability of donor funding. It is challenging to acquire technical cooperation funding through the EBRD, and even the Shareholders Special Fund, which was specifically designed to address the problem of shortage of flexible and “quick” donor funding. A better structure would involve dedicated grant funds from shareholders (similar to the Asian Development Bank Fund).

In the opinion of EBRD bankers, the procedures used for approval of technical cooperation operations linked to the investment projects are quite burdensome and duplicate the process of approving investment operations. A better option might be a dedicated pot of technical cooperation funding allocated to each department where the head of department is provided with delegated authority to approve disbursement of the funding.

Potentially the EBRD could strengthen its advocacy role and its way of communicating lessons acquired over years of engagement in a country. The Communications team should be responsible for improving these areas with the help of bankers. In addition to this, some members of Resident Office staff could be trained in public relations and communications to enhance their skills when addressing large audiences on relevant topics.

4. Conclusions

The EBRD is well-positioned to provide strategic advice to Ukrainian authorities on reforms in the financial sector. Its recommendations and advice are based on years of practical experience in the country and in other countries in the region, which can be used as models for specific policy measures (for example the Russian experience in introducing the LC2 initiative). This close link with operational experience and extensive knowledge of the local market and trends of its development are the EBRD’s unique selling points acknowledged by Ukrainian counterparts.

After 2008, policy dialogue with Ukrainian authorities became more structured and oriented towards specific goals. With bank-wide strategies (for the financial sector), initiatives (such as the LC2 initiative) and international fora (such as Vienna), and clear country priorities (Ukraine Country Strategy 2011 to 2014), the EBRD has a full range of instruments for engagement to achieve positive results.

Some aspects of the policy dialogue however indicate that the process has not been that smooth and that outcomes are difficult to achieve due to a great resistance from local counterparts (in public or private sectors). The lessons from the EBRD's eight years of negotiations of on the LC2 initiative in Ukraine are important and should be integrated in future initiatives. Apart from some factors outside the EBRD's influence (for example changes of to personnel within key counterparts) there are elements that could be changed.

1.1.1. Joined up approach with like-minded organisations

First of all there is a need for a more joined-up approach with other like-minded organisations. Experience of "parallel" dialogue performed by the IFC and the EBRD with Ukrainian authorities on gaining permission for UAH operations was recognised by both parties as unfortunate and causing many delays and complications to both. In Ukraine, it is especially true that when IFIs join forces and speak with one voice, Ukrainian authorities are more inclined to negotiate and compromise.

1.1.2. Improving the approach through greater engagement and flexibility

Secondly it is the approach to the dialogue that is important. Despite having high-class expertise in-house and availability of experienced and skilled consultants the EBRD failed to formulate its proposals in a more engaging way – a way in which Ukrainian counterparts are offered options but not ultimatums, and where thorough analytical work is being done on addressing counter-arguments presented by opponents of the LC2 initiative. Ability to prepare for the meeting and engage with mid-level specialists and high-ranked officials are equally important. Some other cases of policy dialogue (such as in the sphere of Budget Code changes for allowing municipal guarantee lending) demonstrated that a more flexible approach and demonstration of empathy work better in convincing Ukrainian counterparts of the necessity of reforms and in achieving the desired outcome, even with some compromises.

There also should be no automatic assumptions that Ukrainian counterparts have equal level of knowledge and understanding of the issue that the EBRD or other IFIs believe should be addressed. Creating equal access to information and knowledge should be one of the elements of the dialogue – common vision of the solution could not be achieved without common vision of the problem.

1.1.3. Coordinating actions with other IFIs

To co-ordinate actions with other IFIs and donors is an essential part of the policy dialogue in the financial sector and for the LC2 initiative due to their global nature and the level of complexity of Ukrainian problems. It was traditionally good even though some tensions started to emerge in the recent years when the EBRD left its "comfort zone" of transaction-led dialogue and entered the field of more systemic actions in the area of legislation and regulations. Tensions could be localised and supressed through careful planning and identification of "niches" to perform effective "proactive" policy dialogue that is the most relevant to EBRD experience and expertise and that logically complements efforts of other IFIs, especially the IMF and the World Bank.

1.1.4. Interdepartmental coordination and divergent approaches

Banking teams

A rift that exists between banking and "policy" teams of the EBRD is more evident in financial sector policy dialogue than in others. Bankers are protagonists of transaction-based dialogue that addresses concrete challenges facing current and potential clients. They believe the EBRD creates the greatest value and impact through this type of dialogue. Good progress in intra-team co-ordination of policy dialogue is being made in Banking through the development of a part-time position of policy co-ordinator that serves as a focal point for all information related to technical cooperation funding and policy dialogue in the EBRD Financial Institutions team across all countries of operation. This coordinator also engages in cross-team sharing of information and lessons and develops communication campaigns.

Non-banking teams

On the other hand the Office of the Chief Economist, Treasury, the Office of the General Counsel and the LC2 team are engaging (mostly directly with some support from Resident Office bankers) with the NBU, Government agencies and parliament in forward-looking "proactive" dialogue. This type of dialogue strives to attain legal and regulatory changes of a more systemic nature that will potentially make financial markets more competitive, sustainable and mature. These policy actors are more distant from Bank's transactions and sometimes lack knowledge of the situation on the ground, which brings up irritation and protests by bankers.

