CORPORATE GOVERNANCE REGULATION IN BANKS IN THE CONTEXT OF CRISIS: THE ROLE OF THE NATIONAL BANK OF UKRAINE

Yaroslav Mozghovyi*, Kateryna Kondrunina**, Iuliia Ratnykova, Daria D. Skidan*******

Abstract

This paper gives an overview of corporate governance and banking regulation in Ukrainian banks. Particular attention is paid to the regulatory changes by the National Bank of Ukraine which were made in response to the financial crisis. The paper focuses mainly on the regulation influencing the payment schemes and the size of the regulatory capital as the elements of corporate governance system. The research suggests that some documents issued by the National Bank of Ukraine have a contradictory affect on banks' sustainability and might provoke the conflict of interests within the structure of corporate governance.

Keywords: Corporate Governance, Basel, Crisis, Regulation, Banks

** PhD candidate, Department of International Economics, Banking Academy of the National Bank of Ukraine, member of the International Research Center for Banking and Corporate Governance*
Email: mozghovyi@gmail.com
*** Master's student, member of the International Research Center of Banking and Corporate Governance, Banking Academy of the National Bank of Ukraine*
Email: kateryna.kondrunina@gmail.com
**** Master's student, member of the International Research Center of Banking and Corporate Governance, Banking Academy of the National Bank of Ukraine*
Email: ratnykova.iuliia@gmail.com
***** Master's student, member of the International Research Center for Banking and Corporate Governance, Ukrainian academy of Banking of the National Bank of Ukraine*
Email: dariaskidan@gmail.com

1. Introduction

Banks play a significant role in promoting economic development of a country. They fulfill a very important task by matching borrowers and lenders. Banks act as intermediaries when they mobilize savings from surplus units (savers) to shortage units (borrowers) in order to finance productive activities. In the economic system only banks take deposits and grant loans.

Banks are not self-regulated institutions. Each single bank is ruled by corporate governance. Given the importance of banks, the governance of them itself assumes a central role. If bank managers face sound governance mechanisms, they will be more likely to allocate capital efficiently and exert effective corporate governance over the firms they fund. In contrast, if banks managers enjoy enormous discretion to act in their own interests rather than in the interests of shareholders and debtholders, then banks will be correspondingly less likely to allocate society's savings efficiently and exert sound governance over firms. Clearly then, skilled corporate governance is a key factor to bank's success.

Banking system in whole is regulated by Central Bank (National Bank of Ukraine - NBU) which fixes certain requirements, restrictions and guidelines. Because of the importance of banks in the economy, because of the opacity of bank assets and activities, and because banks are a ready source of fiscal revenue, government imposes an elaborate array of regulations on banks. This is especially true in the context of crisis, when the necessity for drastic measures increases tenfold. Crucial problems of banking system arose on the basis of poor liquidity, insufficient capital (both authorized and regulatory), problem assets, bad debts and others. In order to mitigate the effects of crisis in banking sector, several statements were issued by the government. In banks that suffered most temporary administration was introduced. However, taking into account the fact that temporary administration phenomena is widely examined already, the authors concentrated on the statement on improving liquidity of banks at a loss (№421, from 22.07.2009) and statement on enlarging the regulatory capital of banks (№273, from 09.06.2010).

The article focuses on research and assessment of regulation of corporate governance in banks by the NBU during crisis. The main aim is to estimate the timeliness and appropriateness of statements issued on the corporate governance of Ukrainian banks.

2. Literature review

The issue of CG in banks and the aspect of its regulation were examined by several authors as the topic is turning into practical question for the countries due to the globalization processes and liberalization of financial markets.

Corporate governance of banks is largely concerned with reducing the social costs of bank risk-taking and that the regulator is uniquely positioned to balance the relevant stakeholder interests in devising governance standards for financial institutions that achieve economic development objectives, while minimizing the externalities of systemic risk (Kern A., 2006).

Governance in the banking sector is achieved through a set of legal, accounting, financial, and economic rules and regulations. These rules and regulations direct the management, govern performance, and assist in carrying out the responsibilities of the sector (Mahmoud Abul Ayoun, 2003).

Central banks as the main regulators of the banking sector play an important role in defining and reinforcing the principles of good governance in banks.

For example, State Bank of Pakistan (SPB) has been on the forefront in promoting good corporate governance in the country. SBP has implemented a comprehensive corporate governance regime for banks, which is driven by a robust legal and regulatory framework, risk-based supervision and over-arching banking sector reforms, notably, privatization, liberalization and consolidation of banks (Shamshad Akhtar, 2008).

Luc Laeven & Ross Levine (2008) conduct the first empirical assessment of theories concerning risk taking by banks, their ownership structures, and national bank regulations. They show that the relation between bank risk and capital regulations, deposit insurance policies, and restrictions on bank activities depends critically on each bank's ownership structure, such that the actual sign of the marginal effect of regulation on risk varies with ownership concentration.

Peter O. Mülbert (2010) states that poor corporate governance of banks has increasingly been acknowledged as an important cause of the recent financial crisis. Whereas banking regulation/supervision acts as a functional substitute for debt governance, equity governance benefits less from such regulation/intervention. Put succinctly, shareholder interests and supervisors' interests do not run exactly parallel, not even from a long-term perspective.

