Ukraine Bank Supervision Development
Contract #PCE-I-00-99-00006-00 TO#827
Quarterly Report
July 3, 2002 to September 30, 2002

I. The NBU Bank Supervision Department evolves its processes so that risk-based supervision becomes the basis for both its inspection and enforcement. The following aspects of bank supervision are modified to reflect the new emphasis on risk-based supervision.

1. **On-site Inspection: BSD staff is expert, not only in financial analysis (as is presently the case), but also in analysis of how adequate the banks' risk management systems are, in light of current and foreseeable risks that the bank faces with its current and prospective range of services. Written examination procedures place greater emphasis for the risk-management system. The "CAMELS" and "report of examination" -- for each bank examined -- reflect the NBU's evaluation and recommendations for correction of any weaknesses found in the bank's risk management system.**

By September 30, 2002

- Determine the appropriate method of training and devise a plan to deliver training in the evaluation of banks' risk management systems to NBU Senior Management and executive committees, and BSD upper and middle management.
  Advisors: Blimling, Wilson, Ladokhina, Antonova
  NBU Counterpart: Kireev, Ivanenko

The training of NBU and BSD management is to be determined by the Task Force. Task Force training is scheduled for October with BSD management to follow. Mr. Krotyuk asked that training for NBU senior management, that is NBU Board and Supervisory Council, be provided in two to three months. He anticipates substantial changes in the Supervisory Council and felt it would be better to address new members.

- Develop schedule to review chapters of the Onsite Manual to focus and emphasize the evaluation of banks' risk management system.
  Advisors: Blimling, Ladokhina
  NBU Counterpart: Zinchenko, Romanenko

A tentative schedule of revising the Onsite Manual has been developed. As part of their responsibilities, the Task Force will review and finalize the schedule.

By December 31, 2002

- Implement training plan in the evaluation of risk management systems to NBU Senior Management and executive committees, and BSD upper and middle management. Determine appropriate method of training and devise a plan to deliver training to the staff of the NBU head and regional offices.
  Advisors: Blimling, Wilson, Ladokhina, Antonova

NBU Counterpart: Kireev, Ivanenko

- Begin to review targeted chapters of the Onsite Manual and ascertain necessary changes to focus and emphasize the evaluation of a bank's risk management system.
  Advisors: Blimling, Ladokhina
  NBU Counterpart: Zinchenko, Romanenko

- Review and recommend revisions to the CAMELS Policy and Report of Examination to place more emphasis on the evaluation and impact of a bank's risk management system:
  Advisors: Blimling, Ladokhina
  NBU Counterpart: Zinchenko, Romanenko

By March 31, 2003
- Initiate recommendations to change the targeted chapters of the Onsite Manual to focus and emphasize the evaluation of a bank's risk management system.
  Advisors: Blimling, Ladokhina
  NBU Counterpart: Zinchenko, Romanenko

By June 30, 2003
- Assist in the issuance of revised chapters of the Onsite Manual.
  Advisors: Blimling, Ladokhina
  NBU Counterpart: Zinchenko, Romanenko

2. **Offsite Analysis: MIS reports modified, based on the risk-assessment methodology. External audit results incorporated into the supervisory strategy of banks.**

By December 31, 2002
- Review and determine necessary changes that address risk-assessment methodology in current reporting requirements
  Advisors: Kutsenko
  NBU Counterpart: Zinchenko, Romanenko, Karcheva

- Review frame work of supervisory strategies and determine if and to what extent audit results are incorporated in their development
  Advisors: Blimling, Kutsenko, Ladokhina
  NBU Counterpart: Zinchenko, Romanenko, Karcheva

By March 31, 2003
- Make recommendations and assist in implementation of changes and additions to reporting requirements and the development of supervisory strategies.
  Advisors: All
  NBU Counterpart: Zinchenko, Romanenko, Karcheva

3. **Licensing: Requirements for both renewal and new bank licenses are changed to require risk management systems that meet NBU standards.**

By March 31, 2003
- Review and determine necessary changes to licensing policies and practices to require banks to develop and employ comprehensive risk management systems.
  Advisors: Gegenheimer, Telychko
  NBU Counterpart: Parkhomenko

By June 30, 2003

- Make recommendations and assist in implementation.
  Advisors: Gegenheimer, Telychko
  NBU Counterpart: Parkhomenko

4. **Organization and Staffing: Supervisory personnel are trained in risk-based management. The organizational structure of the Bank Supervision Department will be reviewed and changed to reflect the evolution of risk-based management.**

By December 31, 2002

- Identify training opportunities at the National Bank Poland (NBP) or U.S. based regulators for one or more Bank Supervision employees and begin organizing study tour.
  Advisors: Antonova, Ladokhina, Blimling
  NBU Counterpart: Kireev

The Budget for training opportunities is being reviewed and work has begun on identifying contacts with NBP and U.S. based regulators.