Benefits of both sides working together

However uncomfortable current relations between bankers and policy teams might look (and this study does not pretend to know the totality of relationships as we were looking at single country experience – picture in a more panoramic perspective might look more positive), effort should be made to bring those two parts of the institution closer to each other in order to increase the synergy effect of the various initiatives. There is an almost unanimous impression of the stakeholders in the country that the EBRD's engagement in policy dialogue in the financial sector over the last decade has not really changed. This is the result of the "hidden" "proactive" policy dialogue that is not transformed into daily policy dialogue performed by EBRD Financial Institutions team in the country.

Dramatic improvements in the LC2 sphere of policy dialogue in Ukraine since June 2013, will clearly create a better environment for "merging" the two wings of the policy dialogue. To take it further however and to enable some practical improvements that are listed above, the EBRD teams working in the sector should learn how to work in close co-operation and share information that is mutually useful. Some positive changes are already happening thanks to a former Ukraine Director became head of the LC2 team. He was directly involved in protracted and challenging negotiations with Ukrainian authorities with regard to the LC2 initiative (among other issues). Consistency of teams helping in developing and implementing legal changes was mentioned by many stakeholders as a significant advantage that delivers better results.

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Annex 1

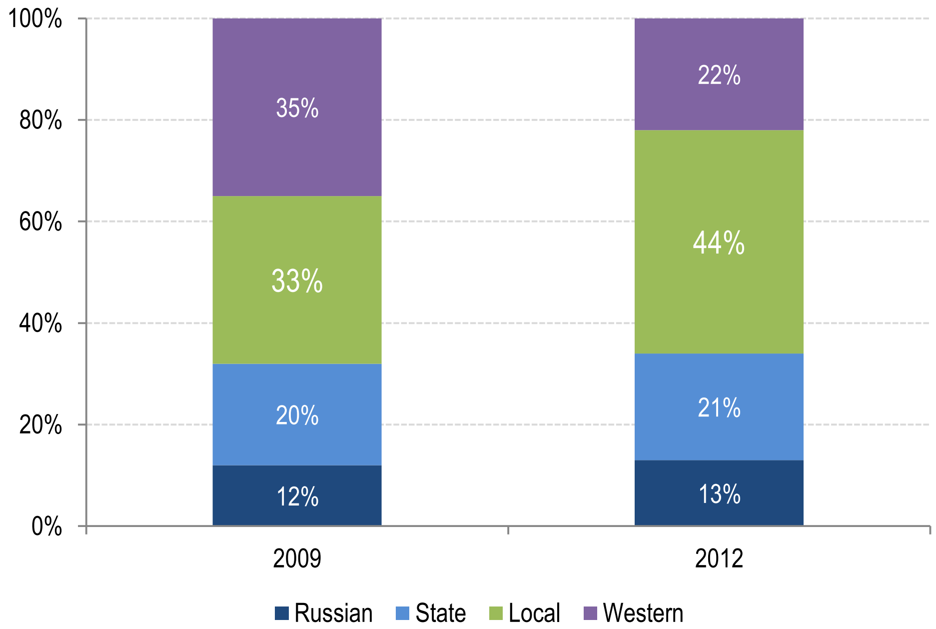
2. Key characteristics of Ukraine's banking sector

2.1. Structure

The banking system in Ukraine is two-tiered, consisting of the NBU and commercial banks. The NBU ensures the stability of the hryvnia, supervises the banking system and issues current banking regulations. It also supervises the operations of commercial banks. [18]

The banking sector expanded rapidly following the entry of a number of international banking groups on the Ukrainian market in 2004. The Ukrainian banking sector currently comprises 176 banks and the percentage of total banking assets to GDP was 80 per cent in 2012. [19] The five largest banks account for less than 37 per cent of total assets showing a relatively competitive banking sector . Twoof the top five banks are state-owned and account for 18 per cent of the market. [20] In 2012, foreign banks held 35 per cent of total assets.

Figure 3: Market shares (% of total assets)



The main challenges of the banking sector in Ukraine are consolidating the banking system, decreasing share of deposits and loans denominated in or indexed to foreign currency and improving the judicial framework.

18 Section based on EBRD-OCE Assessment of Transition Challenges 2013
19 Figures for 2010-2011 from Assessment of Transition Challenges 2013
20 The state-owned Export-Import Bank (Ukreximbank) and a specialized commercial Savings Bank (Oshchadny Bank)

