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May 6, 2003

Mr. Victor Verhun, Project Officer
USAID/Kiev Mission
19 Nizhny Val
Kiev, Ukraine

Subject: **Ukraine Bank Supervision Development**
Contract No. PCE-I-00-99-00006-00, TO #827
Quarterly Report: January 1, 2003 to March 31, 2003

Dear Mr. Verhun:

Enclosed please find a copy of the March 31, 2003 quarterly report for the subject contract.

If you should require additional copies, please feel free to contact me at (703) 747-4538 or via email at jdoeden@bearingpoint.net.

Very truly yours,

Barents Group of KPMG Consulting, Inc.

Jay Doeden
Senior Manager

Enclosure

cc: Ms. Gloria White, USAID/PPC/CDIE, Washington, DC
Mr. Bruce Gelband, Contracting Officer, USAID/Kiev
Mr. Richard Abrams, Advisor, International Monetary Fund
Mr. Alex Flemming, World Bank
Ms. Angela Prigohzina, Operations Officer, World Bank/Kiev
Project File

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Ukraine Bank Supervision Development
Contract #PCE-I-00-99-00006-00 TO#827
Quarterly Report
January 1, 2003 to March 31, 2003

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 schedule for training of NBU and BSD management is currently being developed by the Risk Based Supervision Task Force. Training of the Task Force was conducted in October 2002. The Task Force has decided to wait to provide formal training of BSD management and staff until the Risk Assessment System (RAS) is fully developed and approved, which is anticipated to be in the third quarter of 2003.

- 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. This will occur once the Task Force finalizes the Risk Assessment System (RAS).

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

Training of Task Force was held in October, with additional training delivered to Regional supervision managers in December. The training focused on introducing the concept of Risk-based Supervision and the components of a comprehensive risk management system in commercial banks. The RAS will be finalized in the second quarter of 2003. The Task Force is working on a training schedule (which will be finalized when the RAS is tested) for the BSD management and staff. In late December, Mr. Sergey Tyhypko replaced Mr. Stehlmakh as Governor of the NBU and Mr. Alexander Shlapak was named Deputy Governor of Bank Supervision. Given these changes in NBU senior management, the Task Force is developing a proposal for the training of NBU senior management for Mr. Shlapak's approval.

- 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

The Task Force has not set a schedule for revising the Onsite Manual. Although BearingPoint advisors began reviewing credit related chapters, this exercise has been put on hold until the Task Force identifies a suitable counter part for further development of the Onsite Manual.

- 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

The Resident Advisor has begun a review of the CAMELS Policy and Report of Examination. Recommendations from this review will be provided to the Task Force when they begin the review of Risk-based Supervision tools and techniques.

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

BearingPoint advisors will work closely with bank supervision personnel assigned to this exercise by the Task Force. We anticipate the revision process to begin in the third quarter of 2003, however, this will depend on the activities of the Task Force.

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

The review of existing reports submitted by commercial banks to the NBU has been completed. Identification of current risk assessment methodology is in process, and we expect to complete this action based on the Task Force's schedule. Once the Task Force finalizes the development and testing of the RAS, we will make recommendations to further enhance commercial bank reporting requirements.

- 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

The Resident Advisor has reviewed the supervisory strategy process and a sample of individual bank strategies. While audit results are referred to in various comments, there is little evidence that these results are taken into consideration when developing supervisory strategies. We conducted a thorough review of the status of the internal and external bank audit processes. We are currently working with Task Force members on revamping the bank supervision Supervisory Strategy process, which will incorporate audit recommendations.

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

One of the first initiatives of the new NBU Governor was to optimize the reporting requirements placed on banks. Unfortunately, the RAS policy was not ready by the time of this exercise, and therefore the major goal was to reduce the reporting burden on the banks leaving enough room for early warning indicators, rather than implementing offsite tools needed to assess risks defined by the RAS. As a result of optimizing the current reporting requirements, a good compromise was found between the frequency and content of reports. It is expected that once the RAS policy is finalized there will be another round of reporting requirements review.

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

<u>By March 31, 2003</u>

- 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

We have reviewed NBU Regulations #275, #375 related to registration and licensing of banks. We determined major weaknesses as well as outlined necessary changes to require banks to develop and employ comprehensive risk management systems. More specific recommendations will be provided during the next quarter.

<u>By June 30, 2003</u>

- 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.**

<u>By December 31, 2002</u>

- 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: Pushkaryov (Kireev)

National Bank of Poland Based Training:
We identified training opportunities at the National Bank of Poland's Training Initiative for Banking Supervision (TIBS) for the year 2003. Having conducted preliminary needs analysis at the NBU's GDBS, we envision training at two levels:

1. *Leadership skills for senior managers in BSD responsible for strategic development. This involves Participation of the General Department of Bank Supervision (GDBS) Director and/or Deputy Directors in the Bank Supervision Leadership Program conducted in Warsaw. The Toronto International Leadership Centre organizes this program in partnership with TIBS. The training is scheduled for March 2003. We also envision additional technical skills training for middle level managers responsible for institutionalizing and implementing a risk-based supervision approach. Due to the changes in management that happened at the end of the year 2002 and active involvement of all senior GDBS managers in the development of the "Comprehensive Program for the Development of the Banking System of Ukraine for 2003 – 2005," the GDBS was not able to send one of its managers to the Leadership Development Skills training scheduled for March 2003.*

2. *Technical skills development for NBU staff through four seminars offered by TIBS in 2003 on different issues related to Risk-based Supervision, Credit Risk, and Bank Examination Tools and Techniques. This list of courses will be finalized at the beginning of the next quarter. Other initiatives contemplated include Participation of a large group of NBU staff (15 people) in an On-site Supervision Tools and Techniques course delivered by TIBS, and participation of NBU staff, TIBS and BearingPoint advisors in the development of a tailored Risk-based Supervision course specifically designed for bank supervisors in CIS countries. The following training initiatives are scheduled or planned so far:*
    a. *Scheduled: Seminar on Market Risk Regulation and Supervision, June 3-6, 2003. We shared information on this seminar with different areas of the NBU, including the newly formed group of advisors to the NBU Governor, Research Center of the NBU headed by the former Director of GDBS, Mr. Kireev, and the GDBS. In April the list of participants will be finalized. Since this seminar will be a regional forum, TIBS submitted a request to our project to complete a survey of existing Ukrainian market risk regulation and supervision practices. This survey will be finalized in April and submitted to the TIBS.*
    b. *Planned: Seminar dedicated to Best Practices in Bank Regulation and Examination: Regional Experience and Challenges for bank supervisors of the former Soviet Union countries with potential involvement of the GDBS experts in course development and delivery. This course tentatively planned for November 17-21, 2003 and will be simultaneously translated into Russian. Our project will also be involved into the translation of course materials from English to Russian.*
    c. *Planned: Seminar on Risk-based supervision with a focus on evaluation of risk management systems, risk-based supervision, credit supervision and funds management. This course is tentatively scheduled for September 2003 and can be delivered in Kiev by experienced Polish trainers for the large audience of bank supervisors and examiners of the NBU.*

BearingPoint drafted an official memo to Personnel Department of the NBU that coordinates all training initiatives in order to facilitate communication between the GBDS and TIBS. After the NBU officially expresses interest in these training initiatives, both parties will start the implementation process with active involvement of BearingPoint.

U.S. based training:
After consulting with senior managers of GDBS, we believe that we will use the same format for U.S. based training as was used in 1998 when we partnered with the FSVC in arranging study tours. At that time, three examiners from the NBU Inspection staff participated in examinations of U.S. banks located in the states of New York and New Jersey. According to our original plans, this training is scheduled for late fall/winter of 2003 and will include 3-4 bank examiners going to the States to take part in OCC-based bank examinations. In order to use the same format, NBU staff (4-6 people) must take intensive English language courses. Next quarter we will focus on establishing contacts with U.S. based regulators and finalizing the format for U.S. based training programs.

Part of BearingPoint U.S. based training budget was used to pay for participation of the Head of Financial Monitoring Department in the Annual International Anti-Money Laundering Conference conducted in Miami Beach, Florida, on March 26-29, 2003. This newly established *department will coordinate all anti-money laundering activities initiated by the NBU for the banking sector of Ukraine. Conference results and supporting documents were incorporated into a new policy on financial monitoring that was developed by this department.*

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

Meetings were held with Mr. Kireev, Ms. Faber, Mr. Drobiazko, Ms. Zhabska, and Ms. Mironenko to discuss the purpose of the study tours, their focus and required underlying commitments. Together, with BSD management, we began developing a proposal for a group of NBU employees to participate in United States based study tours. A preliminary list of people was developed and a partial commitment was obtained from Mr. Kireev concerning the English lessons.

Since the focus of this project is risk-based supervision, we want to make sure the that these study tours and potential participants fit into the general scope of the project and the study tours serve the general purpose of educating the best GDBS examiners with risk-based supervision methods and approaches. The next steps are finalizing the lists of potential participants, adjusting the original proposal and obtaining NBU's new management commitment. In soliciting NBU's management commitment, we will recommend including regional examiners into the list of potential participants.

At this stage of development, we focused on the job descriptions and responsibilities of participants (rather than specific individuals) who we think can benefit from leadership development and technical training. BearingPoint will make a strong recommendation to the NBU management to allow bank examiners from regional offices to benefit from this training. In the next quarter we will finalize the list of people and pursue BSD management agreement.

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: Shlapak (Krotyuk), Pushkaryov (Kireev)

We conducted no activity in changes to the organizational structure 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.)

<u>By December 31, 2002</u>

- 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 completed our research into relevant international regulatory practices requiring the presence of risk-management systems and systems of internal control in commercial banks. We reviewed banking laws and regulations of approximately 20 prominent countries worldwide, and selected the most trustworthy and comprehensive examples of legal regulations in the areas of risk management and internal controls. The final review contains a description of approaches, references, and actual language from laws and regulations of Canada, Germany, France, The Netherlands, and The United States.

We compared the current body of Ukrainian legislation, in particular, the Law on Banks and Banking and the Law on the National Bank of Ukraine, with the laws and regulations identified from our research. We outlined, in a memorandum, our recommendations to improve the efficiency and enforceability of regulatory requirements for risk-management systems and systems of internal control in commercial banks of Ukraine.

We also reviewed the system of commercial courts in Ukraine and the current legal framework in requiring an adequate competency level for judges. We prepared a memorandum outlining our opinion on the need for additional training of judges in the areas of economic and financial law, and regulatory enforcement actions.