T.G. Arun and J. D. Turner (2004) contributed into the examination of corporate governance of banks in developing economies: Based on a theoretical discussion of the issue, authors suggest that banking reforms can only be fully implemented once a prudential regulatory system is in place.

The role of financial regulation in influencing the development of corporate governance principles has become an important policy issue, however concerning the crisis period it has received little attention in the literature, especially in Ukrainian environment.

3. Methodology

The data collection covers the wide scope of information concerning corporate governance regulation in banks with the particular attention paid to the National Bank of Ukraine as the main regulator of the Ukrainian banking environment. The relevant legislation analyzed within the framework of banking corporate governance regulation is as follows: Law of Ukraine on Companies (or: Law of Ukraine on Business Associations), No. 1576-XII, 1991 (with amendments through 1995), Law of Ukraine On Securities and Stock Market, 2006, Ukrainian Corporate Governance Principles, 2003, Law on Joint Stock Companies, 2008, Civil Code, 2004, Commercial Code, 2004, Law of Ukraine on State Regulation of Securities Markets in Ukraine, 1996, Presidential Statement on Investment Funds and Investment Companies, 1994, Bank and Banking Activity Act No. 2121, statement of the NBU No.98 as of 28.03.2007 "Guidelines for improving corporate governance in banks". Concerning the crisis aspect of the issue the NBU statement No 273 "Amendments to the regulative documents of the NBU" (9.06.2009) and NBU statement No 421 "On some issues concerning the activities of banks during the financial crisis" (22.07.2009) were considered during the research.

This paper covers the period of 2008-2010 and the sample of the registered banks with reference to the NBU statistics (Table 1).

The research focuses on the influence of the NBU on the corporate governance in banks by introducing legislative documents and requirements aimed at stabilization of the banking sector through the impact on the regulatory capital and liquidity of the banks. The research also explores the historical background of the problem and uses the comparison method of analysis.

Table 1. Main indicators of Ukrainian bank activities

№	Indicators	Date			
		January 1, 2008	January 1, 2009	January 1, 2010	January 1, 2011
1	Number of registered banks	198	198	197	194
2.	Excluded from the State Bank Register	1	7	6	6
3.	Number of banks under liquidation	19	13	14	18
4.	Number of banks that have licenses for performance of banking operations	175	184	182	176

Source: The National Bank of Ukraine

4. Corporate governance regulation framework in the banks of Ukraine

4.1. Background to the concept

Corporate governance is a new concept in Ukraine. Nevertheless, there is a certain legislative and regulatory landscape to implement the practices of corporate governance. The concept of corporate governance in Ukrainian banks got reflected in national legislation with the Civil Code of Ukraine, Banks and Banking Activity Act, Joint Stock Companies Act and the statements of the NBU being the main provisions for the procedures related to the CG in banks.

The National Bank of Ukraine is the main regulator of the banking sector, hence its influence and role is essential enough to determine the CG performance in Ukrainian banks.

In practice the function of the NBU in the sphere of regulation of corporate governance in commercial banks is realized in several ways:

- NBU's participation in the legislative process;
- development of the relevant provisions of the NBU.

Supervision by the NBU of the formation of the corporate governance bodies of banks is a key issue of NBU's participation in CG in banks.

NBU's functions in the formation of the management of banks are as follows:

- approval of the chairman of the board elected by the supervisory board of the bank;
- approval of the chief accountant of the commercial bank, appointed by chairman of the board and elected to the board by the supervisory board.

NBU's initiative to introduce a temporary administrator in commercial banks as a way to improve the financial stability of banking institutions in the financial crisis of 2008-2009, also belongs to corporate regulation (Kostyuk A., 2010).

While there are a number of documents determining the "elements" of corporate governance in Ukrainian banks, one of the recent acts which worth attention (especially taking into account the global trend on national code/principle implementation) is the statement of the NBU of 28.03.2007, № 98 "Guidelines for improving corporate governance in bank". These recommendations do not replace but rather complement the corporate governance principles adopted by the State Commission on Securities and Stock Market dated by 11.12.2003. This statement outlines key recommendations on the activity of Supervisory Board, Executive Board etc. For example, point 1.4 of Chapter 1 "The role and responsibility of the Supervisory Board" says that performing the functions of supervision and control over the activities of the Executive Board, Supervisory Board appoints, controls, and if necessary replaces board members taking care of certain succession plan in top management, examines possible successors in terms of their professional qualifications and skills and ability to manage the affairs of the bank. The Supervisory Board also sets the remuneration of the members of the Board, considering their responsibilities and remuneration police in the bank. Chapter 2 of the document defines the criteria for professional independence and conformity of the Supervisory Board, NBU's experts consider including at least 25% of qualified independent members to the Supervisory Board and creating audit and other committees headed by independent members as the instrument to strength independence and objectivity of the Supervisory Board. Chapter 4 of the document contains recommendations concerning structure, formation and procedures of the Supervisory Board.