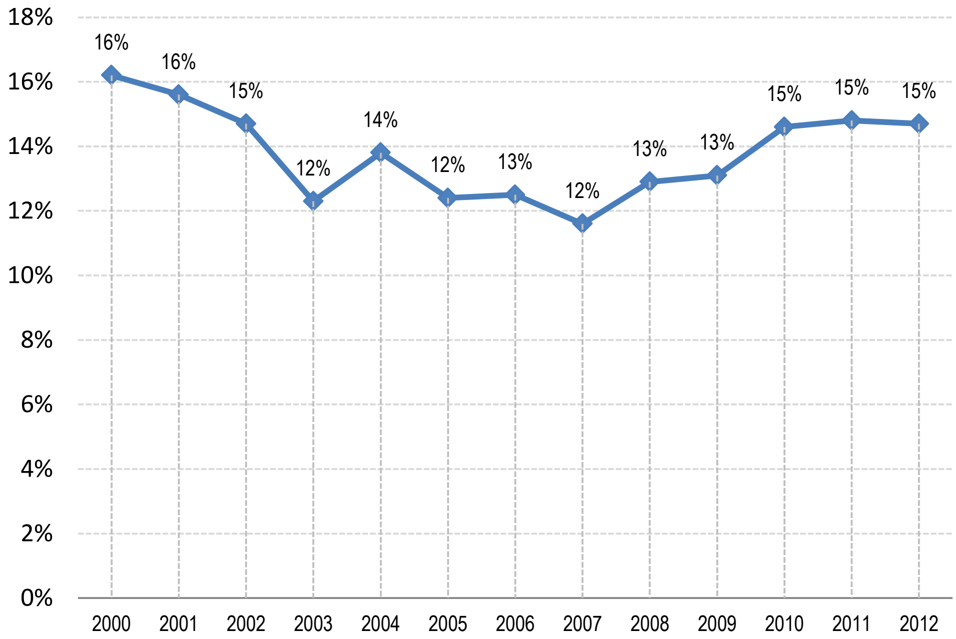
2.2. Key indicators

Table 1: Three main financial sector indicators 2010 to 2012

Indicators	2010	2012
Total Deposits (% GDP)	39.7	38.5
Total Deposits in FX (% total deposits)	42.9	44.8
Loans/Deposits (% GDP)	170	136

The Bank capital to assets ratio helps determine whether a company/banking sector has enough capital to support its assets. [21] During the period from 2000 to 2012 the ratio of the overall banking sector in Ukraine has kept on average a comfortable 14 per cent.

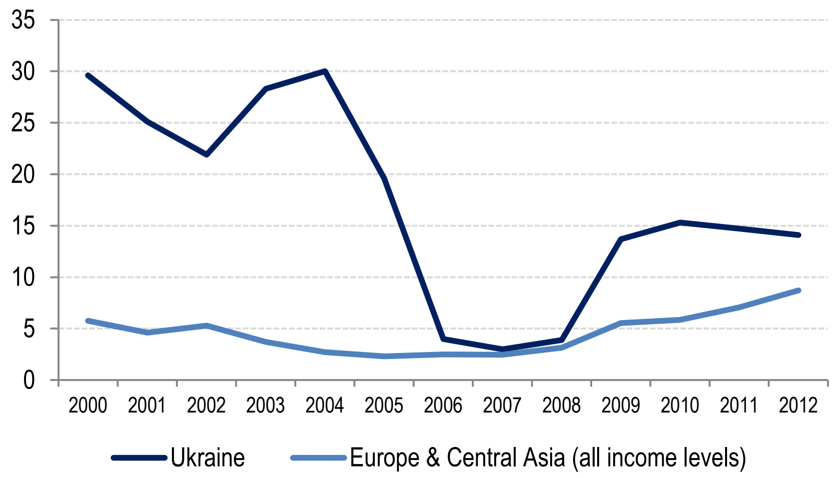
Figure 4: Bank capital to assets ratio (%)



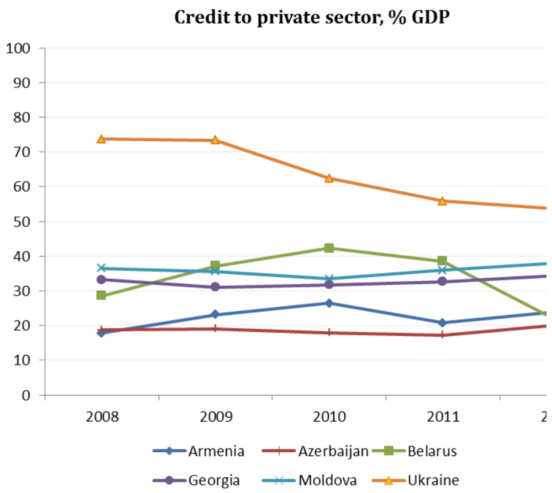
During the from period 2002 to 2006, the share of non-performing loans to total loans decreased considerably from 30 per cent to 2.45 per cent, reaching the average of Europe and Central Asia. The crisis and the economic slowdown raised the share of non-performing loans s to around 15 per cent in 2012.

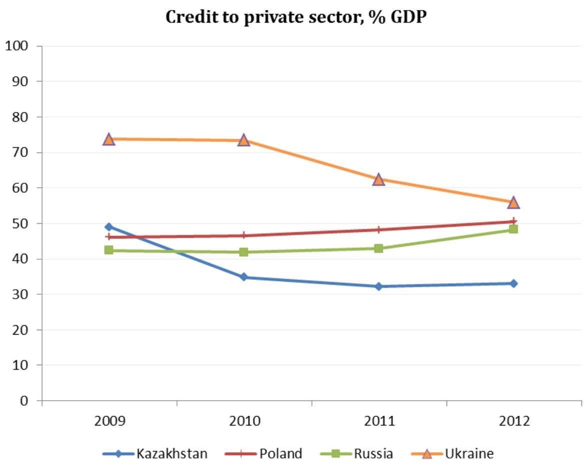
21 World Bank data - Capital and reserves include funds contributed by owners, retained earnings, general and special reserves, provisions, and valuation adjustments. Capital includes tier 1 capital (paid-up shares and common stock), which is a common feature in all countries' banking systems, and total regulatory capital, which includes several specified types of subordinated debt instruments that need not be repaid if the funds are required to maintain minimum capital levels (these comprise tier 2 and tier 3 capital). Total assets include all nonfinancial and financial assets.

Figure 5: Bank non-performing loans to total gross loans (%)



The graphs below show the trend in private sector credit to GDP for Ukraine and eight comparative countries (Eastern Partner countries and Kazakhstan, Poland and Russia). [22] In Ukraine, private credit to GDP reached 52 per cent as of the end of 2012.