- Identify participants in study tour at NBP or U.S. based regulator and conduct study tour.
  Advisors: Antonova, Ladokhina, Blimling
  NBU Counterpart: Kireev

Ongoing

- As risk-based supervision is developed within the BSD, make recommendations to management concerning potential changes in organizational structure.
  Advisors: Blimling, Wilson
  NBU Counterpart: Krotyuk, Kireev

No work in this area during the quarter.

5. **Legal Issues:** *(Note: This section calls for the implementation of new laws and regulations, and amending current legislation. We feel that a thorough review of all pertinent laws and regulations, along with full agreement and cooperation from NBU Bank Supervision and Legal Departments are necessary before implementation can take place. Therefore, the actual implementation phase may only be accomplished after considerable research and consultation with NBU management and staff, and the banking industry.)* **Elements of the legal framework are further elaborated which deal with different aspects of the banks' required systems of risk management. In particular new implementing regulations are developed requiring risk-management units and board-approved risk limits within banks. An amendment to the Law on Banks and Banking is developed to require the internal auditors of commercial banks to report to the Supervisory Council of their bank (rather than, as currently required, to their Board of Management.)**

By December 31, 2002

- Review current body of legislation and regulations to ascertain changes in existing laws and regulations and/or the need for new laws and regulations that would strengthen NBU authority to require and enforce the requirement for risk management systems and

appropriate internal/external reporting requirements. Determine the need, degree, and method of educating judges on the proper scope of judicial review, in order to prevent unnecessary legal impediments to achieving bank supervisory goals.
Advisors: Gegenheimer, Telychko
NBU Counterpart: Krotyuk, Kireev, Pasechnyk, Romanenko

We have begun reviewing relevant laws, specifically the Law on Banks and Banking activity. Additionally, we are conducting research into banking legislation and relevant practice of the USA, Canada, EU-members, Australia, Poland and other countries.

By March 31, 2003

- Develop strategy to ensure recommended changes and the development of new laws and regulations are efficiently accomplished.
  Advisors: Gegenheimer, Telychko
  NBU Counterpart: Krotyuk, Kireev, Pasechnyk, Romanenko

By June 30, 2003

- Begin to provide recommendations on specific laws and regulations concerning risk management systems and internal/external audit issues per strategy.
  Advisors: Gegenheimer, Telychko
  NBU Counterpart: Krotyuk, Kireev, Pasechnyk, Romanenko

BSD is currently preparing recommended changes to the banking law, and we are participating in the Working Group meetings. We are advocating necessary changes to the banking law as regards more efficient corporate governance, risk-management systems and internal control. As a result, BS management is proposing or supporting many changes in this respect. In particular, subordination of Internal Audit to Supervisory Council (not to the management as it is in the current law), more emphasize on strategic and controlling functions of the Supervisory Council, requirements to Supervisory Board members as per Basel principles, requirements as to specific risk management policies in place where limits for risks are established, NBU right to remove members of the management Board or Supervisory Council, etc.

II. The banking community understands and accepts risk-based supervision. The contractor will advise and assist the National Bank in the elaboration of regulatory standards and an action plan for implementation of risk-based supervision at the commercial banks.

1. **Compliance: NBU BSD develops a plan for compliance with the new regulations on risk-based supervision.**

By December 31, 2002

- Working with BSD management, determine the minimally acceptable risk management standards that all banks must maintain *(These standards will also guide our recommendations and efforts in the areas of legal, licensing, onsite manual, offsite risk indicators, training, etc.)*. Develop plan for informing and educating bankers on the necessity of effective risk management systems.
  Advisors: Blimling, Wilson
  NBU Counterpart: Krotyuk, Kireev

We have begun developing a concept paper that will be used by the Task Force in their development of a strategy to educate the banking community on the need for comprehensive risk management systems.