Issues regarding committees of the Supervisory Board are developed in chapter 5. According to the National Bank, "Creation of Supervisory Board committees dealing with specific issues of its activities maximize the effectiveness of the Supervisory Board". Taking into account recommendations, the Supervisory Board at its discretion, establishes such committees, but is responsible for the results of their activities. In this case, committee is composed of at least three board members. Besides one of the committee members should have specific professional education in the sphere of certain committee. Meetings of such committees should happen at least once a quarter or more often if this is necessary. It‘s highly appreciated if banks establish audit committees, risk management, corporate governing and nominating ones [8]. In general, other sections of the document define recommendations for internal and external control, questions of succession, disclosure of information and the activities of the Executive Board.

It should be mentioned that one of the main possible positive outcomes of the implementation of these recommendations is that it will give NBU the opportunity to form the institute of independent directors - members of supervisory boards, active participation of whom will increase confidence in the commercial bank by shareholders, investors, customers, and as a result of the banking market regulator - the National Bank of Ukraine.

The number of bad banks in Ukraine proves inadequate current system of corporate governance, primarily meaning this formal character of relationship and the lack of oversight by supervisory boards of the risk management. Therefore, one of the main tasks of the state in solving this problem is the implementation of mobility mechanisms which influence the internal procedures of corporate governance in banks.

In fact, corporate governance practices in Ukrainian banks are formed under certain contradictory factors. Among the internal factors, above all, the peculiarities of formation of private banks with share ownership in early 1990 in a liberal state policy concerning the banking system should be mentioned. Since that time the typical features of corporate governance in banks are the high concentration of ownership and control in the hands of majority shareholders, the practice of servicing the interests of owners and their private financial-industrial groups, the opacity of corporate structure and so on. On the other hand, major incentives for the development of good corporate governance give the external factors of globalization processes: the arrival of foreign investors into the domestic market, increased competition and dependence of the Ukrainian banks on borrowing in international capital markets. Under the influence of these external factors, the role of public banks and their presence in the stock market is increasing. The current crisis implications put forward new policy emphasis on changing the formal approach of risk management in banks. State policy in the regulation of corporate governance should take into account the effect of both internal factors that shape the specifics of national environment and external factors that stimulate the most effective objective management mechanisms.

Nowadays it could be mentioned that the state and NBU particularly made significant steps towards establishment of a national legal framework in line with international standards. As a result of evaluation mission of IMF and World Bank held in 2002 and 2007 under the Financial Sector Assessment Program Ukraine (FSAP), the very positive work of the NBU on implementation of the Basel Committee standards and best practices in supervisory activities were noted. However, given the voluntary nature of the recommendations the question of their degree of compliance by banks still exists. According to the IFC research "Investigation of changes in corporate governance of the banking sector of Ukraine", only 25% of survey participants confirmed that they improve corporate governance in accordance with the implementation of legislative documents. On the other hand, it is the NBU CG Guidelines and corporate governance principles of the State Securities Commission which are the main sources of information on corporate governance in Ukraine.

In the period of crisis risk management and internal controls in banks require an immediate attention. Hence, the priorities of the NBU today are concentrated mainly on measures to stabilize the financial performance of banks. But in terms of the post-crisis perspective the issue of banking supervisory matters transition to Basel II standards remains relevant.

Taking into account the current performance of Ukrainian banks and strategic plans of Ukraine to join the European Union, public authorities should consider the initiatives of the Basel Committee on anti-crisis and long-term measures to improve bank supervision and regulation.

Thus, the role of the Ukrainian banking regulator in post-crisis period is to strengthen legislative, regulatory and supervisory functions with reference to the following priorities:

- Accelerating the adaptation of national legal system to European norms and standards of corporate governance in banks with concern to the specific national environment;
- Continuation of market reforms on stock market development and increase of investment attractiveness of the country in order to promote the influence of good CG factors on corporate governance on Ukrainian banking system;
- Development of measures to monitor and control the activities of public banks on stock
- market;
- Improvement of the regulatory framework for the assessment and management of banking risks in accordance with Basel II;
- Spreading the practice of information disclosure by banks through the introduction of legislative

and regulatory requirements, and cooperation with stock exchanges (Golovina Y., (2009).

4.2. The NBU regulation of banks' liquidity in crisis

Crisis consequences and rising number of banks at a loss forced the NBU to issue a statement №421 "On some issues concerning the activities of banks during the financial crisis" on June 22, 2009. The statement contained mandatory restrictions for the corporate governance of unprofitable banks. Among other points, the NBU obliges the corporate governance of banks that are at a loss:

- to stop dividend payment to shareholders or capital allocation in an form;
- to stop any bonus payment to all bank staff;
- not to increase the amount of capital investment and intangible assets;
- not to spend any sums of money on financial consultant service (and to review exciting contracts);
- not to establish new subsidiaries and departments;
- to take urgent measures in order to upturn the level of liquidity, profitability and optimization of bank costs.

The NBU bans the following operations for unprofitable banks:

- providing blank credits;
- carrying out active transactions with insiders, in particular regarding new loans and guarantees;
- making early repayment of debt securities of banks' own emissions except when early repayment of debt securities of banks' own emission occurs at a price not higher than 50% of nominal, and does not result in a significant deterioration in liquidity;
- making redemption;
- purchasing private securities on banks' behalf.

In a year, on July 06, 2010 the statement №421 was cancelled by the statement №315, issued by the NBU "On cancellation of NBU statement on some issues concerning the activities of banks during the financial crisis". According to the document, all the restrictions implemented by the №421 statement are not valid any more for the reason of positive trends in banking system.