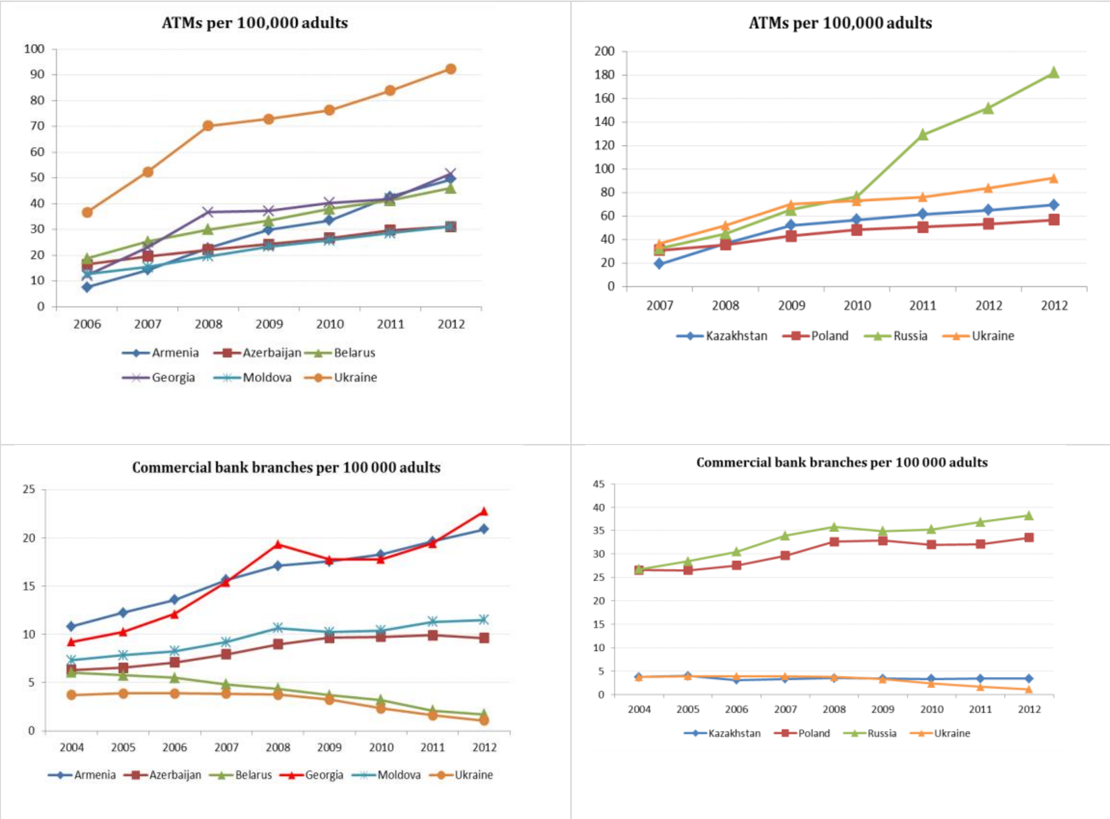


2.3. Outreach

The number of ATMs per 100,000 adults[23] and the number of commercial bank branches per 100,000 adults[24] are two indicators of the geographical outreach of formal financial services. The data highlights a large increase in the number of ATMs during 2006 to 2012 indicating that access to commercial bank services has deepened. In Ukraine, the number of ATMs has increased considerably compared to other eastern partner countries but less rapidly than in Russia.

22 Transition report 2011 & 2012
23 World Bank data - Calculated as: (number of ATMs)*100,000/adult population in the reporting country
24 World Bank data - Calculated as: (number of commercial banks + number of commercial bank branches)*100,000/adult population in the reporting country

In 2006, there were four bank branches and 37 ATMs per 100,000 adults in Ukraine. In 2012, there was one bank branch per 100,000 adults while there were 92 ATMs per 100,000 adults. Due to the crisis, the number of bank branches per 100,000 adults has decreased, especially since 2008. This figure has never been particularly high in Ukraine, which reveals a lack of penetration of banking services.