<u>By March 31, 2003</u>

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

We have developed and distributed a comprehensive memo on recommended changes in law to relevant members of the Task Force. The memo incorporates many recommendations made in our previous internal memoranda on legal enhancement, but it is further elaborated and covers some other relevant issues. The idea was to discuss the memoranda with Task Force members and use the results of the discussion as well as members' vision on real timeframes for those changes in order to better develop the strategy (anticipated schedule of those amendments). Due *to overload of management we had only preliminary discussion within the Task Force. The development of a schedule with real tentative dates of achieving necessary steps will require feedback from all related members of the Task Force (methodology, legal, licensing, audit) and coordination with some benchmarks and deadlines outlined in the "Comprehensive Program for the Development of the Banking System of Ukraine for 2003 – 2005." This will require additional time and may be achieved only in the next quarter.*

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: Shlapak (Krotyuk), Pushkaryov (Kireev), Pasechnyk, Romanenko

In November and December 2002, we participated in several meetings of the GDBS working group charged with developing amendments to the Law on Banks and Banking. We took advantage of this opportunity to promote our ideas for improving the efficiency of risk-management systems in banks. As a result, the GDBS included many of our recommendations in their official submission to the NBU Legal Department. These recommendations included subordination of the Internal Audit function to the Supervisory Council (rather than to management as it is in the current law), more emphasize on strategic and controlling functions of the Supervisory Council, requirements of the Supervisory Council members as per Basel principles, requirements as to specific risk management policies rather than merely establishing risk limits, the NBU right to remove members of the management Board or Supervisory Council, ability to apply enforcement measures in case of inadequate risk-management systems or policies, 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.**

<u>**By December 31, 2002**</u>

- 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: Shlapak (Krotyuk), Pushkaryov (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. Task Force members have met with three banks, which have also provided presentations on their risk management systems.

<u>**By March 31, 2003**</u>

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

See II.3 below.

<u>**By June 30, 2003**</u>

- Obtain approval and implement plan.
  Advisors: Blimling, Wilson
  NBU Counterpart: Shlapak (Krotyuk), Pushkaryov (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.**

<u>**By September 30, 2002**</u>

- 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: Pushkaryov (Kireev), Ivanenko

We have informally conducted an inquiry on the risks that commercial bank management focuses their risk management systems. This information was gathered through discussions with on-site supervisors, off-site analysts, and commercial bankers. The information has allowed us to guide the Task Force in prioritizing the development of the Risk Assessment System. As the Task Force continues to develop the "Pilot Bank" program, they will determine the need, structure, methodology and presentation of a formal survey.

By December 31, 2002

- Assist in conducting survey.
  Advisors: Blimling, Wilson
  NBU Counterpart: Shlapak (Krotyuk), Pushkaryov (Kireev)

The Task Force continues its work on the development of a Risk Assessment System and laying the preliminary groundwork for the "Pilot Bank" program.

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, Vance, Kutsenko, Ladokhina
  NBU Counterpart: Shlapak (Krotyuk), Pushkaryov (Kireev)

A draft Risk Assessment System (RAS) was developed based on best international practices. Within the Task Force a Core Group was established which included representatives of the onsite and offsite areas, a person from the group of Governor's advisors, and two representatives of BearingPoint. The immediate task of the Core Group was to review and amend the proposed RAS in order to develop a draft that would be the most suitable for Ukrainian conditions, including the legislation, practices and expertise available to the banking supervision area. As a result, the draft RAS was presented to Task Force members, NBU regional offices, and commercial banks in order to obtain their opinion and input, which is to be taken into consideration at the preparation of the final version of the RAS.

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)

The Task Force continues to its work on the development of the "Pilot Bank" program. By working with this group of banks, the Task Force will decide the best means of communicating the essential elements of a comprehensive risk management system, that all commercial banks in Ukraine must develop.

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, Vance, Ladokhina
  NBU Counterpart: Task Force (see #5 below)

The method chosen as means of communicating to commercial banks essential elements of a risk management system and the plan of its introduction are related to the implementation of the Pilot Bank Program, which began on March 21, when the draft RAS was sent to commercial banks for their input. The Pilot Bank Program consists of two essential elements:
1) The RAS testing in a commercial bank based on which recommendations will be developed on both the RAS improvement, and on the development or enhancement of the risk management system in this bank. Also, based on the testing results guidelines for commercial banks on their risk management systems will be developed. The testing is to be conducted within an onsite examination. For this, Ukrsotsbank was chosen, where the scheduled onsite examination starts on April 10, 2003.
2) For the Pilot Bank Program, eight banks were selected to make presentations to the Task Force on their risk management systems in order to fulfill two objectives:

a. *To obtain information on the extent to which the banks have developed risk management systems in order to take this into consideration during the preparation of the guidelines on the risk management system; and*
b. *To use this opportunity as a PR action to promote the NBU initiative on the risk based supervision.*

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)

The Task Force will begin to address the extent of tools they feel the NBU should provide to commercial banks during remainder of the year.

By March 31, 2003

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

No activity this quarter – the Task Force was working on the first draft of Risk Assessment System. Only once RAS gains its final form will the Task Force begin to develop the necessary tools.

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

   With permission from Mr. Krotyuk and Mr. Kireev, the Risk Based Supervision Task Force, with Ms. Ivanenko in charge, was formed in September 2002. The Task Force membership is comprised of key Bank Supervision managers, a representative from the NBU Legal Department, representatives from the Governor's advisor group and BearingPoint advisors. We provided training to the Task Force in the essentials of risk-based supervision and the key elements of a commercial bank's risk management system. Additionally, the Task Force began a series of presentations delivered by commercial bankers covering their risk management systems. The Task Force has identified and defined 10 risk categories that will focus BSD risk based supervision efforts. They have decided on the format of the Risk Assessment System and began to develop risk assessment criteria for each of the risk categories. This process is scheduled for completion by mid-February.

   BearingPoint contribution to the Task Force involved the preparation of materials on the definition of risks, risk assessment systems and the concept of risk-based supervision. We provided to the Task Force material from a number of regulatory agencies, including Canada, Hong Kong, India, Japan, South Africa, Singapore, the U.S. Federal Reserve, FSA, FSR, etc., during this development stage. Additionally, we prepared an article on risk management and risk assessment systems requested by Mr.Drobiazko to be published in January 2003 in the Financial Risks magazine. Materials of the Financial Services Roundtable were used for the preparation of the article.

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.)

<u>By December 31, 2002</u>

- 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

BearingPoint has established contacts with International Management Institute, the National Center for the Training of Bank Personnel of Ukraine, World Bank and other donor agencies and trade groups. As the Task Force finalizes its Risk Assessment System and approaches to Risk-Based Supervision, we will be able to determine the level and need for their involvement as well as specific methods and timeframes. These organizations are aware of our efforts in the development of a Risk-Based Supervision approach and will be informed on our continuous efforts in this area.

As soon as Risk Assessment System and risk-based supervision methodology are finalized, we will be able to develop a plan for the involvement of training institutes, other donor agencies and trade groups in the development and delivery of bankers training and assessment of products and risk management systems.

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

This element is delayed until the Task Force finalizes its risk assessment system and "Pilot Bank" program. Meanwhile, BearingPoint is gathering training material for potential seminars to be delivered by the Task Force to commercial banks. BearingPoint is also working with FMI in the development of a Corporate Governance seminar(s) for Supervisory Council members of commercial banks.

<u>By March 31, 2003</u>

- 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

The Task Force is in the process of testing the newly created RAS (see above). When the test is finalized, and input from the "Pilot Bank" program is analyzed, the Task Force and BearingPoint advisors will develop the necessary policies, regulations and guidance to *commercial banks. BearingPoint advisors are working closely with the inspection crew testing the RAS. This participation will add valuable insight into the development of policy guidelines.*

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: Pushkaryov (Kireev), Zinchenko, Pasechnyk, Romanenko

We have reviewed the current body of legislation, including the laws "On Banks and Banking Activity", "On the National Bank of Ukraine", "On Audit Activity", in addition to NBU Regulation #114 "On approval of Regulation on organization of internal audit in commercial banks of Ukraine" dated 03/20/98, NBU Regulation #358 "On approval of Methodological guidelines as to application of standards for internal audit in commercial banks of Ukraine" dated 07/20/99, NBU Regulation #53 "On measures as to further development of bank audit" dated 02/09/99, NBU Regulation #271 "On approval of Policy on Qualification Commission of the National Bank of Ukraine on certification of auditors, provisional administrators and liquidators of banking institution, and Policy on certification of auditors of banking institutions", other rules and regulations. Our opinion as to the adequacy of the regulatory framework requiring bank directorate and management to fully incorporate, in a systematic way, the recommendations of internal and external auditors, will be provided to the Task Force when they begin their review of laws and regulations.

By March 31, 2003

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

During meetings of the GDBS working group charged with developing amendments to the Law on Banks and Banking that took place in November – December 2002, we made recommendations on subordination of the Internal Audit function to the Supervisory Council (rather than to management as it is in the current law), more emphasize on strategic and controlling functions of the Supervisory Council, requirements of the Supervisory Council *members as per Basel principles, the NBU right to remove members of the management Board or Supervisory Council. The GDBS included many of our recommendations in their official submission to the NBU Legal Department. We also incorporated our recommendations in a comprehensive memo on necessary legal changes that was distributed to relevant parties.*

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

In October – November 2002 BearingPoint advisors established relations with Institute of Internal Auditors (Mrs. Shpakovska) and reinforced relations with National Centre for Training Bank Personnel in Ukraine (Mr. Geyets). Both these institutions are involved in the process of training bank internal auditors. At that time, we explored the possibility of updating their training curricula to address risk management practices and requirements once the Task Force formulates by the Task Force.

In February – April 2003 a survey was conducted to find out current problems and on-going initiatives of government and self-regulated agencies with respect to internal and external audit functions. Based upon this, study recommendations were prepared on how to improve these functions.

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

In November 2002, the NBU via Dutch Grant/World Bank funding launched a program to review the existing audit regulations pertaining to bank external audits. This program is to be extended into the first quarter of 2003. In December 2002, Mr. Kireev requested that BearingPoint advisors work closely with this WB initiative to ensure application of best international practice with respect to bank external audits.

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

Activity complete. We conducted meetings with Personnel Department representatives (Mr. Bezugly, Manager of the training unit/Deputy Director of the Personnel Department and Ms. Pshenychna, his deputy), Ms. Ivanenko, Mr. Kireev, Ms. Faber, Mr. Drobiazko, and employees from the Division of Coordination and Planning, which is in charge of the training function for the bank supervision area. The purpose of the meetings were 1) to gain an understanding of BSD management ideas on how to improve the efficiency of bank supervision training; 2) determine how the Personnel Department plans to implement the Comprehensive Program for Training and Retraining of Bank Supervision Employees; and 3) determine the focus of our further cooperation with the Personnel Department, the BSD and the Dutch Grant/World Bank funded training initiatives.

Bank Supervision managers envision the training of their staff as a combination of different training methods, including internal unit seminars held by managers and experienced employees; formal training events organized by the Personnel Department; and internships and training opportunities conducted abroad.