The analysis of the banking system of Ukraine during the period 2009-2010 years showed that in July, 2009, when the statement №421 was issued there were 64 unprofitable banks, which fall under the effect of the statement (one of the most efficient reason for banks' losses was reserve allocations on credit operations). However, in July, 2010 only 24 banks out of 64 under consideration still remained at a loss. At the same time, 28 banks earned profit and 12 were in process of liquidation. Moreover, as for the January 01, 2011, the number of profitable banks escalated to 31 (Appendix 1).

Prior to the 2011 Banking Supervision was prohibited to impose sanctions concerning the situation when the losses of financial institutions are caused by the forming the reserves and funds for compensation of possible losses on credit transactions effected pursuant to loan agreements entered into prior to October 1, 2008, or on restructured loans. However, such mitigation requirements were the subject to the provision by the bank schedule of gradual (within six months) bringing these economic standards to the level approved by the NBU.

Particular emphasis is placed not only on the bans, which are inherently logical and justified in crisis conditions, but also on very loyal approach to the banks, the losses of which are explained by the need to create reserves for loan portfolio. The majority of the points of the statement are aimed at minimizing the outflow of funds from banks. In particular, debt investors are hardly able to realize the right to bring debt instruments of banks to buyback. In this way the statement was able to reduce the expanses of banks in the short term and brought encouraging results.

At the same time, it should be mentioned that statement №421 was conflict-arising towards shareholders in the aspect of dividends and towards staff – in bonuses. Moreover, it did not provide any sufficient background to identify and prevent alternative ways of getting abovementioned payments, which could be determined as payment manipulations. That's why after the cancellation of the document the necessity of the new anticrisis banking regulation came to pass.

4.3. The NBU approach to the banks' regulatory capital

The increased application of regulatory capital requirements to financial institutions has been a significant trend in corporate governance and financial regulation over the past half century. Regulatory capital requirements largely originated in the United States as a response to the deregulation of the 1970s and 1980s. Because of the Glass-Steagall distinction between commercial banks and securities firms, two parallel regimes were developed. One is for banks and is administered by the Fed, OCC and FDIC. The other is for securities firms and is administered by the SEC. Under this bifurcated system, capital requirements have been implemented for different purposes, reflecting the differing natures of banks and securities firms. The term "regulatory capital" firstly was implemented in the Basel I[30].

In the Basel I accord bank regulatory capital was divided into two "tiers", each with some subdivisions. Tier 1 capital, the more important of the two, consists

[30] Basel Committee on Banking Supervision (1988), International Convergence of Capital Measurement and Capital Standards, Basel.

largely of shareholders' equity. This is the amount paid up to originally purchase the stock (or shares) of the bank (not the amount those shares are currently trading for on the stock exchange), retained profits subtracting accumulated losses, and other qualifiable Tier 1 capital securities.

Regulators have since allowed several other instruments, other than common stock, to count in tier one capital. These instruments are unique for each national regulator, but are always close in nature to common stock. One of these instruments is referred to Tier 1 capital securities.

There are several classifications of tier 2 capital, which is composed of supplementary capital and is called temporary capital unlike tier 1 which is permanent capital. In the Basel I, it is stated, that tier 2 includes undisclosed reserves, revaluation reserves, general provisions, hybrid instruments and subordinated term debt.

Undisclosed reserves are not common, but are accepted by some regulators where a bank has made a profit but this has not appeared in normal retained profits or in general reserves. Most of the regulators do not allow this type of reserve because it does not reflect a true and fair picture of the results.

A revaluation reserve is a reserve created when a company has an asset revalued and an increase in value is brought to account. A simple example may be where a bank owns the land and building of its headquarters and bought them for $100 a century ago. A current revaluation is very likely to show a large increase in value. The increase would be added to a revaluation reserve.

A general provision is created when a company is aware that a loss may have occurred but is not sure of the exact nature of that loss. Under pre-IFRS accounting standards, general provisions were commonly created to provide for losses that were expected in the future. As these did not represent incurred losses, regulators tended to allow them to be counted as capital.

Subordinated debt is forms lower tier 2 debt, usually has a maturity of a minimum of 10 years. To ensure that the amount of capital outstanding doesn't fall sharply once a lower tier 2 issue matures and, for example, not be replaced, the regulator demands that the amount that is qualified as tier 2 capital amortizes (i.e. reduces) on a straight line basis from maturity minus 5 years (e.g. a 1 bn issue would only count as worth 800 mln in capital 4 years before maturity).

Regulators in each country have some discretion on how they implement capital requirements in their jurisdiction. According to the NBU bank's regulatory capital is one of the key banks indicators, its' primary purpose is to cover the negative consequences of various risks that banks accumulate in their activity, and protect deposits, financial stability and stable operation of banks. Regulatory capital is composed of basic (level 1) and additional capital (level 2) capital.

Basel I has been replaced by a significantly more complex capital adequacy framework commonly known as Basel II[31]. After 2012 it will be replaced by Basel III[32] that is a new global regulatory standard on bank capital adequacy and liquidity. The third of the Basel Accords was developed in a response to the deficiencies in financial regulation revealed by the Global Financial Crisis. Basel III strengthens bank capital requirements and introduces new regulatory requirements on bank liquidity and bank leverage.