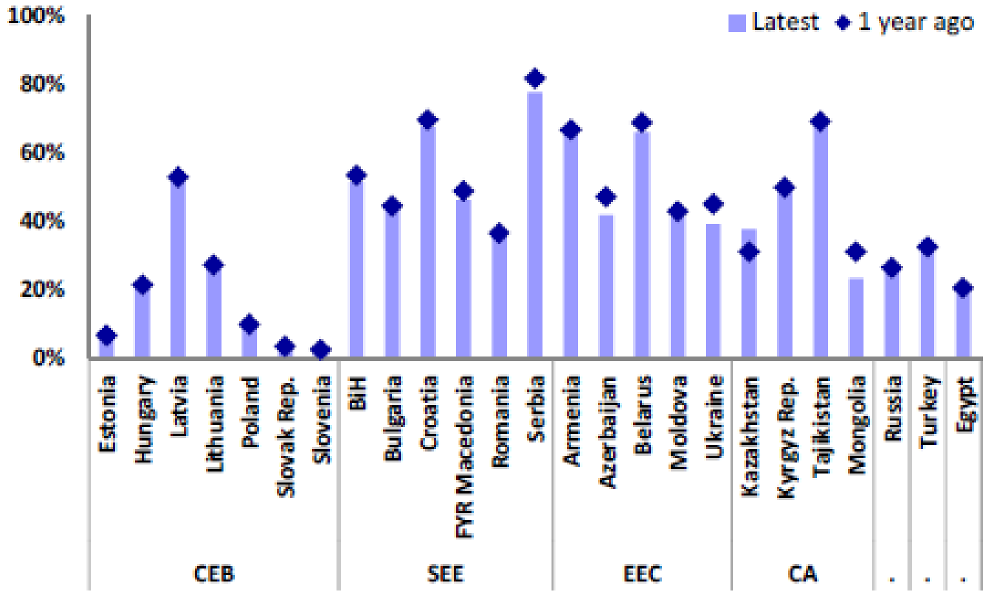


2.4. Level of dollarisation of Ukrainian financial system

Since the 1998 financial crisis, the hryvnia has been effectively pegged to the US dollar. This is not a unique case as numerous emerging markets use dollar pegs to fix exchange rates. However, in the case of Ukraine, the dropping value of the US dollar has had a direct negative impact on Ukraine's external competitiveness because Europe is a more important trading partner to Ukraine than the United States. As a result, a stronger euro could have two possible negative effects for Ukraine, namely inflationary pressures and negative impacts on savings which are often held in dollars. The weakening of the US dollar could lead to a switch from dollar prices to euro prices, which would have an adverse impact on consumers' purchasing power. However, it seems that the NBU will not be able to continue to peg the hryvnia to the US dollar indefinitely and the authorities will have to face difficult choices with regards to monetary policy.

The percentage of foreign bank deposits to total bank deposits is a frequent measure of dollarization of a country. This figure for the EBRD's countries of operations is shown in the graph below:

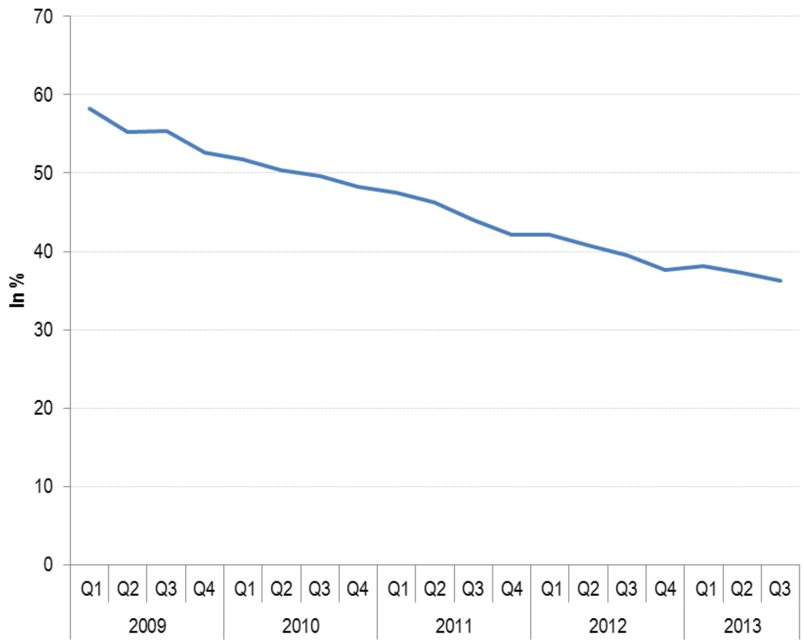
Figure 6: Foreign deposits to total deposits ration (per cent)



Source: Regional Economic Prospects in Countries of Operations: January 2014, EBRD Office of the Chief Economist (National Authorities via CEIC data services)

In Ukraine, foreign currency has been used extensively for the purpose of making commercial loans as illustrated by the graph below. The ratio of foreign currency denominated loans to total loans has considerably decreased since 2009 but amounted to 36.3 per cent in the third quarter of 2013.

Figure 7: Foreign-Currency-Denominated Loans to Total Loans



Source: IMF Data Warehouse

Annex 2

1. Detailed timeline

		Context	Ukraine actors	EBRD actors	Other actors	Inputs and Actions	Outputs	Outcomes
2008	November	The global financial crisis reached its peak which forced global leaders and institutions to discuss the options for cushioning the negative effect on national and global economies. A range of decisions were taken by IFIs and international organisations to provide "crisis packages" to the most affected market operators. This was complemented by national rescue packages and measures aimed at reducing the exposure to the crisis, including nationalisation or partial nationalisation of the banks.		The EBRD's Board, President - **decision makers**		The EBRD took the decision to allocate an additional €1 billion in 2009 budget to help countries of operations to cope with the crisis. Half of that money was spent in seven new EU member states which were scheduled for graduation in 2010. A further €1 billion was allocated in late 2009. Ukraine and Russia were among largest recipients of funds.	A number of projects and financial packages were offered to countries of operations to strengthen the local financial system and provide resources for supporting the banking system and avoiding defaults created by a bank run. Resources were allocated to existing projects to substitute the deficit of resources from other sources.	The EBRD became one of the core international players that provided resources and advice to governments in its countries of operation on managing the crisis consequences in the national context and the ways for engaging in international and regional initiatives that could help to reduce deleveraging and risks of systemic failures in financial and fiscal systems. The depth and breadth of discussions with member countries and other IFIs led to creation of more sustainable platforms for co-ordinating efforts in preventing deep negative consequences of crisis in the EBRD's regions of operations.