The Personnel Department plans to more extensively and efficiently use different training facilities throughout the country (the NBU Kiev Training Center, the Sumy Banking Academy and its branches in Kharkiv and Cherkasy, and the L'viv Banking Institute). Due to logistical difficulties the Personnel department is to centralize the training of BS managers (beginning from the lowest level) in the Kiev Training Center, while the base for the BS technical staff training will be the Sumy Banking Academy. In December 2002, we visited the Sumy Banking Academy to meet the Academy representatives, see the facility and evaluate their processes. The meetings and our visit to Sumy provided us with considerable insight about the training issues and activities being addressed by the BSD and the Personnel Department.

In line with our plans regarding the formal training and accreditation programs, and at the request of the BSD Division of Coordination and Planning, we discussed with the Personnel Department the development of a training database for banking supervisor. We learned that the

Personnel Department is working with a newly developed personnel database that includes a training module. We will assist them in the implementation of this database as it pertains to the bank supervision training initiatives.

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

We gathered information for the survey of international experience in the Bank Supervision training area. We have gathered information via the Internet on the Australian Central Bank and Prudential Regulation Authority, Bank of England/FSA, Toronto Training Center, Federal Reserve, OCC, Bank of Poland, and South African Central Bank. We are currently analyzing the information and developing a clearer understanding of where we need to focus our efforts to address what the NBU lacks in its training process.

We concentrated on needs analysis process that is currently used by the NBU. Based on what we learned, we prepared a report that includes a review of current needs analysis process used by Personnel Department of the National Bank, summary of international experience and recommendations.

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

In October and November of 2002, BearingPoint advisors reviewed existing Train-the-Trainers manuals available to NBU from preceding USAID contracts as well as from other sources. The general findings are that these manuals concentrate mostly on development of oral communication/presentation skills, and are accompanied with planning and control sections. The training is designed to assist instructors on the use of existing training materials. Therefore, we will focus our updates on sections devoted to teaching how to develop presentations and other training materials.

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

BearingPoint has a pool of resources in this area, and we are in the process of updating teaching tools and methods that can be used by BSD trainers and management. This pool will be used to educate a group of trainers who will be used to deliver courses developed for the implementation and institutionalization of risk-based supervision concept. Since this training will happen on different levels and will be delivered for different target audiences (NBU senior management and Supervisory Council members, GDBS senior management, managers of territorial offices, inspectors and analysts, task force members, etc) we will tailor our train-the-trainers and other teaching tools appropriately.

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: Shlapak (Krotyuk), Pushkaryov (Kireev), Zinchenko, Personnel Department, Task Force

We have prepared a memorandum to the Division of Coordination and Planning addressing the general definition of the certification concept and process, and an explanation on how it is related to the formal training process, supported by the provisions of laws and regulations.

We examined the relevant body of legislation, including the Law "On Banks and Banking", Law "On the National bank of Ukraine", Law "On State Service", President Decree "On comprehensive program for preparation of state servants" #1212/2000, CMU Regulation "On *conducting attestation of state servants", Labor Code of Ukraine, other rules and regulations. Based on results of the research, we prepared a memorandum in Ukrainian for BSD management and the Personal Department. The memorandum provides brief explanation of a certification concept and supports its legal feasibility by giving specific references and language from current Ukrainian laws and regulations.*

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: Shlapak (Krotyuk), Pushkaryov (Kireev), Zinchenko, Personnel Department, Task Force

We started to work on the survey of international certification experience. But because of the changes in the NBU management, which delayed some of our benchmarks and cause the refocus in other, the paper will be finished and presented to the NBU in the next quarter.

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: Shlapak (Krotyuk), Pushkaryov (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

We obtained a copy of the latest Basle Core Principles assessment conducted by IMF/WB. This will be used in monitoring the success of future compliance efforts.

By June 30, 2003

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

Outside Contacts (for quarter ending September 30, 2002)

Advisor	Organization	Contact Name	Time
Alex Kutsenko	NBU, Ministry of Economy	Andriy Kyyak	6 weeks – work on Comprehensive Program on Banking System Development for 2003 – 2005.
	Cemonex (USAID)	Natalia Vovchuk	2 hours – interview on audit issues
	Institute of Internal Auditors	Tatiana Spakovska	2 hours – interview on audit issues
	U.S. Treasury	Mel Brown	2 hours
Marina Antonova	USAID	Victor Verhun	5 days
	National Center for Training of Bank Personnel of Ukraine	Olexander Geyets	4 hours
	Academy for Educational Development	Svetlana Leontyeva	4 hours
	IBTCI	Nataliya Vovchuk	4 hours
	Department of Financial Monitoring of the NBU	Olexiy Berezhnyi	10 days
	TIBS (National Bank of Poland)	Anna Duda	2 days
Frank Blimling	FMI	Ann Wallace John Landsburg	6 hours
	Commercial Law Center	Jamie Bowman	2 hours
	USAID	Victor Verhun	5 hours
	USAID	Rick Gurley & Victor Verhun	2 hours
	Dutch Grant	Charles Canfield	2 hours

	U.S. Treasury	Mel Brown	12 hours
	Financial Markets International	Ann Wallace	3 hours

Other Work Requested By NBU

Governor Tyhypko requested our input into the development of Comprehensive Program for Ukraine Banking System Development for 2003 – 2005. The Program was drafted within two weeks in February, presented for comments to the Cabinet of Ministers (Ministry of Economy), presented in the Parliament during April 2 Parliament Hearings. It is expected President Kuchma will sign the Program mid-April.

Mrs. Ivanenko requested our comments on the new initiative from NBU Accounting Department to eliminate accounts to recognize past-due loans. A memorandum was drafted explaining what the risks of such a step and how the NBU can achieve its new accounting goals without loosing this important information.

Mr. Kyyack, manager of the Governors advisory group requested our participation in the area of individual deposit guarantee. BearingPoint advisors will participate in the Task Force for Individual Deposit Insurance.

At the request of Foreign Exchange Department, we conducted a survey of recent Basel Committee documents on customer due diligence and anti-money laundering papers.

At the request of the NBU and USAID, we organized a trip for Mr. Berezhnyi, Head of Financial Monitoring Department, to the Annual International Anti-Money Laundering Conference at Miami Beach, Florida.

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List of Attachments

1. Technical Assistance Overview
2. Risk-Based Supervision
3. Comprehensive Program for the Development of the Banking System of Ukraine for the years 2003-2005
4. Comments on the Comprehensive Program for the Development of the Banking System
5. Status of Audit Profession in Ukraine
6. Problems and Future of External Audit
7. Licensing Requirements and Risk-management Systems: Situation in Ukraine and International Practice
8. Legal Amendments for Risk-Based Supervision
9. Summary of Pilot Bank Program
10. Pilot Bank Program
11. Survey of International Practices in the Training Organizations Area for Banking Supervision

Technical Assistance Overview

BearingPoint.
Formerly KPMG Consulting

MEMO

To: Mr. Sergey Tyhypko, Governor of the National Bank of Ukraine
Cc: Mr. Krotyuk, Deputy Governor of the National Bank of Ukraine
Mr. Kireev, Manager of the General Department of Bank Supervision
From: Mr. James E. Horner, Managing Director
Ms. Karen J. Wilson, Senior Advisor
Mr. Frank E. Blimling, Senior Advisor
Date: January 21, 2003
Re.: Technical Assistance Programs Provided by BearingPoint, Inc.

As members of your bank supervision technical assistance team, please accept our congratulations on your recent appointment as Governor of the National Bank of Ukraine. We have had the great opportunity to serve as the United States Agency for International Development (USAID) advisors to the Bank Supervision Department since 1995. We look forward to working with you and your staff.

BearingPoint, Inc. (formerly Barents Group of KPMG Consulting, Inc.) has worked closely with NBU bank supervision management and personnel in their progress towards developing a modern and sustainable bank supervision approach. This long-term partnership arrangement has focused our technical assistance on capacity building in the areas of Off-site Analysis, On-site Inspections, Problem Bank Resolution, Legal/Regulatory Development, Senior Managerial Policy advice as well as providing training to staff levels at the Kiev NBU headquarters and regional offices.

An effective bank supervision function is critical to overall financial sector improvement, and an area which central banks throughout Central and Eastern Europe and the former Soviet Union have committed significant resources to develop. As we mention above, this program concentrates on capacity building, which centers on certain building blocks that are central to international bank supervisory practices. This developmental process is a long-term endeavor, usually requiring from 8 to 10 years. Because of the progress made since 1995 toward building an effective bank supervision function, USAID continues to support the NBU through its technical assistance program. Ukraine is the first country of the former Soviet Union that USAID has focused technical assistance specifically in the development of risked-based supervision. This assistance is directly related to the progress made in the past several years and the commitment demonstrated by NBU Bank Supervision Department (BSD) senior management. As the NBU Governor, we believe you will find that your bank supervision function continues to strengthen, building on the foundation established by your bank supervision management team and USAID technical assistance.

Working closely with BSD management and staff, BearingPoint advisors are concentrated on building a risk-based supervision approach that ensures commercial bank management establishes appropriate systems to determine acceptable risk levels and maintain proper controls. Risk-based supervision puts the focus on bank management, rather then the BSD, in setting guidelines for risk. The BSD takes a proactive supervisory approach directed toward ensuring that commercial banks have a risk management system that prevents problems. It increases the reliance on bank management and market mechanisms in the BSD supervisory focus, and decreases reliance on standardized numerical calculations in guiding supervisory activities.

Risk-based supervision builds on existing supervisory tools and techniques, but expands the focus of supervisory efforts to ensure that commercial bank management boards and supervisory councils develop a risk management system that prevents high-risk activities, financial weaknesses, and violations of laws, regulations and normative standards. For example, over the years, BearingPoint advisors have encouraged on-site inspectors, through the routine use of the On-site Manual, to review the adequacy of a bank's policies and internal controls during the inspection process. While they have discussed weaknesses in policies and internal controls in the Report of Examination, and off-site analysts have attempted to address these weaknesses between inspections, the primary focus has been corrective action of violations of laws and normative standards. Whereas, under risk-based supervision, the BSD will require bank management and the supervisory council to develop a comprehensive risk management system that, not only ensures corrective action, but also establishes policies and procedures that prevents weaknesses and ensures compliance.

Effective bank supervision requires a supportive regulatory framework, strong supervisory processes, and a well-trained, professional staff. Bank supervisors must possess a high degree of independence, and the will to take appropriate actions when necessary. All these elements of effective bank supervision, when properly integrated, results in a safe and sound banking system, capable of withstanding economic adversities and supporting the financial interests of Ukraine and its citizens. Effective bank supervision strives to ensure that banks are well managed, financially strong and adequately capitalized.

The major objectives of BSD management, and our technical assistance efforts, were to position the BSD to accurately assess the level of capital, increase the level of capitalization in the banking industry, and strengthen the overall financial condition of banks. This involved supporting the development and implementation of international accounting standards and establishing reporting requirements for banks in conveying accurate financial information to the NBU. Additionally, substantial policy development was accomplished in the area of capital adequacy, and reserves for loans and other assets.