Basel III proposes many new capital, leverage and liquidity standards to strengthen the regulation, supervision and risk management of the banking sector. The capital standards and new capital buffers will require banks to hold more capital and higher quality of capital than under current Basel II rules. The new leverage and liquidity ratios introduce a non-risk based measure to supplement the risk-based minimum capital requirements and measures to ensure that adequate funding is maintained in case of crisis[33].

Serious measures to improve the financial sector through the corporate governance regulation are not only planned but also implemented in Ukraine. NBU has increased "capital" standards for the market, but in a very peculiar way – by increasing the absolute criteria for its adequacy rather than relative ones, as world practice has.

At the insistence of international financial institutions Ukraine held two stress-testing for banks on their compliance with the criteria for adequacy. According to the results of the last one, Ukrainian banking system needs a capital increase estimated at 40 bln UAH. Obligation to increase this amount of bank capital by the end of this year was recorded in the agreement between Ukraine and the IMF.

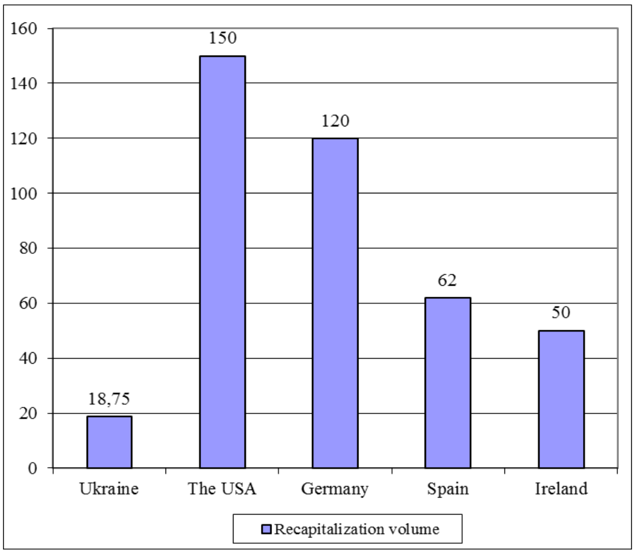
According to Fitch, the capital needs of the Ukrainian banks may be much larger. According to analysts of the agency since the beginning of the crisis (the fourth quarter of 2008) before the end of the first half of this year, revenues of the new capital in Ukrainian banking system amounted to about Moody's Analytics: "Basel III New Capital and Liquidity Standards FAQs" 86 bln UAH that is more than half the sector needs to recapitalize, which is about 150 bln UAH according to earlier calculations of the agency (figure 1).

[31] Basel Committee on Banking Supervision (2004), International Convergence of Capital Measurement and Capital Standards. A Revised Framework, Basel.

[32] http://www.bis.org/list/basel3/index.htm

[33] http://www.moodysanalytics.com/~/media/Homepage/Insights/MA-Basel-III-FAQs.ashx

Figure 1. Recapitalization needs of banks in different countries, bln USD



As noted by the agency experts themselves "considerable uncertainty remains regarding the ultimate level of losses in the system as a whole and at individual banks, and hence on the final cost of sector recapitalizitaion". In this case, progress in dealing with problem loans and recapitalization will be the major challenges for the system.

On the 13th of July The National Bank of Ukraine sent to the banks a Statement № 273[34] from 09.06.2010 "About Changes to Some Regulative Documents of The NBU" with which among everything stated:

Point 2. Banks, that on the 16th of July 2010 have regulative capital less than 120 mln UAH are obliged to increase it up to the mentioned level before the 01.01.2012.

Point 6. Banks who do not fulfill this requirement will be prohibited to accept deposits from individuals over the volume recorded at the time of coming into force of Resolution № 273.

In such conditions banks, that were in the black list (their quantity on the 16.06.2010 was 49 – 28% of the total Ukrainian banking system (Appendix 2) had three possible ways to act:

- to accept the requirements and to enlarge their regulatory capital;
- do not accept the requirements and feel the consequences on their own experience;
- to use all possible reserves and draw on the 16.07.2010, the short-term (up to several days), deposits of individuals, in order to increase artificially the limit of the deposit portfolio to the date of the regulatory capital increase.

Apparently, many banks chose the third way, as the NBU had to change the rules of the game, or rather the date on which to fix deposit portfolio. According to a letter from 23.07.2010 № 40-111/3557- NBU reports that "for the banks, which at the time of entry into force of Resolution № 273 had the size of regulatory capital less than 120 mln UAH , the volume of deposits of individuals should be fixed on the 20.07.2010 (according to the balance of 19.07.2010).

In other words, 23.07.2010, having a data of the banks' reports on 20.07.2010, and apparently observing the outflow of those deposits, which were collected on the 16.07.2010, the NBU retroactively change the record date of the deposit portfolio. Moreover, the NBU elaborates that the replenishments of the deposit contracts that provided for the capitalization or the completion on 16.7.2010 are also not counted in the calculation. Only contracts signed after 16.07.2010 or that concluded additional agreements on increasing the deposit amount after the mentioned date will be taken to the account.

In this peculiar manner the regulator makes it clear that paragraph 6 of Resolution № 273 from 09.06.2010, should be executed anyway but in fair way, and the only possible variant to solve this problem for banks is to increase the regulatory capital.