By March 31, 2003

- Present plan to BSD management.
  Advisors: Blimling, Wilson
  NBU Counterpart: Krotyuk, Kireev

By June 30, 2003

- Obtain approval and implement plan.
  Advisors: Blimling, Wilson
  NBU Counterpart: Krotyuk, Kireev

2. **Diagnostic: NBU Bank Supervision Department (BSD) reviews the main products and services of a sample of the two tiers of larger banks (about 25 banks, accounting for over three-fourths of banking system assets) and assesses the types of risks relevant for each.**

By September 30, 2002

- Develop methodology for surveying a sample of banks to determine the types and volume of products and services they offer, and how the banks management deals with associated risks.
  Advisors: Blimling, Kutsenko
  NBU Counterpart: Kireev, Ivanenko

We decided that this task is part of the Task Force's responsibility. We will work with Task Force in developing the survey and its methodology.

By December 31, 2002

- Assist in conducting survey.
  Advisors: Blimling, Wilson
  NBU Counterpart: Krotyuk, Kireev

By March 31, 2003

- Assist in interpreting survey results to assess the risks relevant for each bank and their array of products and services.
  Advisors: Blimling, Wilson
  NBU Counterpart: Krotyuk, Kireev

3. **Template: NBU BS develops a template covering the panoply of risks, and describes the key elements needed for an effective risk management system.**

By December 31, 2002

- Determine the best method(s) to communicate elements of an effective risk management system. *(May not involve the development of a "template", but rather incorporated in the revision and development of supervisory manuals, and tools developed for commercial banks.)*
  Advisors: Blimling, Wilson
  NBU Counterpart: Task Force (see #5 below)

By March 31, 2003

- Develop plan to begin the introduction of the methods developed in the above step to BSD management and staff, and banking industry.
  Advisors: Blimling, Wilson
  NBU Counterpart: Task Force (see #5 below)

4. **Tools: NBU BS develops tools for the commercial banks in implementing "risk based" systems, such as examples of policies, audits programs, MIS software for implementation by individual banks.**

By December 31, 2002

- Determine the extent of tools the NBU can provide to commercial banks to assist in implementing and sustaining risk management systems.
  ***Advisors:* All**
  NBU Counterpart: Task Force (see #5 below)

By March 31, 2003

- Begin to assist the NBU in developing necessary tools.
  Advisors: Kutsenko, All
  NBU Counterpart: Task Force (see #5 below)

5. *(Note: We have determined that a separate Director and Committee is not necessary since "Risk-based Supervision" is to become an integral part of all supervisory efforts. Instead, we are proposing that a task force be established that will guide the BSD through the implementation of "Risk-based Supervision".)* **Risk-based Supervision Director and Committee: The NBU designate a small group of examiners to be responsible for risk management implementation ("Risk-Based Supervision Committee") and senior Bank Supervision Department Official ("Risk-Based Supervision Director"), who will be the NBU's primary liaison with the banks in the implementation of the new methodology. This group is responsible for training other NBU examiners in risk management, for reviewing implementation plans and policies, and for evaluating and providing on-site assistance regarding the procedures developed by individual banks.**

By December 31, 2002

- Develop proposal for creation of the Task Force, establishing specific responsibilities and criteria for membership. Assist in establishment of the Task Force and membership selection.
  Advisors: Blimling, Wilson
  NBU Counterpart: Krotyuk, Kireev, Ivanenko

We have gained permission from Mr. Krotyuk and Mr. Kireev to form the Task Force, with Ms. Ivanenko in charge. We have interviewed all but three of the Task Force Members (they have been away from the NBU). We anticipate our first Task Force meeting in early to mid October. We will introduce the responsibilities of the Task Force and set an agenda for subsequent meets. We will also provide training to Task Force members beginning in October.

6. **Communication: NBU's "Risk-based Supervision Committee" develops seminars and prepares training materials to be made available to the banks as guidance on implementation of risk-based systems and the new NBU regulations in this area. (A policy manual should be given to the bankers by the NBU early in the process to provide this guidance and as a basis for discussion at meetings with senior bankers.)**

By December 31, 2002

- Establish contacts/relationships with trade groups, i.e., bankers association, risk managers' association, training groups/institutes, internal and external auditing groups, etc. Determine the feasibility of industrial advisory groups to work with the NBU, and if feasible, develop method and timing of cooperation. *(This step is critical in the development of bankers training and assessment of products and risk management systems.)*
  Advisors: Antonova, Kutsenko, Ladokhina, Blimling
  NBU Counterpart: Task Force

- Determine the necessary training materials and plan of delivery to cover all commercial banks in Ukraine.
  Advisors: Ladokhina, Antonova, Blimling
  NBU Counterpart: Task Force