		Context	Ukraine actors	EBRD actors	Other actors	Inputs and Actions	Outputs	Outcomes
2009		The global financial crisis forced banks to reconsider their strategies and to reduce exposure in emerging markets in order to reduce the risks of further losses. Central and eastern European countries suffered heavily from uncontrolled and unco-ordinated deleveraging. Defaults in those regions' subsidiaries caused parent banks to withdraw and conflicts started to emerge between home and host country central banks. There was no platform for discussing the challenges and co-ordinating efforts in order to minimise the risks for both eurozone and non-eurozone markets.		The EBRD's Board, Treasury and Office of the Chief Economist - **decision maker (money allocation), influencer, advocate and adviser**	The World Bank, IMF, EU, European Investment Bank, Austrian Government, central banks and commercial banks from Western and central and eastern European countries - **decision makers and influencers**	The European Bank Coordination Vienna Initiative was launched as a framework for safeguarding the financial stability in central and eastern Europe at the height of the global economic crisis. It is a private-public sector platform, which brings together key IFIs, the European Commission and relevant EU institutions, the principal cross-border banking groups, and home and host country authorities, complementing other initiatives.	A systemic regional crisis was avoided as parent banks from western Europe have continued to support their systemically important subsidiaries in central and eastern Europe and viable local banks have managed to stay in business. A joint IFI Action Plan in support of banking systems and lending to the real economy in central and eastern Europe was launched by the EBRD jointly with the European Investment Bank and World Bank in February 2009 along the Vienna Initiative. €33 billion were provided for crisis-related support for financial sectors in the region.	The Vienna Initiative became an important forum for private and public partners active in the banking sphere of Europe and beyond. Through various mechanisms - institutional and financial - it mobilised resources necessary for addressing significant challenges of financial and banking systems, contributing to overall macroeconomic stability. From a one-off reactive platform the Vienna Initiative became a systemic mechanism that is contributing to resolving continuous challenges in the financial and banking sectors of the region.
2010	**March**	Lack of clear understanding among Ukrainian stakeholders of the advantages of strengthening local currency markets and the positive role IFIs could play in their development.		Treasury and the Office of the General Counsel departments - **experts and interested party**		The EBRD organised a seminar in Kiev "Resumption of lending to the real economy through the development of a Hryvnia financing market".	As a follow up to the seminar, the Bank forwarded legal and regulatory changes (including to the Securities Market Law) to the authorities that are imperative to the EBRD's ability to borrow and lend in UAH.	Raising awareness of the challenges and opportunities of hryvnia lending in Ukraine and the potential it has for the financial sector and national economy in general. The role of IFIs could be critical as their risks are different from those of commercial banks and they can kick-start the process.

		Context	Ukraine actors	EBRD actors	Other actors	Inputs and Actions	Outputs	Outcomes
	May	Excessive use of foreign currency in some countries of operations became especially apparent during 2008 global financial crisis. Some countries, including Ukraine, Hungary and the Baltic countries suffered from over-reliance of its banking system on foreign currency.		The EBRD's Board - **decision maker**		The EBRD launched the Local Currency and Capital Markets Initiative (LC2 initiative) aimed at reducing the excessive reliance on foreign capital and use of foreign currency borrowings in some countries of operations.	The LC2 initiative strives to achieve (1) local currency funding operations and technical cooperation to develop domestic market infrastructure; (2) local currency funding, lending, debt and equity investments to strengthen local investor base (particularly pension funds and insurance companies); (3) structural reforms as a result of policy dialogue together with other IFIs.	Through promoting use of local currency in Ukraine and other countries of operations the EBRD is contributing to development of the local money and stock market, supports transition to more mature stages of the financial system where non-banking financial actors are becoming more prominent. It also increases supply of "long" money in local currency which is in huge deficit in the post-2008 world in the central, eastern and south eastern European and in Ukraine in particular.
	October	In the aftermath of the crisis the EBRD required a new strategic approach to activities in the financial institutions sector, which would effectively combine investments, TC and policy dialogue in order to achieve positive outcomes in the reform of financial sector in the countries of Bank's operations.		The EBRD's Board - decision maker, the EBRD's EBRD Financial Institutions team and Office of the Chief Economist - **adviser**		The EBRD's Board approved the Financial Sector Strategy "Dealing with the Legacy of the Crisis and Supporting the Development of Sustainable Financing of the Real Economy in EBRD Countries of Operations".	The Bank identified five priorities in the sector that should guide its investment activities, technical cooperation and policy dialogue. These priorities include: (1) complete the crisis response activities and stimulate lending to the real economy; (2) help develop local capital markets and both funding and lending in local currency; (3) promote better governance, sustainable business models and improved risk management of banks and non-bank institutions; (4) support consolidation, privatisation and re-privatisation of the banking sector; (5) support development of new regulatory frameworks in close coordination with other IFIs, including in the area of cross-border regulation.	The Bank's Strategic Framework for the Financial Sector is based on the realities of global markets, and takes into account the new strategic priorities of the EBRD in the aftermath of crisis and new strategic initiatives (Vienna and the LC2 initiative) improves streamlining of the efforts and concentration of resources in the areas that could bring the maximum transition effect and support stability of financial systems - national, international and global.