To further meet these objectives, the areas of on-site inspection and off-site analysis were expanded to determine the validity of bank information and acquire a sufficient understanding of a bank's financial strengths and weaknesses to take appropriate supervisory action. This included expanding the on-site inspection process and developing a comprehensive manual for use during inspections. The off-site supervision process was further developed to include an expanded prudential normative calculation process, an early warning system and a bank performance report. The enforcement process was also further expanded and strengthened to allow the BSD to take meaningful actions to force bank management to correct deficiencies and address weaknesses.

Our technical assistance efforts began by assisting BSD management in building a supportive regulatory framework and developing fundamental supervisory processes, primarily Off-site Analysis, On-site Inspections, and Problem Bank Resolution. We assisted extensively in implementing these supervisory processes and providing substantial formal and on-the-job training to the BSD staff. We continue to assist the NBU in this development and implementation phase of building effective bank supervision processes. We share the same goal as the management of the NBU, that is, to build a self-sustainable bank supervision process, capable of applying modern supervisory techniques, keeping pace with industrial changes, and promoting the development of the Ukrainian banking system.

While the BSD has made major progress since 1995 in becoming an effective bank supervisor, the supervisory approach they employ functions more as a "policeman," reacting to problems and violations of laws, regulations and normatives. The BSD establishes for all banks numerical standards relating to capital, liquidity, large loans, loans to insiders, etc. However, these standards do not take into account the level of risk in individual institutions. Our current project endeavors to support BSD management in furthering the NBU supervisory approach to determine how bank management identifies, measures, monitors and controls risks, or in other words, assess the quality of a bank's risk management system.

Ensuring that bank management and supervisory councils develop appropriate risk management systems is one area that is most needed for the NBU to fully comply with the Basel Committee's Core Principles of Effective Bank Supervision. While the BSD must continue to act as a "policeman" when necessary, under risk-based supervision inspectors and analysts will take a more consultative role in ensuring that bank management and supervisory councils establish risk management systems that prevent problems from developing.

BearingPoint advisors have assisted BSD management in establishing a Risk Based Supervision Task Force to design, develop and implement a risk-based supervisory approach. The Task Force has begun work on developing a Risk Assessment System. Once this is complete, the Task Force will initiate a review of inspection and analytical tools, and begin revising existing and developing new tools needed to carry out a meaningful risk-based supervision approach. Additionally, the Task Force will review laws and regulations to ensure the BSD has a solid regulatory base to fulfill its responsibilities.

In recognition of the need for banks to develop more comprehensive risk management systems and assist in the development of the BSD supervisory approach, the Risk Based Supervision Task Force, with assistance from BearingPoint advisors, is designing a "Pilot Bank" program. This program will be comprised of approximately ten banks that have agreed to review and contribute to the design and testing of risk based supervision tools and techniques recommended by the Task Force. The banks will also assist in expanding the Task Force member's understanding of risk management in commercial banks and provide guidance in developing appropriate regulations and policy directives.

A third focus of our current project is to assist the BSD in developing a formalized training program and accreditation process. Because of high personnel turnover that the BSD experiences, and the continual necessity to have highly trained professionals, BSD management recognizes the importance of having a self-sustained formalized training and accreditation process. We will address this need by assisting the BSD and NBU Personnel Department in developing a curriculum for a set of core courses, providing input in training BSD personnel to deliver in-house training, and begin the development of an accreditation process.

In summary, our current technical assistance project is designed to assist BSD management in their efforts to develop a risked-based supervision approach that conforms to international standards, and positions the NBU to take a more proactive and forward looking approach to supervising Ukrainian banks. Risk-based supervision will allow the BSD to respond appropriately to the impact and frequency of changes in the banking industry, while more efficiently allocating its limited supervision resources.

Through risk-based supervision, the NBU places the responsibility and accountability of a bank's condition with its management and supervisory council. Thus, requiring them to develop and implement a comprehensive risk management system for their bank. A comprehensive risk management system will allow them to respond appropriately to a volatile economic and banking environment. More specifically, it will allow them to effectively deal with the speed of change, deregulation, increased competition, volatile interest rates, increased capital requirements and the impact of technology. All these issues, along with others, must be addressed to ensure their bank remains profitable, adequately capitalized and financially sound.

Risk-based supervision and a sustainable modern bank supervision process require the development and implementation of a formalized training program. By working with the NBU Bank Supervision and Personnel Departments, and World Bank advisors and instructors, we will assist in the development and implementation of a consistent and sustainable training program for bank supervision personnel. This formal program will become the foundation in building an accreditation process that ensures bank supervision personnel possess the necessary knowledge and skills to competently perform their responsibilities and represent the NBU in a professional manner.

As a form of introduction, Appendix "A" provides a brief description of our individual responsibilities and involvement in technical assistance programs. Appendix "B" is a chart depicting the current status of development of the NBU supervisory process as it moves towards its goal of being a modern, self-sustainable bank supervisor.

At your convenience, we wish to meet with you to further discuss our technical assistance project(s). Meanwhile, Mr. Blimling, our resident advisory, is available to provide additional information. His office is located in Room 615 in the Bank Supervision Department and he can be reached at internal telephone Ext. 4182.

Appendix "A"

James Horner, Managing Direct of BearingPoint, Inc. Mr. Horner has managed all BearingPoint technical assistance projects to the BSD since 1995. Although, located at our headquarters in McLean, Virginia, Mr. Horner travels extensively to Ukraine providing insight and assistance in all areas of technical assistance.

Mr. Horner is an expert in bank supervision and financial institution strengthening. He oversees and advises central banks and supervisory organizations in Poland, Ukraine, Moldova and to a lesser extent in Russia, Kazakhstan, Uzbekistan, Bulgaria, and Romania. Mr. Horner spent fifteen years with the Office of the Comptroller of the Currency (OOC), during which he was involved in all aspects of bank supervision, including the analysis of the international activities of many multinational banks.

Karen Wilson, Senior Advisor. Ms. Wilson joined our project in 1997 as a resident advisor, providing senior policy advice to the Deputy Governor of Bank Supervision and senior management of the BSD. Ms. Wilson currently resides in New York, NY, and as on previous projects, provides short-term assistance (two to six weeks in duration) to the NBU each quarter. She also provides consultation on a continuous basis from her home in New York.

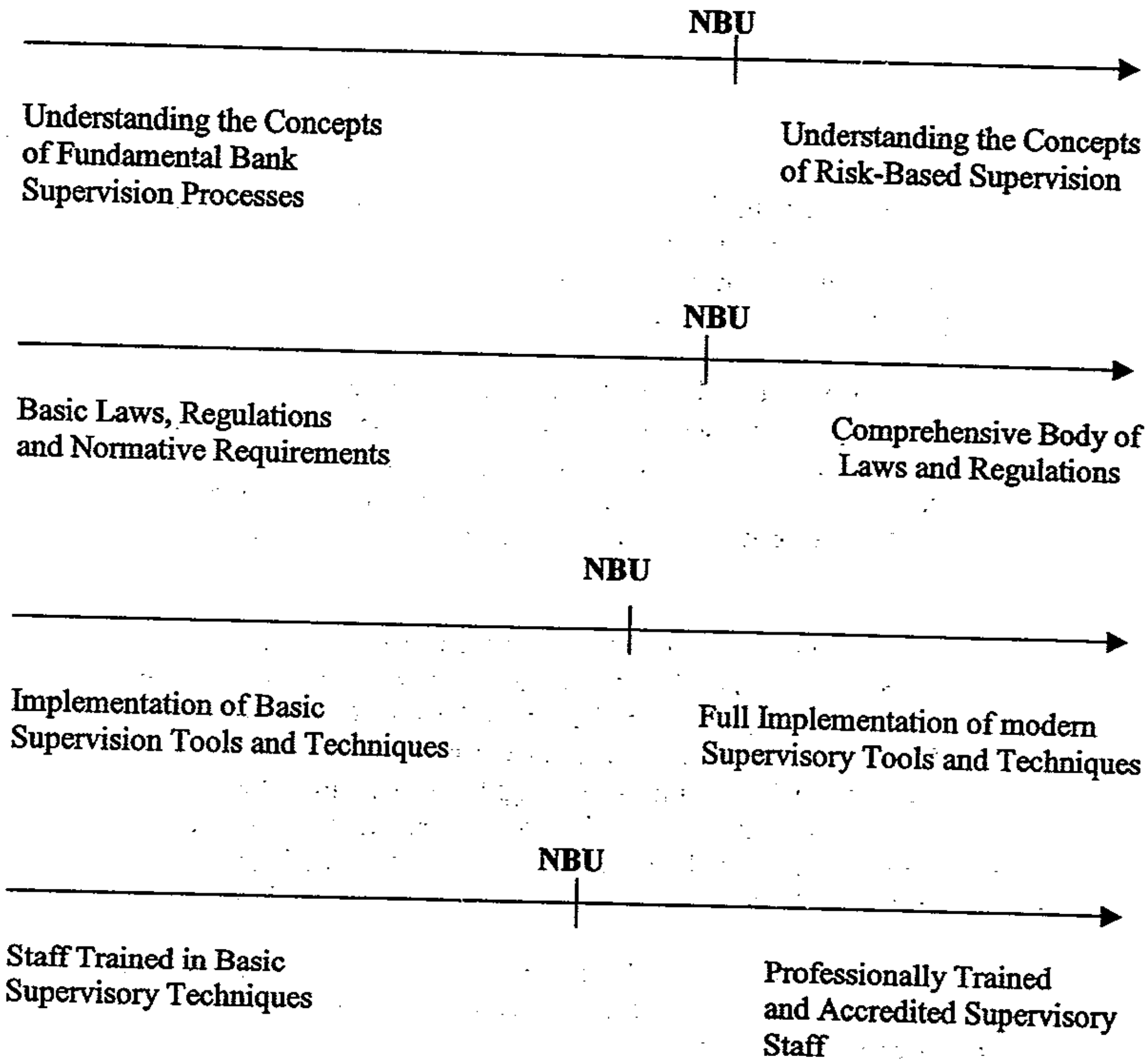
Ms. Wilson spent over 28 years with Comptroller of the Currency, holding several senior positions including: Deputy Comptroller of the Northeastern District – responsible for a staff of 432 who had supervisory responsibility for 387 banks (including the largest and prestigious U.S. financial center institutions) in a twelve state area; Acting Deputy Comptroller for Multinational Banking – oversight responsibility for the 11 largest national banks in the U.S. and their foreign operations; and Chief National Bank Examiner – responsible for the development and implementation of banking policy, the examination procedures handbook, regulations and regulatory accounting.

Frank Blimling, Senior Advisor. Mr. Blimling joined the BearingPoint project at the NBU in late 1996, providing assistance in the areas of On-site Supervision and Problem Bank Resolution. As resident advisor, Mr. Blimling manages a team of five local experts and professionals. Mr. Blimling's experience in Banking Supervision is extensive, having spent eighteen years with The Office of the Comptroller of the Currency (OCC) and six years as senior advisor to the National Bank of Ukraine (NBU) and the Palestinian Monetary Authority in Ramallah, Israel.