Several questions appear so far: how fair and reasonable the solutions of NBU are, does the current recapitalization in Ukraine correspond to the global trends and would their completion make domestic banking system more reliable?

This debatable issue was discussed by a lot of bank directors and banking association representatives.

Opponents of raising the minimum regulatory capital (small banks managers in majority) called it discriminatory, violation of the basic principle of competition – the equality of all market participants.

To protect the small banks it could be mentioned that there is no problem of liquidity, there is a

[34] http://zakon.nau.ua/doc/?uid=1194.503.0

challenge where to place these funds – the problem of borrower reliability. The thing is that customers today is not ready yet to receive these resources, because they are busy restoring the problems of sale of goods and services, aimed to achieve a minimum level of profitability, and vital issue that raised due to the new crisis share of the debt service costs because of the general decline of return on their activity.

The high rate of capitalization may discredit the very idea of capitalization as a way to improve the safety and stability of the bank, since small financial institutions in such short terms will be forced to use certain manipulations. All Ukrainian banks that have become problem banks or have been eliminated were capitalized at high rates.

Basel III defined stages of raising capital - from 2013 till 2018.[35] The bank's recapitalization demands for the banks of the third and fourth groups should be gradually and adequately fit in mentioned period so as to bank are able to recapitalized without extra problems.

Due to higher requirements to the minimum level of regulatory capital banks of the third and fourth groups must increase their capital base in half as much again that could result in a corresponding capital efficiency decrease, because to date the banks are not capable to increase their assets half-fold as no one knows where to get such sources for capitalization.

Small banks today are more stable than large financial institutions. As the argument the following data could be provided: the ratio of capital to assets and capital to deposits of the fourth group takes in first place among different groups of banks, and the third group is on the second place. In addition, small banks in their liabilities have NBU refinancing share that is half of that of big banks, as they were not that active in taking upon currency risk by lending foreign currency (20-30% of the portfolio, comparative to 60-70% in big banks).[36]

A high level of regulatory capital does not save the banks from problems, e.g. Ukrprombank' default with the regulatory capital 16 times higher than the norm now. Opponents of Statement №273 consider evaluation of capital adequacy rate for all banks as more economically grounded for banking system capitalization.

On the other hand the decision of Statement № 273 adoption has some arguments in it's' favor. Because of the market dispersion today native banks do not have the enough financial ability to support large-scale projects, that's why for example the Euro-12 preparations are mainly held by the state budget.

Banks need a high level of capital to cover not only credit risk (the level of NPLs in the banking sector in Ukraine is 35-40%), but also market risks, risks of expected and unexpected losses, etc.

Efficiency of the banking system directly depends on the level of capitalization and in the context of the development of system's infrastructure. The question of efficiency is a good opportunity for a number of banks to merge and become more profitable. The Ukrainian banking system needs a jump for which it needs investment that require capital.

It's important to admit, that not only the level of capital determines the competition. Large banks have their own advantages, but also some specific problems. In addition, they represent a greater systemic risk to the whole banking system. Small banks have other risks, although they do not affect the system stability to such an extent as larger banks do. Usually on the market that works properly, there is room for everyone - for medium, small and large banks, specialized and universal. Size is just one of comparative advantage, in addition to financial stability, portfolio diversification, customer service quality etc. And sometimes not to be big is an advantage.

The regulator support and the achievement of financial stability - in the interests of all banking sector participants and interested groups, even if it means the necessity to bring in an additional capital. Large banks, especially those that are the part of international financial groups generally have more opportunities to build up capital.

However, small banks also need to raise capital following the regulatory requirements. This is mandatory for anyone who wants to stay in business. Perhaps it is difficult now, but in the end it will make the banking sector stronger and support the economy more adequately, which is the biggest contribution to the stability of the entire society.

National Bank in its turn is pointing out that bank is a specific institution responsible not only for the funds of shareholders, but also for appealed depositors and creditors' funds. Stating from the nature of banking operations in their activities certain risks appear, list of which does not concluded the prescribed standard of regulatory capital adequacy. Even with the assets of sufficient quality, bank with insufficient insolvency covering of risk is not able to provide payments to creditors and depositors in proper time and in full measure. The size of regulatory capital should cover the negative consequences of various risks that banks assume in their work.

In his comments, the National Bank refers to the Directive 2006/48/EC of European Parliament and Council from 14.06.2006[37], which defines the criteria for minimum capital requirements for banks, which "must be proportionate to the risks to which they are directed". NBU motivated introduction of Statement

[35] http://www.bis.org/press/p100912.htm

[36] http://www.bank.gov.ua/Bank_supervision/index.htm

[37] http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2006:177:0001:0001:EN:PDF

273 standards by "the need to protect bank depositors from the risk of undue payments and prevent panic among the population".

The norm of 120 mln UAH. was established in accordance with the Regulations on the procedure of regulating the activities of banks in Ukraine (as was in force until June 2010) the minimum amount of regulatory capital is at least 10 million euros. The minimum level of regulatory capital in UAH must be calculated at the rate of the euro, defined as the arithmetic average of the IV quarter of 2009 (11.81706. UAH for 1 euro).