By March 31, 2003

- Develop policy manual that will provide guidance to commercial banks in establishing and maintaining risk management systems.
  Advisors: Blimling, Wilson, All
  NBU Counterpart: Task Force

By June 30, 2003

- Deliver policy manual and assist in distribution.
  Advisors: Blimling, Wilson, All
  NBU Counterpart: Task Force

7. **Role of external and internal auditors: The NBU, through its regulations and its inspection procedures, focus on getting the management and bank boards to more rigorously incorporate, in a systematic way, analyses and**

recommendations of the internal and their external auditors. (Substantial work is needed in this area. Regulation, certification, and actual practices of internal and external audit in Ukraine are very weak.)

By December 31, 2002

- Determine status of regulatory framework requiring bank directorate and management to fully incorporate, in a systematic way, the recommendations of internal and external auditors.
  Advisors: Gegenheimer, Telychko
  NBU Counterpart: Kireev, Zinchenko, Pasechnyk, Romanenko

By March 31, 2003

- Make recommendations for necessary changes to statutory requirements.
  Advisors: Gegenheimer, Telychko
  NBU Counterpart: Kireev, Zinchenko, Pasechnyk, Romanenko

- Determine status of bank internal and external audit practices, professional training, certification and licensing requirements.
  Advisors: Kutsenko, Telychko
  NBU Counterpart: Zinchenko

- Determine status of NBU efforts to improve internal and external audit functions in commercial banks.
  Advisors: Kutsenko, Telychko
  NBU Counterpart: Zinchenko

By June 30, 2003

- Make recommendations for further efforts to improve internal and external audit practices and BSD oversight.
  Advisors: Kutsenko, Telychko
  NBU Counterpart: Zinchenko

III. The NBU Bank Supervision Department implements an institutionalized program for training, career advancement and certification of bank supervision officials. The NBU Bank Supervision Department, USAID advisors, and World Bank advisors and instructors will work together to develop an integrated approach to establish a consistent and sustainable program for improved training and for "certification" of bank supervision personnel.

1. **Curriculum: The NBU BSD develops a comprehensive, classroom-training curriculum for a set of core courses that all bank supervision personnel would be expected to take during their initial years in the Department.**

By December 31, 2002

- Analyze and assess existing approaches to the organization of the training process in the NBU and BSD, and develop recommendations on their improvement.
  Advisors: Ladokhina, Antonova
  NBU Counterpart: Ivanenko, Personnel Department

We have started our review of the NBU and BSD training process. Initial contacts have been made with the counterpart, Ms. Ivanenko, assigned by Mr. Kireev.

By March 31, 2003

- Prepare a survey of international experience in the training area and approaches to training in bank supervision in different countries to be presented to the BSD management and the Personnel Department together with our recommendations developed within the previous bench mark.
  Advisors: Antonova, Ladokhina
  NBU Counterpart: Ivanenko, Personnel Department

By June 30, 2003

- Revise and further develop curriculum for core courses and, in coordination with the Dutch Grant, present it to the BSD management and personnel for their input and approval.
  Advisors: Ladokhina, Antonova
  NBU Counterpart: Ivanenko, Personnel Department

2. **Trainers: A group of its seasoned bank supervisors become classroom trainers, as part of their regular duties.**

By December 31, 2002

- Update Train-the-Trainers course materials and present to the BSD for approval and further use as a universal teaching tool.
  Advisors: Kutsenko, Ladokhina
  NBU Counterpart: Ivanenko, Zinchenko, Task Force

Mr. Kutsenko attended a USAID sponsored training seminar in Bratislava, Slovakia, which dealt primarily with distance training, but also provided considerable material for train-the-trainer efforts and certification. We will incorporate materials and knowledge gained from this seminar in our pursuit of developing training and accreditation processes.

By March 31, 2003

- Develop a set of standard teaching tools to be used by BSD management and trainers (e.g. Train-the-Trainers Manual, follow-up forms, evaluations and needs analysis questionnaires, etc.).
  Advisors: Antonova, Kutsenko, Ladokhina
  NBU Counterpart: Ivanenko, Zinchenko, Task Force

By June 30, 2003

- Together with BSD trainers, analyze materials available to BSD and develop a pool of resources to be used for training purposes.
  Advisors: Antonova, Ladokhina, Kutsenko, Blimling
  NBU Counterpart: Ivanenko, Zinchenko, Task Force

3. Certification: The NBU develops minimum qualifications for certification of fully qualified bank supervisors. The certification process should include: satisfactory completion of a set of core courses, normally to be taken by BSD bank supervision staff (from Kiev and regions) during their first three years in the Department; successful ratings by supervisors for the candidate's experience of having worked for certain periods of time in specified fields of responsibility of the Department (e.g. on-site exams, off-site supervision, licensing, registration); a passing score on an objective Certification Test that the BSD will administer from time to time.