Expanded CV's upon request.

Appendix "B"

Bank Supervision Development



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Risk-Based Supervision

RISK-BASED SUPERVISION

Introduction

This policy describes the methods the National Bank of Ukraine (NBU) uses to assess risks in banks. It is an internal NBU process; banks are not required to adjust their own risk management processes to coincide with this methodology. The NBU has adopted this approach to ensure greater consistency and efficiency in inspections and other supervisory activities.

The NBU's philosophy for supervising all institutions focuses on risk. Higher risk institutions or areas with higher risk profiles demand greater supervisory attention. While applying this common philosophy to all institutions, the NBU recognizes the different complexities of risk facing banks. The NBU is committed to providing high-quality supervision directed at identifying material problems, or emerging problems in individual institutions or the banking system, and ensuring that such problems are appropriately corrected.

The policy begins with definitions that will be used throughout the process. The following section describes the NBU's supervision philosophy, *Risk-based Supervision*. The policy then describes the risk assessment system.

Risk-based Supervision

Risk-based Supervision requires supervisors to determine how certain existing or emerging issues facing an institution or the banking industry affect the nature and extent of risks in that institution. Based on that risk evaluation, supervisors then structure regulatory supervisory plans and actions. *Risk-based Supervision* builds upon the risk-based supervisory philosophy historically used by the NBU. This enhancement provides consistent definitions of risk, a structure for assessing these risks, and a more integrated use of risk assessment in the supervisory process.

The NBU recognizes that banking is a business of taking risk in order to earn profits. Risk levels, however, must be appropriately managed and controlled. Banking risks also must be evaluated in terms of their significance. These assessments should be ongoing.

Risk-based Supervision leaves the responsibility for controlling risks with bank management and the Supervisory Council. The NBU assesses how well a bank manages this risk over time, rather than only assessing the condition at a single point in time. With *Risk-based Supervision*, the NBU functions in more of an oversight than an audit role. *Risk-based Supervision* allows the NBU to supervise in a proactive manner by concentrating on systemic risks and institutions or areas that pose the greatest risk to the system.

For the entire industry, the NBU's *Risk-based Supervision* identifies areas that, in aggregate, pose the potential for presenting an unacceptable level of risk to the banking system. For high risk activities or activities that have become particularly risky because of market conditions, the NBU's goal is to communicate with, and influence, the industry through direct supervision, policy, and regulation. In situations where an individual bank is not properly managing its risks, the NBU's goal is to use appropriate means to influence bank management to adjust its practices to conform with sound fundamental banking principles.

Some risks are inherent to banking. A wide body of knowledge exists within the industry on how to identify, measure, control, and monitor these inherent risks. *Risk-based Supervision* acknowledges those inherent risks and seeks to guide supervisory resources in the most effective manner. For example, risk profiles will be supported by the performance of limited testing during inspections directed at confirming whether adequate controls are in place. This should reinforce initial risk profiling and assist in tailoring supervisory programs to risk profiles of individual institutions. This profiling is essential in the development of supervisory cycles and the choice of supervisory tools. The risks facing the industry are diverse and complex. More significant and sophisticated risks require enhanced controls and monitoring by both the bank and the NBU. The NBU is committed to directing its most significant resources to these complex and evolving risks where they present material, actual, or potential risks to the banking system.

Risk-based Supervision allocates greater resources to those areas with higher risks. The NBU accomplishes this by:

- Identifying risks using common definitions. This set of risks forms the basis for supervisory assessments and actions.

- Measuring risk based on common evaluation factors. Risk measurement is not always quantified in monetary terms; it is sometimes a relative assessment of exposure. For example, numerous internal control deficiencies may indicate a bank has an excessive amount of operations risk.

- Evaluating risk management to determine if bank systems adequately manage and control the identified risk levels. The sophistication of the systems will vary based on the level of risk present and the size and/or complexity of the institution.

- Assigning greater resources to areas of higher or increasing risk, both within an individual institution and among institutions in general. This is done through the supervisory strategy process.

- Using appropriate supervisory tools based on the risks, reaching conclusions on risk profile and condition, and following up on areas of concern.

To accomplish the above tasks, supervisors should discuss preliminary conclusions of this risk-based supervisory strategy with bank management and adjust conclusions and strategies based on those discussions, if appropriate. The NBU can then focus supervisory efforts on significant risks, i.e., the areas of highest risk within a bank and within the banking system.

Definition of Risk

For purposes of the NBU's discussion of risk, the NBU assesses banking risk by its impact on capital and earnings. Risk is the potential that events, expected or unanticipated, may have an adverse impact on the institution's capital or earnings.

The simple existence of risk is not necessarily reason for concern. To put risks in perspective, supervisors should decide if the risks a bank is undertaking are warranted. Generally, risks are warranted when they are understandable, measurable, controllable, and within the institution's capacity to readily withstand adverse performance. Unwarranted risk can occur whether deliberate or unintentional. When risks are unwarranted, supervisors must communicate with management and the Supervisory Council, and encourage them to mitigate or eliminate the unwarranted risks. Appropriate actions for the bank to take would include reducing exposures, increasing capital, or strengthening risk management processes.

Risk Management

Because market conditions and company structures vary, there is no single risk management system that works for all banks. Each institution should develop its own risk management program tailored to its needs and circumstances. The sophistication of the risk management system will increase, for example, with the size, complexity, and geographic diversity of each bank. All sound risk management systems, however, have several common fundamentals. For example, sound risk management systems are independent of risk-taking activities. Regardless of the risk management program's design, each program should include:

- Risk identification: Proper risk identification focuses on recognizing and understanding existing risks or risks that may arise from new business initiatives. Risk identification should be a continuing process, and should occur at both the transaction and portfolio level.

- Risk measurement: Accurate and timely measurement of risks is a critical component of effective risk management. A bank that does not have a risk measurement system has limited ability to control or monitor risk levels. Further, the sophistication of the risk measurement tools a bank uses should reflect the complexity and levels of risk it has assumed. The bank should periodically verify the integrity of the measurement tools it uses. Good risk measurement systems assess both individual transactions and portfolios.

- Risk control: The bank should establish and communicate limits through policies, standards, and/or procedures that define responsibility and authority. These control limits should be meaningful management tools that can be adjusted if conditions or risk tolerances change. The institution should have a process to authorize exceptions or changes to risk limits when they are warranted.

- Risk monitoring: Institutions should monitor risk levels to ensure timely review of risk positions and exceptions. Monitoring reports should be frequent, timely, accurate, and informative, and should be distributed to appropriate individuals to ensure action when needed.

Effective risk management requires the bank's Supervisory Council be informed. The Supervisory Council must guide the bank's strategic direction. A key component of strategic direction is endorsing the organization's risk tolerance by approving policies that set standards, either orally or in writing. Well-designed monitoring systems allow the Supervisory Council to hold bank management accountable for operating within established tolerance levels.

Capable management and appropriate staffing also are critical to effective risk management. Bank management is responsible for the implementation, integrity, and maintenance of risk management systems. Management also must keep the Supervisory Council adequately informed. Management must:

- Implement the bank's strategic direction.

- Develop policies, formal or informal, that define the institution's risk tolerance that are compatible with the institution's strategic goals.

- Oversee the development and maintenance of management information systems to ensure they are timely, accurate, and informative.

- Ensure that strategic direction and risk tolerances are effectively communicated and adhered to throughout the organization.

When supervisors assess risk management systems, they consider policies, processes, personnel, and control systems. A significant deficiency in one or more of these components constitutes a deficiency in risk management. All of those systems are important, but the sophistication of each will vary depending upon the complexity of the institution. Smaller, less complex institutions normally have less formalized policies, processes, and control systems in place than do larger institutions. This does not mean, however, that risk management systems are not just as important for less complex institutions. It simply means that the formalization of the process is less distinct. All institutions should be able to clearly articulate and demonstrate the effectiveness of their own risk management systems. Nonetheless, an effective risk management process includes consistent policies, processes, personnel, and control systems.

- Policies reflect the institution's intent and commitment to pursuing desired results. They set standards and courses of action to pursue, implement, or enforce specific objectives. Good policies link with, and reflect, an institution's underlying mission, values, and principles. They also clarify the institution's tolerance for risk. Mechanisms should be in place to trigger a review of policies in the event that activities or tolerances change. Policies may be written or unwritten depending upon the effectiveness of management and the complexity of the area or institution. In any event, standards should be articulated and adhered to in practice.

- Processes are the procedures, programs, and practices that govern how an institution will pursue its objectives. Processes define how daily activities are carried out. Good processes are consistent with the underlying policies, are efficient, and include checks and balances.

- Personnel are the staff and managers that execute or oversee performance of the processes. Good staff and managers are qualified, competent, and perform as expected. They understand the institution's mission, values, policies, and processes. Compensation programs should be designed to attract, develop, and retain qualified personnel.

- Control systems are tools and information systems that bank managers use to measure performance, make decisions, and assess effectiveness of existing processes. These feedback devices must be timely, accurate, and informative. They measure performance and assist in decision-making.

Categories of Risk

The NBU has defined ten categories of risk for bank supervision purposes. These risks are: Credit, Interest Rate, Liquidity, Market, Foreign Exchange, Operations, Strategic, Reputation, Legal and Information Technology (IT). These categories are not mutually exclusive; any product or service may expose the institution to multiple risks. For analysis and discussion purposes, however, the NBU identifies and assesses the risks separately.

Credit Risk

Credit risk is the current or prospective risk to earnings and capital arising from an obligor's failure to meet the terms of any contract with the institution or otherwise fails to perform as agreed, including the possibility of restrictions on or impediments to the transfer of payments from abroad. Credit risk is found in all activities where profitability depends on counter party, issuer, or borrower performance. It arises any time bank funds are extended, committed, invested or otherwise exposed through actual or implied contractual agreements, whether reflected on or off balance sheet.

In assessing credit risk it is advisable to segregate individual and portfolio credit risk. The source of individual credit risk is a separate specific counter party of the bank – a borrower, debtor, or issuer of securities. Individual credit risk assessments envision an assessment of the creditworthiness of a specific counter party, i.e. its individual capacity to timely and fully meet its obligations. Portfolio credit risk shows in a decrease in bank assets value (other than as a consequence of change of a market interest rate). The source of portfolio credit risk is the bank's overall outstanding transactions bearing credit risk – loan portfolio, securities portfolio, accounts receivable portfolio, etc. Portfolio credit risk assessment envisions an assessment of bank assets concentrations and diversification.

In addition, international lending includes country risk, which refers to risks associated with the economic, social and political environments of the borrower's home country. Country risk may be most apparent when lending to foreign governments or their agencies, since such lending is typically unsecured, but is important to consider when making any foreign loan or investment, whether to public or private borrowers. There is also a component of country risk called "transfer risk" which arises when a borrower's obligation is not denominated in the local currency. The currency of the obligation may become unavailable to the borrower regardless of its particular financial condition.