It should be noted that despite crisis, the process of increasing the owned capital is continuing. Thus, for 10 months of 2010, the owned capital increased by 17,8% (up to 140 bln), and regulatory - on 13,3% (up to 154 bln)[38].

With the help of measures taken before the crisis, the current capital structure of Ukrainian banks is similar to the envisaged reform package of the Basel Committee. Therefore, controller does not intend to raise the absolute value of the adequacy of regulatory capital standard (10%) that is currently high enough and the main issue is an improving the quality of regulatory capital due to the changes in requirements for its structural components.

An intensive banking regulatory activity is also typical for actual events in the world. In November 2010, G-20 leaders approved the new rules for banking regulation (known as Basel III), establishing a much more stringent criteria for quality, transparency and adequacy of bank capital and assets. The idea is that it should cool the top managers and shareholders propensity to undue risk and enhance banks' immunity to new cataclysm.

Gradual transition to the new standards is to begin in January 2013, but by 2019 the banks will have to bring their capital in full compliance with them.[39]

After the entry into force of the Basel III lack of owned capital in 35 largest credit institutions of USA amount to 100-150 billion dollars with 90% of this amount fall into six major banking institutions. The need to increase the capital of the top ten largest German banks exceeds 100 billion Euros.[40]

Bank of Spain currently estimates that potential needs to bring core Tier 1 to 8% for all banks should not exceed EUR 20bn.[41] Moody's downgraded its rating on Spanish government bonds to the second highest notch on fears that the cost of re capitalizing the country's many cajas would probably reach €40 to €50 billion (about $55 to $69 billion).[42] That would be far more than the €20 billion ($28 billion) estimated by the office of President Jose Luis Rodriguez Zapatero and would substantially increase Spain's public debt ratio.

The Irish Government has confirmed it is to receive an €85bn ($112bn) loan from the European Union and the International Monetary Fund with Irish banks to receive €35bn of the package. Banks will receive €10bn for immediate recapitalisation and €25bn in contingency funding, while the other €50bn will finance Irish budget deficits.[43]

Interesting, that in Switzerland requirements for its leading banks are almost doubled than the prescribed in Basel III. The need for tighter regulation consider reasonable, since the total assets of the two largest banks – UBS and Credit Suisse - four times higher than GDP.[44]

5. Conclusions

The National Bank of Ukraine as the main regulator of the banking sphere plays a significant role in the procedures and elements of the corporate governance within the commercial banks through introducing the statements with requirements and guidelines for banks. The impact of the NBU on CG was particularly observed during the crisis. There are a number of measures by NBU presented as the anti-crisis ones. However, the effectiveness of all of them is still under discussion and evaluation.

The statement of the NBU № 421 issued in July 2009 contained regulations of the elements of liquidity strengthening. These measures were applied within a certain group of banks, which were out of profit. Hence, the statement failed to have an overall systematic impact on the whole banking system. Considering that the main articles of the statement concerned the issue of bonuses and dividends payment, there is clear evidence of connection between this regulatory act and corporate governance performance in banks. However, even though the NBU cancelled the statement in July, 6 2010 due to the "positive trends observed in the banking system", we also consider certain payment manipulation schemes practiced by some banks as the potential reason for its cancellation.

The NBU statement № 273 approved on July, 9 2010 introduced the new normative of the volume of the regulatory capital for banks. It was observed that 49 banks which didn't meet the requirement of 120 mln UAH[45] belong to the 4th group of the Ukrainian banking system with the lowest performance indicators, meaning that the only chance for them to survive is to merge or be taken over (even with the

[38] http://www.bank.gov.ua/Bank_supervision/index.htm

[39] http://www.bis.org/list/basel3/index.htm

[40] http://www.bundesbank.de/index.en.php

[41] http://www.fxstreet.com/fundamental/analysis-reports/euro-compass/2011/01/25/

[42] http://blogs.forbes.com/afontevecchia/2011/03/10/moodys-downgrades-spains-credit-rating-as-recapitalization-could-cost-e50bn/

[43] http://www.gfsnews.com/article/505/1/

[44] http://www.snb.ch/

[45] 120 mln UAH = 10,8 mln EUR

scenario of the hostile one as the price of the deal might be markedly lowered). That's why the result of this statement can be described as the disciplinary measure for the CG bodies of the successful banks and at the same time a strong push towards the intensification of bank capital concentration. Consequently the question of the NBU motives to implement such approach is arisen, which might be a good issue for further research.

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Appendix 1
Ukrainian banking system profit/loss dynamics