By December 31, 2002

- Study existing laws and regulations in order to support the feasibility of a certification concept for BSD management and the Personnel Department.
  Advisors: Gegenheimer, Telychko, Antonova, Ladokhina
  NBU Counterpart: Krotyuk, Kireev, Zinchenko, Personnel Department, Task Force

By March 31, 2003

- Develop and present a paper on international certification experience for bank supervision personnel to be used as a basis for further development of a certification concept for the NBU.
  Advisors: Antonova, Ladokhina
  NBU Counterpart: Krotyuk, Kireev, Zinchenko, Personnel Department, Task Force

By June 30, 2003

- Develop a certification concept to be presented to the BSD management, Personnel Department and the NBU management for their input and approval (in cooperation with the Dutch Grant).
  Advisors: Ladokhina, Antonova
  NBU Counterpart: Krotyuk, Kireev, Zinchenko, Personnel Department, Task Force

IV. Surveys and Assessments.

1. Survey of Gender Composition of staff, with indications of supervisory and non-supervisory personnel.

By September 30, 2002

- Conduct Survey and submit with work plan to USAID.

Advisors: Ladokhina
NBU Counterpart: Kireev

Survey complete and officially submitted to USAID in Kiev.

2. Assessment of the NBU's operational implementation of Basle Core Principles, subject to agreement by the NBU.

By December 31, 2002

- Obtain Permission to conduct assessment or use assessment of third-party.
  Advisors: Blimling
  NBU Counterpart: Kireev

By June 30, 2003

- Conduct assessment, if necessary, and submit to USAID.
  Advisors: Blimling, Wilson
  NBU Counterpart: Kireev

3. Obtain an average examination rating of the "M" component of CAMELS for Tier I and Tier 2 banks.

By June 30, 2003

- Determine the average rating of "M" component and submit to USAID.
  Advisors: Kutsenko, Blimling
  NBU Counterpart: Kireev, Zinchenko

Outside Contacts (for quarter ending September 30, 2002)

Advisor	Organization	Contact Name	Time
Alex Kutsenko	Institute of Banking Education of National Bank of Slovakia	USAID	5 Days – Distance Learning in Banking: Training of Trainers (Seminar in Bratislava)
	National Center for Training of Bank Personnel of Ukraine	USAID	5 Days – Distance Learning in Banking: Program Management (Seminar in Kiev)
	USAID	Victor Verhun	7 hours
	USAID	Rick Gurley Victor Verhun	4 hours
	U.S. Treasury	Mel Brown	2 hours
Raya Ladokhina	National Center for Training of Bank Personnel of Ukraine	USAID	4 hours – Distance Learning in Banking: Program Management (Seminar in Kiev)
	Association of Risk Managers of Ukraine	Anatoly Dobryasko	4 hours - Status and Development of Prospects of Risk Management in Financial Institutions (Seminar in Kiev)
Marina Antonova	National Center for Training of Bank Personnel of Ukraine	USAID	5 days – Distance Learning in Banking: Program Management (Seminar in Kiev)
Evgeniy Telychko	US AID	Viktor Verhun	2 Hours – Internet research to gather statistic information on banking system of Poland. 1 Hour - Arranging meeting for USAID and NBU officials.
Frank Blimling	Association of Risk Managers of Ukraine	Anatoly Dobryasko	4 hours - Status and Development of Prospects of Risk Management in Financial Institutions (Seminar in Kiev)
	USAID	Victor Verhun	3 hours

	USAID	Rick Gurley & Victor Verhun	2 hours – 6 hours preparation time
	U.S. Treasury	Mel Brown & George Mullanex	2 hours

Other Work Requested By NBU

Banking Law Working Group meetings included discussion of many changes to the Banking law, not only those pertaining to RBS.

Mr. Kireev requested us to provide input to the Methodology Unit concerning regulatory oversight of Cooperative Banks. We conducted research, developed recommendations, and produced a memorandum.

Mr. Kireev requested us to comment on the regulatory treatment of bank branches for prudential normative purposes. We developed recommendations and produced a memorandum.