Liquidity Risk

Liquidity risk is the current or prospective risk to earnings and capital arising from a bank's inability to meet its liabilities when they come due without incurring unacceptable losses. Funding liquidity risk arises from the inability to manage unplanned outflows of funds and changes in funding sources and/or to meet off-balance sheet liabilities.

We also single out market liquidity risk, which is defined as the current or prospective risk to earnings and capital arising from a bank's inability to quickly unwind gaps in its positions at current market rates without incurring unacceptable losses. Market liquidity risk arises from the failure to recognize or address changes in market conditions that affect the ability to attract funds in necessary volumes and at acceptable rates and/or to liquidate assets quickly and with minimal loss in value.

Interest Rate Risk

Interest rate risk is the current or prospective risk to earnings and capital arising from adverse movements in interest rates. This risk impacts both the earnings of a bank and the economic value of its assets, liabilities and off-balance sheet instruments. The primary types of interest rate risk to which banks are typically exposed are: (1) repricing risk, which arises from timing differences in the maturity (for fixed rate) and repricing (for floating rate) of bank assets, liabilities and off-balance sheet positions; (2) yield curve risk, which arises from changes in the slope and shape of the yield curve; (3) basis risk, which arises from imperfect correlation in the adjustment of the rates earned and paid on different instruments with otherwise similar repricing characteristics; and (4) optionsality risk, which arises from the express or implied options imbedded in many bank assets, liabilities and off-balance sheet portfolios.

Market Risk

Market risk is the current or prospective risk to earnings and capital arising from adverse movements in bond prices, security and commodity prices and foreign exchange rates in the trading book. This risk arises from market making, dealing, and position taking in debt and equity securities, currencies, commodities, and derivatives (bonds, securities, currencies, and commodities).

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Risks arising under similar circumstances with regard to similar instruments in the banking book are addressed in other relevant categories of the risk assessment system.

Foreign Exchange Risk

Foreign exchange risk is the current or prospective risk to earnings and capital arising from adverse movements in currency exchange rates and banking metal prices. Foreign exchange risk can be separated into:

- Transaction risk
- Translation risk
- Economic foreign exchange risk

Transaction risk refers to the impact of adverse movements in currency exchange rates on the value of open foreign currency positions. However, since it generally arises from market making, dealing and position taking in foreign currencies it is covered in the market risk guideline. Translation risk refers to the variability in accounting values that result from variations in exchange rates which are used in translating carrying values in foreign currencies to base currency. Economic foreign exchange risk refers to changes in competitive strength of the financial institution or its entities in the foreign market due to fundamental changes in exchange rates.

Operations Risk

Operations risk affects the long-term existence of a banking institution, and arises from breakdowns in corporate governance or internal controls. Such breakdowns can lead to financial losses through error, fraud, or failure to perform in a timely manner or cause the interests of the bank to be compromised in some other way, for example, by its dealers, lending officers or other staff exceeding their authority or conducting business in an unethical or risky manner. Other aspects of operations risk include major failure of information technology systems or events such as major fires or other disasters.

Reputation Risk

Reputation risk is the current or prospective risk to earnings and capital arising from adverse perception of the image of the financial institution by customers, counter parties, shareholders, or regulators. This affects the bank's ability to establish new relationships or services or service existing relationships. This risk may expose the institution to administrative, civil and criminal liability, financial loss or a decline in its customer base. Reputation risk exposure is present throughout the organization and, therefore, banks are obligated to exercise appropriate treatment in dealing with its customers and with the community.

The public perception can be delineated as follows:

- Market perception: e.g. actual or potential customers or counter parties, or shareholders
- Regulatory perception: e.g. the National Bank of Ukraine, Securities and Exchange Commission, State Tax Administration, and other authorized bodies.

Legal Risk
Legal risk is the current or prospective risk to earnings and capital arising from violations or non-compliance with laws, rules, regulations, agreements, prescribed practices, or ethical standards, as well as from the possibility of dubious interpretation of effective laws or rules. Banks are exposed to legal risk due to relations with a great number of stakeholders, e.g. customers, counter parties, intermediaries, etc., as well as regulators, tax authorities, and other authorized agencies. Legal risk can lead to fines and penalties, payment of damages, diminished reputation, deteriorating position in the market, reduced expansion potential, and lack of contract enforceability.

Strategic Risk
Strategic risk is the current or prospective risk to earnings and capital arising from adverse business decisions, improper implementation of decisions, or lack of responsiveness to changes in the business environment. This risk is a function of the compatibility of a bank's strategic goals, the business strategies developed to achieve those goals, the resources deployed against these goals, and the quality of implementation. The resources needed to carry out business strategies are both tangible and intangible. They include communication channels, operating systems, delivery networks, and managerial capacities and capabilities. The organization's internal characteristics must be evaluated against the impact of economic, technological, competitive, regulatory, and other environmental changes.

Information Technology (IT) Risk
IT risk is the current or prospective risk to earnings and capital arising from inadequate information technology and processing in terms of manageability, exclusivity, integrity, controllability, and continuity. Further, IT risk arises from an inadequate IT strategy and policy, and from inadequate use of the information technology.

Measuring and Assessing Risk

To ensure effective risk-based supervision, the NBU requires a common framework to document decisions about risk. The risk assessment system (RAS) provides a concise method of communicating and documenting judgments regarding the quantity of risk, the quality of risk management, the level of supervisory concern (measured as aggregate or composite risk), and the direction of risk. The common definitions explained above are critical to identifying risks consistently. A list of evaluation factors that supervisors should consider in making the assessments is also provided. These evaluation factors are recommended criteria and may be expanded by supervisors, if necessary.

Assessments of risk in the RAS must reflect both a current and prospective view of the institution's risk profile. This assessment drives supervisory strategies and activities. It also facilitates discussions with bank management and Supervisory Council members and helps to ensure more efficient supervisory activities (examinations, offsite surveillance, etc.).

Supervisors should discuss conclusions from the RAS with appropriate bank management and the Supervisory Council. Bank management's input may help clarify or modify the supervisor's RAS conclusions. While the NBU does not require bankers to adopt a similar process, supervisors must effectively communicate the rationale for their decisions in evaluating risk to ensure effective supervision. These discussions will help the NBU and bank management reach a common understanding of the risks, focus on the strengths and weaknesses of risk management, and ensure that future supervisory plans are achieved.

The Risk Assessment System

The NBU has defined a system for assessing each major risk category. The Risk Assessment System provides a consistent means of measuring the risk and determining which supervisory procedures will be performed. For six of the risk categories – credit, liquidity, interest rate, market, foreign exchange, and operations, the supervisor assesses the quantity of risk, the quality of risk management, the aggregate risk and the direction of risk. For effective use of the system, supervisors should consider the current condition of the bank as well as factors that may identify increasing risks. Under the Risk Assessment System, a bank's risk profile has four components:

- **Quantity of Risk,** which is the level or volume of risk that the bank faces and is characterized as low, moderate, or high.

- **Quality of Risk Management,** which is how well risks are identified, measured, controlled, and monitored and is characterized as strong, satisfactory, or weak.

- **Aggregate Risk,** which is a summary judgment that reflects the level of supervisory concern considering both the quantity of risk and the quality of risk management, weighing the relative importance of each. It is assessed as high, moderate, or low for each of the ten categories of risk. Mitigating factors such as insurance may impact the supervisor's assessment of aggregate risk. Aggregate risk assessments direct the specific activities and resources outlined in supervisory strategies. A list of evaluation factors supplements the decision process.

- **Direction of Risk,** which is the probable change in the aggregate level of risk over the next 12 months and is characterized as decreasing, stable, or increasing. The direction of risk will influence the supervisory strategy, including the extent that expanded procedures might be used. Decreasing direction indicates the supervisor anticipates, based on current information, the aggregate risk will decline over the next 12 months. Stable direction indicates the supervisor anticipates that aggregate risk will remain unchanged. Increasing direction indicates the supervisor anticipates that aggregate risk will be higher 12 months in the future.

The quantity of risk and quality of risk management should be assessed independently. Therefore, when assigning the individual Risk Assessment System ratings, the assessment of the quantity of risk should not be affected by the quality, no matter how strong or weak, of risk management. Also, strong capital support or strong financial performance should not mitigate an inadequate risk management system. The supervisor should not conclude that "high" risk levels are bad and "low" risk levels are good. The quantity of risk simply reflects the level of risk the bank accepts in the course of doing business and whether this is good or bad depends on whether its risk management systems are capable of identifying, measuring, monitoring and controlling that amount of risk.

The remaining risks – strategic, reputation, legal and IT, affect the banks capital and earnings, but are difficult to measure precisely. Consequently, the NBU modified how the risks are assessed and measured, assessing only the **aggregate risk** and **direction of risk**. The characterizations of **aggregate risk** and **direction of risk** are the same as for the other seven risks.

Supervisors should complete the Risk Assessment System for institutions at the end of each supervision cycle (usually 12 months). It should be updated any time the supervisor becomes aware of changes to the risk profile on an interim basis.

The Application of Risk to Supervision

In completing the Risk Assessment System, the supervisor determines the level of supervisory concern and direction of risk for each risk category. This decision will determine the supervisory procedures to be used: for example, a full scope on-site examination, targeted examinations, offsite surveillance, etc.

The application of risk management techniques and standards will enable supervisors to tailor supervisory programs for each institution. The goal of supervision is to provide the most effective but least intrusive supervision possible, which is in the interest of both the institution and its depositors and other creditors.

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NBU Risk Assessment System

Credit Risk

Credit risk is the current or prospective risk to earnings and capital arising from an obligor's failure to meet the terms of any contract with the institution or otherwise fails to perform as agreed, including the possibility of restrictions on or impediments to the transfer of payments from abroad. Credit risk is found in all activities where profitability depends on counter party, issuer, or borrower performance. It arises any time bank funds are extended, committed, invested or otherwise exposed through actual or implied contractual agreements, whether reflected on or off balance sheet.

In assessing credit risk it is advisable to segregate individual and portfolio credit risk. The source of individual credit risk is a separate specific counterparty of the bank – a borrower, debtor, or issuer of securities. Individual credit risk assessments envision an assessment of the creditworthiness of a specific counterparty, i.e. its individual capacity to timely and fully meet its obligations. Portfolio credit risk shows in a decrease in bank assets value (other than as a consequence of change of a market interest rate). The source of portfolio credit risk is the bank's overall outstanding transactions bearing credit risk – loan portfolio, securities portfolio, accounts receivable portfolio, etc. Portfolio credit risk assessment envisions an assessment of bank assets concentrations and diversification.

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Evaluation Factors

Supervisors should consider the following evaluation factors in making risk assessments. These evaluation factors are recommended criteria and may be expanded by supervisors, if necessary. They are an overview of issues that can assist the supervisor in making decisions within the RAS. The actual data of the ongoing risk assessment and control system existing at the bank are to make sure that management makes adequate and effective decisions and are considered by supervisors when assessing the bank's risk.