	Profit/Loss		
Name of banks	July 1, 2009	July 1, 2010	January 1, 2011
RAIFFEISEN BANK AVAL	-1 084 986	35 894	745
UKSIBBANK	-830 665	-1 262 329	-3 145 186
ALFA-BANK	-192 818	551	1 012
OTP BANK	-565 334	236 204	609 432
PROMINVESTBANK	-375 211	-454 484	-844 981
NADRA	-1 040 895	4 563	4 740
FORUM	-283 290	-1 478 291	-3 282 345
FIRST BANK UKR.INTERNATIONAL	-604 127	43 021	235 378
FINANSY TA KREDYT	-187 364	-54 301	-188 637
SWEDBANK	-478 942	47 524	86 155
UKRGAZBANK	-76 419	6 187	10 058
UKRPROMBANK	-4 603 184	under liquidation	
KREDITPROMBANK	-166 471	14 943	25 294
ERSTE BANK	-343 168	-143 958	-133 794
UNIKREDYT BANK	-53 511	17 172	40 130
RODOVID BANK	-1 510 894	-3 762 145	-4 264 124
UNIVERSAL BANK	-99 879	-72 727	-593 591
PRAVEKS-BANK	-193 206	-149 951	-188 413
DONGORBANK	-109 309	3 648	5 055
VAB BANK	-74 085	-204 535	-621 347
KREDOBANK	-129 237	-353 224	-391 854
DOCHIRNIY BANK SBERBANKU ROSSII	-249 043	-1 493 622	-1 468 846
IMEKSBANK	-30 164	2 529	27 522
"CREDIT-DNIPRO"	-33 498	2 685	4 567
KYIVSKA RUS	-10 041	563	5 668
SEB BANK	-86 499	-296 107	-259 837
"KIEV"	-1 202 568	-227 782	-220 702
BM BANK	-5 444	-18 008	-14 995
PROCREDIT BANK	-62 725	-12 722	-12 506
EXPOBANK	-7 709	-14 425	-122 856
BTA BANK	-21 974	655	5 888
CREDIT EUROPE BANK	-106 832	14 584	8 237
"EUROPEAN" BANK	-141 411	under liquidation	
UKRINBANK	-11 459	-44 950	857
TAVRIKA	-2 324	3 352	5 203
IPOBANK	-640	under liquidation	
PLATINUM BANK	-3 329	2 495	9 409
BIG ENERGY	-41 806	under liquidation	
BG BANK	-19 807	678	362
EAST-EUROPEAN BANK	-6 181	under liquidation	
CITY-BANK	-27 719	-15 209	-14 525
ZAKHIDINKOMBANK	-81 765	3 407	94
REGIONAL DEVELOPMENT BANK	-38 768	under liquidation	
"LVIV"	-13 789	-7 321	-36 400
SOTSCOMBANK	-5 602	-40 227	-50 452
NATIONAL STANDARD	-227 074	under liquidation	
METABANK	-4 397	569	1 457
"DNISTER"	-288 242	under liquidation	
ARTEM BANK	-7 650	3 583	430
AGRICULTURAL COMMERCIAL BANK	-2 589	under liquidation	
TRANSBANK	-471 782	under liquidation	
"ARMA"	-45 186	under liquidation	
TRUST	-3 432	-1 702	180
CAPITAL BANK	-5 600	31 714	8 853
"SYNTHESIS"	-1 873	-60 520	under liquidation
VOLODYMYRSKIY	-2 376	272	-8 056
"CONTRACT"	-4 784	573	132
ODESSA-BANK	-66 533	under liquidation	
EUROPEAN BANK OF RATIONAL	-740	-3 130	1 129
CREDITWEST BANK	-4 451	33	255
BANK RUSSIAN STANDARD	-11 224	-7 574	252
FINEKSBANK	-13 198	335	1 143
UKRAINIAN BANK OF DEVELOPMENT	-617	1 015	1 607
CREDIT - OPTIMA	-5 664	577	99

Source: worked by the authors, based on the data of The NBU

Appendix 2
The list of Ukrainian banks that had a regulatory capital less than 120 mln UAH, 01.06.2010

№	Name	Regulatory capital
1	PROFIN BANK	119,00
2	AGROCOMBANK	118,30
3	GRANT	117,10
4	CREDITWEST BANK	116,50
5	CONCORD	113,60
6	D-M BANK	112,90
7	MORSKYI	112,90
8	MOTOR BANK	112,40
9	VBR	110,20
10	PORTO_FRANKO	109,90
11	METABANK	109,30
12	INTERNATIONAL INVESTMENT BANK	107,20
13	ERDE BANK	106,00
14	SYNTES	102,70
15	UKRAINIAN CAPITAL	99,70
16	FINROSTBANK	98,70
17	INTERBANK	98,20
18	TERRA BANK	98,00
19	UKR. RDB	97,60
20	UKRKOMUNBANK	96,20
21	LEGBANK	94,10
22	UKOOPSPILKA	92,30
23	TMM-BANK	92,20
24	KOMINVESTBANK	91,80
25	RADABANK	91,20
26	CHORHOM. DRB	90,50
27	COMMERCIAL INDUSTRIAL BANK	90,40
28	PROMENKOMBANK	87,40
29	POLICOMBANK	87,30
30	INDUSTRIAL AND FINANCE BANK	85,70
31	NOVYI	85,50
32	CAPITAL TRUST	85,10
33	EUROBANK	83,60
34	OKSI BANK	82,90
35	CONTRACT	81,80
36	ASVIO BANK	77,20
37	KREDYT-OPTIMA	76,30
38	INVESTBANK	76,20
39	BANK VALEZ	75,80
40	YEVROPROMBANK	75,40
41	BANK ¾	75,20
42	REGION BANK	74,00
43	BANK TRUST	73,00
44	OLYMPIC UKRAINE	69,70
45	LAND CAPITAL	65,50
46	FINEKSBANK	65,20
47	FAMILNYY BANK	63,00
48	STOLYCYA	57,80
49	EASTERN INDUSTRIAL BANK	53,10

Source: Ukrainian Banks' Association