		Context	Ukraine actors	EBRD actors	Other actors	Inputs and Actions	Outputs	Outcomes
2011	**March**	Comprehensive evidence base for identifying the real needs of the Ukrainian local currency market is lacking. There is a need for systemic assessment, understanding the roles and positions of Ukrainian authorities and other IFIs active in the sector.		The Office of the Chief Economist, Treasury - **experts and interested party**	The IMF, IFC, World Bank - **experts and intereste d party**	The EBRD mission to Kiev (jointly with the International Monetary Fund, World Bank and IFC) took place from the 16th to the 18th March to discuss with Ukrainian authorities and market operators the situation on Ukraine's financial markets and how it could be improved. A range of recommendations were proposed in Initial Needs Assessment Report. "Ukraine. EBRD Local Currency and Local Capital Markets Initiative" was released in June 2011.	The EBRD identified a list of six main areas that require changes and improvement in order to create beneficiary conditions for positive dynamics of developments on Ukrainian financial markets (the list is not exhaustive). These areas are: (1) strengthening macroeconomic stability and monetary policy; (2) foreign exchange market liberalisation; (3) money market development; (4) strengthen the liability base of the banking sector; (5) promote the reduction of non-performing loans to help restore lending; (6) improve sustainability of the pension system.	Needs Assessment Report outlined the potential areas for further policy dialogue with regard to developing local financial markets. It provided a basis for more substantial and intensive policy dialogue between EBRD and Ukrainian authorities as for unlocking the potential of local currency investment operations by IFIs and local capital markets development in line with the needs of the economic system of the country and in congruence with the global trends and regulations.

		Context	Ukraine actors	EBRD actors	Other actors	Inputs and Actions	Outputs	Outcomes
2012	January	The central eastern and south eastern European countries are important hosts to foreign banks headquartered predominantly in western Europe. The ongoing eurozone crisis has highlighted the risk of disorderly deleveraging of western parent banks vis-à-vis their affiliates in the regions and difficulties in cooperation between home and host country authorities. Further dialogue was required between central banks, commercial banks, IFIs working in the region and the EU.	NBU, MEDT - **interested parties**	The EBRD's Board, Treasury and Office of the Chief Economist - **decision maker (money allocation), influencer, advocate and adviser**	The World Bank, IMF, EU, European Investment Bank, Austrian Government, central banks and commercial banks from Western and central and eastern European countries **- decision makers and influencers**	The Vienna 2 initiative is launched. Through coordinated action by home and host-country regulators and supervisors and the banks themselves it will strive to achieve its key objectives: (1) avoid disorderly deleveraging; (2) ensure that potential cross-border financial stability issues are resolved; (3) achieve policy actions, notably in the supervisory area that are taken in the best joint interest of home and host countries. Ukraine joined Vienna 2 as a member.	Vienna 2 is crucial for monitoring of, and reporting on, the deleveraging process. Setting up temporary structures where private and public sector decision makers meet to exchange experience and discuss appropriate actions, use of peer pressure to help resolve common problems. Drawing practical conclusions from the experience of the host countries and proposing action on those conclusions. Discussions of macro-prudential issues.	Having established public-private forum with the representatives of all key regulatory agencies and big banks with exposure in central, eastern and south eastern Europe adds value to the EBRD initiatives in the sector, and to initiatives by other IFIs and EU. It created additional channel of communication, co-ordination and developing solutions that are acceptable for both "recipient" and "donor" countries that face various challenges (sometimes similar and sometimes different). Ukraine's becoming a member of Vienna 2 had positive impact on the dynamics of relationships between the EBRD, NBU and other authorities and facilitates progress in some key areas of policy dialogue.
	May	The legal base to enable IFIs to perform UAH operations is absent.	Parliament of Ukraine - **decision maker**			Parliament approved in first reading amendments to the Law on Securities Market that would enable IFIs to issue hryvnia bonds. The draft changes include requirements that issuance volumes and interest levels are to be approved by the Cabinet of	Amended legislation that ensures progressive development of Ukraine's securities market.	Amendments should enable further development of local capital markets in Ukraine.

						Ministers and bond proceeds are to be used exclusively for the crediting of Ukraine's real economy or long-term development projects.		
	May	Lack of resources for some expert and technical advice that is needed for Ukrainian authorities to learn about best international practices and their relevance to the Ukrainian environment.	MEDT, State Commission on Securities and Stock Market - **beneficiaries**	The EBRD's Technical Cooperation Committee - decision maker, Legal Transition team and Treasury - **interested party and expert**	The IFC, World Bank, IMF - **decision makers and interested party**	A technical cooperation project "Ukraine Legal Framework for Derivatives Transactions" with the budget of €250,640 approved. Its objective is to assist the working group of Ukrainian authorities in preparing legal provisions which will introduce a number of amendments and additions to existing legislation, thereby providing for validity and enforceability of derivative transactions in Ukraine. The EBRD closely co-ordinates this activity with the IFC, World Bank and IMF though there were some disagreements on the draft law itself which caused diversion in opinions between the EBRD and IMF	Draft legislation was prepared and passed the first stage of internal consultations in the government, parliament and NBU. It was published on MEDT website in June 2013 for public consultations.	Gathering different Ukrainian authorities around the table to agree the key principles of the draft derivatives law was important step for gaining single position which at the end should ensure the approval and implementation of the legislation.
	September	New strict requirements for banks imposed by Basel III and stress tests by EBU are influencing the strategies of engagement of western European banks in central, eastern and south	NBU, MEDT - **interested party and decision maker**	Treasury, EBRD's Office of the Chief Economist, Office of the General Counsel - **decision makers and interested party**	IMF, WB, EIB, EU, central banks, regulators and commercial banks from across central, eastern and south eastern Europe - **decision makers and interested parties**	Ukraine joins Vienna Initiative 2 meeting for the first time after being recognised as important partner in the discussion.	Ukraine joined a number of working groups, including non-performing loans.	Additional channel of communications with Ukrainian authorities has been opened. Their ability to take part in regular meetings of the forum that aims at co-ordinating actions of public and private players in the banking sector of central, eastern and south eastern Europe is very beneficial for exchange of experience, developing models relevant to