- The existence of an adequate, effective and communicated internal regulatory framework (policies, procedures, etc) for credit risk management approved by the Supervisory Council (or its committee) and/or the Board of Managers and appropriate compliance practices.

- Asset (loan, investment, etc.) portfolio composition and the existence of concentrations. Relevant factors include:

  - Products.
  - Risk classification/ratings.
  - Customers.
  - Geographic regions.
  - Sources of repayment.
  - Types of economic activity.
  - Debt Originations.
  - Size of loans.
  - Single/related counterparty(s).
  - Collateral.

- The protection provided by collateral. In evaluating collateral, supervisors should analyze collateral type, quality, margins, adequacy and frequency of collateral revaluation, marketability, and the level and nature of documentation exceptions.

- The existence of appropriate underwriting standards (written or unwritten).

- The bank's exposure to unfunded commitments (guarantees, commercial and standby letters of credit, lines of credit mandatory and not mandatory for delivery, etc.).

- Trends in active operations volume and growth, delinquencies, non-performing loans, classified loans, and losses from active operations.

- The adequacy of the institution's provision for losses from active operations.

- The existence of timely, accurate, and comprehensive management information.

- The effectiveness of credit administration, including credit analysis, monitoring, problem asset resolution, collateral valuation, and lien documentation.

- The adequacy of methods used to identify credit problems.

- Staffing levels and skills in relation to volume and complexity of the bank's active operations.

- Whether proper accounting treatment is used for balance sheet and off-balance sheet assets and provisions.

- The existence of appropriate control mechanisms (audit, internal reviews of lending activity, appropriate procedures, etc.) to grade portfolios, ensure accuracy of data, and monitor compliance with policies or laws.

Quantity of Credit Risk

Review of those factors should allow supervisors to assess the Quantity of credit risk as:

Low	Moderate	High
Credit risk diversification is actively managed.	Attention to credit risk diversification is adequate.	Credit risk diversification is unsatisfactory.
The level of loans outstanding and credit commitments are low relative to total assets.	The level of loans outstanding and credit commitments are moderate relative to total assets.	The level of loans outstanding and credit commitments are high relative to total assets.
The ratio of loans and credit commitments to regulatory capital is low.	The ratio of loans and credit commitments to regulatory capital is moderate.	The level of loans and credit commitments to regulatory capital is high.
Growth in credit risk generating assets has been planned for, and appears consistent with management and staff expertise and/or operational capabilities.	Some growth in assets generating credit risk has not been planned or exceeds planned levels, and may test management and staff expertise or operational capabilities.	Growth in assets generating credit risk was not planned or exceeds planned levels, and stretches management and staff expertise and/or operational capabilities. Growth may be in new products or with out-of-area borrowers.
New loans are conservative in structure, terms, growth, or settlement practices.	New loans are prudent in structure, terms, growth, or settlement practices.	New extensions are aggressive in structure, terms, growth, or settlement practices.
Few or no exceptions to sound underwriting standards exist.	A limited volume of exceptions to sound underwriting standards exists.	A large volume of exceptions to sound underwriting standards exists.
Collateral values and quality satisfactorily support credit exposure.	Collateral values and quality protect credit exposure.	Collateral is illiquid or values and quality provide inadequate support.
The level of noncurrent and doubtful loans is low and the trend is stable.	The level of noncurrent and doubtful loans is moderate; the trend is stable.	The level of noncurrent and doubtful loans is high, and the trend is stable, or is moderate and the trend is increasing.
The level of adversely classified assets is low.	The level of adversely classified assets is moderate.	The level of adversely classified assets is high.
Adversely classified assets can be worked through in the normal course of business.	Adversely classified assets can be worked through in reasonable time frames.	Adversely classified assets may require extended time for resolution.
Reserves for losses on active operations are adequate and cover inherent losses. Exposure to loss of earnings or capital from credit risk is minimal.	Inherent losses on active operations should not seriously deplete current Reserves or necessitate more than normal provisions. Exposure to loss of earnings or capital from credit risk is manageable.	Losses on active operations may seriously deplete current Reserves or require significant additional provisions to cover inherent losses. Exposure to loss of earnings or capital from credit risk is substantial.

Quality of Credit Risk Management

Review of those factors should allow supervisors to assess the quality of credit risk Management as:

Strong	Satisfactory	Weak
Management fully understands all aspects of credit risk and anticipates and responds timely and adequately to changes in market conditions of lending.	Management reasonably understands key aspects of credit risk and generally adequately responds to changes in market conditions of lending.	Management does not understand, or has chosen to ignore, key aspects of credit risk. It does not anticipate or take timely and appropriate actions in response to changes in market conditions of lending.
Current policies on active operations effectively establish and communicate portfolio objectives, risk tolerances, and underwriting and risk selection standards.	Policies are fundamentally adequate. Enhancements can be achieved in one or more areas, but are generally not critical. Specificity of risk tolerance, or underwriting and risk selection standards may need improvement to fully communicate policy requirements.	Polices are deficient in one or more ways and require significant improvement in one or more areas. They may not be sufficiently clear or are too general to adequately communicate portfolio objectives, risk tolerances and underwriting and risk selection standards.
Management information systems (MIS) provide accurate, timely and complete portfolio information. Management and the supervisory council receive appropriate reports to analyze and understand the bank's credit risk profile.	MIS may require modest improvement in one or more areas, but management and the supervisory council generally receive appropriate reports to analyze and understand the bank's credit risk profile. MIS facilitates exception reporting, and MIS infrastructure can support ad hoc queries in a timely manner.	MIS have deficiencies requiring attention. The accuracy and/or timeliness of information may be affected in a material way. Portfolio risk information may be incomplete. As a result, management and supervisory council may not be receiving appropriate or sufficient information to analyze and understand the banks credit risk profile. Exception reporting requires improvement, and MIS infrastructure may not support ad hoc queries in a timely manner.
Staffing levels and expertise are appropriate for the size and complexity of portfolios of active operations. Staff turnover allows for the orderly transfer of responsibilities. Training programs facilitate on-going staff development.	Staffing levels and expertise are generally adequate for the size and complexity of portfolios of active operations. Staff turnover may create some gaps in portfolio management. Training initiatives may be inconsistent.	Staffing levels are inadequate in numbers or skill level. Turnover is high. Bank does not provide sufficient resources for staff training.
Credit risk analyses are comprehensive and promote early identification of emerging risks.	Credit risk analyses are satisfactory, as are risk measurements and monitoring systems.	Credit risk analyses are not comprehensive or are of deficient quality.
Internal grading appropriately	Internal grading reasonably stratifies	Internal grading of loans does not

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stratifies portfolio quality and provides early detection of potential problems.	portfolio quality.	accurately reflect the portfolio's quality.
Internal lending activity review and internal and external audit of active operations are timely, comprehensive, and independent.	Lending activity review and internal and external audit of lending operations are acceptable.	Serious weaknesses exist in lending activity review and internal and external audit of lending operations, such as lack of independence, timeliness, or scope of review.
The methodology of calculation of reserves for losses on active operations is sound and appropriate coverage of risks exists.	The methodology of calculation of reserves for losses on active operations is generally adequate and coverage of risks is acceptable.	The methodology of calculation of reserves for losses on active operations is flawed. It provides insufficient coverage of risks present in the portfolios.

Credit Risk

Credit risk is the current or prospective risk to earnings and capital arising from an obligor's failure to meet the terms of any contract with the institution or otherwise fails to perform as agreed, including the possibility of restrictions on or impediments to the transfer of payments from abroad. Credit risk is found in all activities where profitability depends on counter party, issuer, or borrower performance. It arises any time bank funds are extended, committed, invested or otherwise exposed through actual or implied contractual agreements, whether reflected on or off balance sheet.

In assessing credit risk it is advisable to segregate individual and portfolio credit risk. The source of individual credit risk is a separate specific counterparty of the bank – a borrower, debtor, or issuer of securities. Individual credit risk assessments envision an assessment of the creditworthiness a specific counterparty, i.e. its individual capacity to timely and fully meet its obligations. Portfolio credit risk shows in a decrease in bank assets value (other than as a consequence of change of a market interest rate). The source of portfolio credit risk is the bank's overall outstanding transactions bearing credit risk – loan portfolio, securities portfolio, accounts receivable portfolio, etc. Portfolio credit risk assessment envisions an assessment of bank assets concentrations and diversification.

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Summary Conclusions:

The quantity of credit risk is:

❑ Low	❑ Moderate	❑ High

The quality of credit risk management is:

❑ Strong	❑ Satisfactory	❑ Weak

Inspectors should consider both the quantity of credit risk and quality of credit risk management to derive the following conclusions:

Aggregate credit risk is:

❑ Low	❑ Moderate	❑ High

The direction is expected to be:

❑ Decreasing	❑ Stable	❑ Increasing

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Liquidity Risk

Liquidity risk is the current or prospective risk to earnings and capital arising from a bank's inability to meet its liabilities when they come due without incurring unacceptable losses. Funding liquidity risk arises from the inability to manage unplanned outflows of funds and changes in funding sources and/or to meet off-balance sheet liabilities.

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Evaluation Factors

Supervisors should consider the following evaluation factors in making risk assessments. These evaluation factors are recommended criteria and may be expanded by supervisors, if necessary. They are an overview of issues that can assist the supervisor in making decisions within the RAS. The actual data of the ongoing risk assessment and control system existing at the bank are to make sure that management makes adequate and effective decisions and are considered by supervisors when assessing the bank's risk.

- The volume and composition of asset-based liquidity in relation to the liability structure. Relevant factors include:
  - Highly liquid assets.
  - Securities and other assets, which can be accepted for refinancing transactions (taking into account the liquidity of their market).
  - Asset sales, securitization opportunities, etc.

- Volume, structure and diversification level of passives (liabilities and capital). Relevant factors include:
  - Proportion of liabilities in the bank's passives
  - Proportion of:
    - Term liabilities and demand liabilities
    - Individual funds and corporate funds
    - Interbank funds
  - Existence of volatile sources of funds sensitive to changes in the bank's risk level
  - Concentrations:
    - By provider of funds
    - By instrument (for example, certificate of deposit, deposit account, debit card, etc.)
    - By maturity

- The average weighted cost of attracted funds for a given bank in relation to its peer banks

- Net funding gaps, with an emphasis on short-term exposures, including:
    - Projected funding needs.
    - Ability to cover potential funding gaps at reasonable prices by attracting additional resources
    - The depth and breadth of financial markets, where funds can be attracted

- The composition of on- and off-balance sheet portfolios, including:
    - Outflows and inflows of funds
    - Liquidity of collateral and early termination arrangements (for example, deposit arrangements, etc.)
    - The depth and breadth of secondary markets available to convert the instruments to cash.