		eastern Europe. Measures to mitigate the deleveraging and exit of some significant banks are needed for preventing large-scale financial crisis in "recipient" countries.						Ukrainian context but with integrated best practices. Agreeing positions with other central banks and regulators is important for ensuring the stability of Ukraine's banking sector.
	December	New LC2 team was first assembled in 2011 and specialist Department created in November 2012.		The EBRD's Board - **decision maker**		Andre Kuusvek, Ukraine Country Director, is appointed as Director of newly created the LC2 team within finance unit at the EBRD. He continued to execute the role of Ukraine Director till April 2013 when a new Director was appointed.	Andre Kuusvek has exceptionally deep knowledge of the Ukrainian context, extensive experience of conducting business in the country and wide network of contacts. His new LC2 role at the EBRD is exceptional for Ukraine as provides a sort of "personal bridge" that will be a strong asset for future negotiations with the Ukrainian counterparts and co-ordination of efforts with colleagues in the EBRD Financial Institutions team and others, other IFIs and private banks in Ukraine.	Greater understanding of the local context and a long track-record of engagement with Ukrainian authorities on the issues of local currency lending and bond issuance will enable the LC2 team to be more effective in the policy dialogue which after adoption of framework legislation and regulations in summer 2013 should concentrate on implementation and design of new financial facilities in UAH, and advice on further reforms of financial markets for enabling more operations in local currency.

		Context	Ukraine actors	EBRD actors	Other actors	Inputs and Actions	Outputs	Outcomes
2013	February	Lack of political will on the highest level prohibits many reforms in Ukraine, including in the financial sector.	Ukrainian President Yanukovych - decision maker, NBU, MFU and other agencies - **interested parties, decision makers**	EBRD President - **decision maker**		The EBRD's President Suma Chakrabarty visited Kiev to meet with President Victor Yanukovych, Prime Minister Mykola Azarov and other high-level officials. The LC2 initiative was among the core issues discussed during the meetings.	President Yanukovych officially requested NBU to prepare necessary changes to legislation and regulations that would enable the EBRD's lending in UAH.	Political will of Ukraine's top leadership was crucial in resolving the long-standing issue of the inability of the EBRD and other IFIs to operate in local currency market of Ukraine. This will have positive long-term effects on the markets and will increase supply of long- and mid-term lending resources to Ukrainian businesses and public companies that are keen to co-operate with IFIs but have unhedged risks.
	March	Lack of an agreed position of Ukrainian authorities on the draft derivatives legislation has been an issue for many years which precludes its finalisation and approval.	Minister of Economic Development and Trade Prasolov - decision maker, NBU, Securities Commission - **interested parties**	The EBRD's Legal Transition Team and Treasury - **experts**	Consultants from law firms - **experts and advisers**	The Ministry of Economic Development and Trade created a working group for preparing the final legislation on derivatives. First Deputy Minister Anatoliy Maksiuta appointed as Chair.	Three main agencies - NBU, MEDT and Commission on Securities and Stock Markets - are brought together to develop a unified position on the directions of development of derivatives market in Ukraine. Draft legislation prepared by the EBRD (not by the IMF) was approved as a basis for final document.	The EBRD strengthened its position in the dialogue through engaging with all interested parties, facilitating the process of agreeing the position and reaching final legislation that is realistic and has higher chances of being approved and implemented.
	June	Ukrainian legislation does not allow IFIs to issue bonds in local currency which substantially limits their ability to lend to large groups of clients who are not hedged against foreign	Ukraine parliament **- decision maker**, National Securities and Stock Market Commission - **decision maker**			Ukraine parliament approves changes to the Securities Market Law, which enables IFIs to issues local bonds.	Amendments to the law open the road for IFIs to operate on the securities market with local currency bonds. To launch this in practice IFIs require secondary legislation to be finalised by the National Securities and Stock Market Commission and approved by the Cabinet of Ministers.	Parliament's decision has an immense and very positive impact on IFIs operating in Ukraine. From now on they can diversify their portfolio and expand the base of clients by engaging those whose activities are predominantly domestic and who are unhedged against foreign exchange risks. After operational barriers are removed (when secondary legislation is enacted) many clients in the private and public sector, especially in municipal utilities sector, energy efficiency, agribusiness, will be able to benefit

		exchange risks due to nature of their activities.						from new products and services offered by the EBRD and other IFIs.
	July	The EBRD had no right to have bank accounts in local currency as NBU was cautious about its potential to tip the balance on the fragile market of local currency where NBU remains to be a monopolist.	NBU - **decision maker**			After eight years of intensive negotiations NBU finally made amendments to its instructions with regard to ability of IFIs to open accounts in UAH and perform financial operations in local currency. Other IFIs are benefiting from it as well (though the IFC's situation is less clear as there is a separate instruction allowing it to operate in local currency albeit with substantial barriers that precluded the IFC from UAH lending so far).	The EBRD will be able to open accounts in local currency (UAH) and perform investment operations without higher risks associated with exchange rates.	This change will have long-term effect on the nature of the EBRD's operations in Ukraine. As experience from other countries shows, a substantial growth in local currency operations will have a beneficial effect on the national economy and financial markets, though it is just one of a number of more fundamental reforms aimed at improving the investment climate in the country.