- Resistance to the institution's name in the marketplace as demonstrated by deteriorating credit ratings and debt spreads over comparable government securities.

- The cost of funding for this institution compared to the cost with its competition.

- The views of formal or informal rating services and analysts about the institution, including current ratings and rating trends. Publications in mass media.

- The existence of appropriate contingency planning.

- The existence of timely, accurate, and informative management information.

- The level and skill of management and staff.

- The existence of proper control mechanisms to monitor the accuracy of information, proper accounting treatment, and compliance with policies or laws.

Quantity of Liquidity Risk

Review of those factors should allow supervisors to assess the quantity of liquidity risk as:

Low	Moderate	High
Earnings and capital exposure from the liquidity risk profile (cash flows, current position and liquidity needs, liquidity management strategy) is negligible	Earnings or capital exposure from the liquidity risk profile is manageable.	Potential exposure to loss of earnings or capital due to high liability costs or unplanned asset reduction below their balance-sheet value may be substantial.
Liquidity position is favorable, with negligible exposure to earnings and capital expected.	The liquidity position is not expected to deteriorate in the near term.	Liquidity position is extremely unfavorable, resulting in substantial exposure to loss of earnings or capital.
Ample funding sources exist. Funding sources provide the bank with a competitive cost advantage.	Sufficient funding sources exist to provide cost-effective liquidity.	Funding sources and portfolio structures suggest current or potential difficulty in sustaining long-term cost-effective liquidity.
Borrowing sources are widely diversified, with little reliance on significant funds providers.	Borrowing sources are diversified with few providers sharing common investment objectives, timing, and economic influences.	Borrowing sources are concentrated in a few providers or providers with common investment objectives or economic influences.
Market alternatives exceed demand for liquidity, with no adverse changes expected.	The bank is not excessively vulnerable to funding difficulties should an adverse change in market perception occur. Earnings or capital exposure is manageable.	The institution has virtually no access to market of funds as a consequence of its inadequate perception or ignoring by the market.
Support provided by the parent company is strong.	Parent company provides adequate support.	Little or unknown support provided by the parent company.

Quality of Liquidity Risk Management

Review of these factors should allow supervisors to assess the quality of liquidity risk management as:

Strong	Satisfactory	Weak
Policies approved by the Supervisory Council (or its committee) and the Board of Managers effectively communicate to personnel guidelines for liquidity risk management and designate responsibility.	Policies approved by the Supervisory Council (or its committee) and the Board of Managers adequately communicate to personnel guidance for liquidity risk management and assign responsibility. Minor weaknesses may be present.	Supervisory Council-approved policies are inadequate or incomplete. Policy is deficient in one or more material respects.
Management fully understands all aspects of liquidity risk.	Management reasonably understands the key aspects of liquidity risk.	Management does not understand, or ignores the key aspects of liquidity risk.
Management anticipates and responds well to changes in market conditions.	Management adequately responds to changes in market conditions.	Management does not anticipate or take timely or appropriate actions in response to changes in market conditions.
Liquidity risk management processes reflect a sound culture that has proven effective over time.	Liquidity risk management processes are adequate.	Liquidity risk management processes are deficient.
Management information is timely, complete and reliable.	Management information is generally timely, accurate, complete and reliable.	Management information systems do not provide adequate information for managing liquidity risk.
Appropriate attention is given to balance sheet symmetry and the cost effectiveness of liquidity alternatives.	Access to funding markets is properly assessed and diversified, and attention to balance sheet symmetry is appropriate.	Management has not realistically assessed the institution's access to sources of funds and has not paid sufficient attention to diversification. Attention to balance sheet symmetry is deficient.
Contingency plans are effective and take into account all relevant factors.	Contingency planning is effective, and the cost of liquidity alternatives is adequately considered.	Contingency planning is either nonexistent or incomplete. The cost of liquidity alternatives has not been adequately considered. A high probability exists that contingency funding sources are needed. Improvement is not expected in the near future.

Liquidity Risk

Liquidity risk is the current or prospective risk to earnings and capital arising from a bank's inability to meet its liabilities when they come due without incurring unacceptable losses. Funding liquidity risk arises from the inability to manage unplanned outflows of funds and changes in funding sources and/or to meet off-balance sheet liabilities.

We also single out market liquidity risk, which is defined as the current or prospective risk to earnings and capital arising from a bank's inability to quickly unwind gaps in its positions at current market rates without incurring unacceptable losses. Market liquidity risk arises from the failure to recognize or address changes in market conditions that affect the ability to attract funds in necessary volumes and at acceptable rates and/or to liquidate assets quickly and with minimal loss in value.

Summary Conclusions:

The quantity of liquidity risk is:

❑ Low	❑ Moderate	❑ High

The quality of liquidity risk management is:

❑ Strong	❑ Satisfactory	❑ Weak

Inspectors should consider both the quantity of liquidity risk and quality of liquidity risk management to derive the following conclusions:

Aggregate liquidity risk is:

❑ Low	❑ Moderate	❑ High

The direction is expected to be:

❑ Decreasing	❑ Stable	❑ Increasing

Interest Rate Risk

Interest rate risk is the current or prospective risk to earnings and capital arising from adverse movements in interest rates. This risk impacts both the earnings of a bank and the economic value of its assets, liabilities and off-balance sheet instruments. The primary types of interest rate risk to which banks are typically exposed are: (1) repricing risk, which arises from timing differences in the maturity (for fixed rate) and repricing (for floating rate) of bank assets, liabilities and off-balance sheet positions; (2) yield curve risk, which arises from changes in the slope and shape of the yield curve; (3) basis risk, which arises from imperfect correlation in the adjustment of the rates earned and paid on different instruments with otherwise similar repricing characteristics; and (4) optionsality risk, which arises from the express or implied options imbedded in many bank assets, liabilities and off-balance sheet portfolios.

Evaluation Factors

Supervisors should consider the following evaluation factors in making risk assessments. These evaluation factors are recommended criteria and may be expanded by supervisors, if necessary. They are an overview of issues that can assist the supervisor in making decisions within the RAS. The actual data of the ongoing risk assessment and control system existing at the bank are to make sure that management makes adequate and effective decisions and are considered by supervisors when assessing the bank's risk.

- The existence of an adequate, effective and communicated internal regulatory framework (policies, procedures, etc) for interest rate risk management approved by the Supervisory Council (or its committee) and/or the Board of Managers and appropriate compliance practices.

- The size and stability of net interest margins.

- The component and aggregate levels of interest rate risk including repricing, basis, yield curve, and option risk relative to earnings and capital.

- How adequately the bank assesses interest rate risk over both the short- and long-term.

- The vulnerability of earnings and capital under meaningful rate changes such as gradual rate shifts and yield curve twists. The appropriateness of the scenarios should be evaluated in the context of the current rate environment. Rate scenarios of sufficiently wide variability will be necessary to provide meaningful analysis.

- The character of risk such as the volume and price sensitivity of various products.

- The relative volume of and prospects for continued support from low cost and stable funding sources.

- The existence of timely, accurate, and informative management information to monitor interest rate risk.

- The existence at the bank of practices of periodical review of the justification and validity of risk assessment assumptions and models.

- Whether a process exists for independently measuring and analyzing risk in all significant activities from interest rate movements using a variety of scenarios.

- Whether the bank has sufficient expertise and whether it adequately responds to changing market conditions.

- Whether the bank has sufficient expertise and market access to flexibly adjust risk levels.

- The level and skill of management and staff.

- The existence of proper control mechanisms to monitor the accuracy of information, proper accounting treatment, and compliance with policies or laws.

Quantity of Interest Rate Risk

Review of those factors should allow supervisors to assess the quantity of interest rate risk as:

Low	Moderate	High
Exposure reflects little repricing risk and minimal exposure to basis risk and yield curve risk. Options positions are clearly identified and well managed.	Exposure reflects repricing risk, basis risk, yield curve risk, and options risk that are collectively maintained at manageable levels.	Exposure reflects significant repricing risk, high levels of basis risk, undue yield curve risk, or significant levels of options risk.
Mismatched positions are short-term.	Mismatched positions may be longer term, but are effectively hedged.	Mismatched positions are longer term and costly to hedge.
The mismatches are unlikely to cause earnings or capital volatility due to the movement in interest rates.	Substantial volatility in earnings or capital due to the movement of interest rates is not anticipated.	The probability of substantial volatility in earnings or capital due to the movement of interest rates is high.
The support provided by low-cost, stable nonmaturity deposits is significant and absorbs or offsets exposure arising from longer-term repricing mismatches or options risk.	The support provided by low-cost, stable nonmaturity deposits absorbs some, but not all, of the exposure associated with longer-term repricing mismatches or options risk.	The support provided by low-cost, stable nonmaturity deposits is not significant or sufficient to offset risk from longer-term repricing mismatches or options risk.

Quality of Interest Rate Risk Management

Review of those factors should allow supervisors to assess the quality of interest rate risk management as:

Strong	Satisfactory	Weak
The internal regulatory framework approved by the Supervisory Council/Board of Managers is sound and effectively communicates guidelines for management of IRR, functional responsibilities, and risk tolerance.	The internal regulatory framework approved by the Supervisory Council/Board of Managers adequately communicates guidelines for management of IRR, functional responsibilities, and risk tolerance. Minor weaknesses may be evident.	The internal regulatory framework approved by the Supervisory Council/Board of Managers is inadequate in communicating guidelines for management of IRR functional responsibilities, and risk tolerance.
Management, responsible officials and respective structural units fully understand all aspects of interest rate risk.	Management, responsible officials and respective structural units reasonably understand the key aspects of interest rate risk.	Management, responsible officials and respective structural units do not understand or choose to ignore key aspects of interest rate risk.
Management anticipates and responds well to changes in market conditions.	Management adequately responds to changes in market conditions.	Management does not anticipate or take timely and appropriate actions in response to changes in market conditions.
Responsibility for monitoring risk limits and measuring exposures is independent from those executing risk-taking decisions.		Responsibility from monitoring risk limits and measuring exposures is not independent from those executing risk-taking decisions.
Measurement tools and methods enhance decision making by providing meaningful and timely information under a variety of defined and reasonable rate scenarios.	Measurement tools and methods have minor weaknesses, but are appropriate given the size and complexity of the institution's on- and off-balance sheet exposures.	Measurement tools and methods are overly simplistic in light of the relative size and complexity of the institution's on- and off-balance sheet exposures.
Management information systems are timely, accurate, complete and reliable.	Management information is generally timely, accurate, complete and reliable.	Management information systems contain significant weaknesses.
Limit structures provide clear parameters for risk to earnings and the economic value of equity under a variety of defined and reasonable interest rate scenarios.	Limit structures are adequate to control the risk to earnings and the economic value of equity under defined and reasonable interest rate scenarios.	Limit structures are not reasonable or do not reflect an understanding of the risks to earnings and the economic value of equity.

Interest Rate Risk

Interest rate risk is the current or prospective risk to earnings and capital arising from adverse movements in interest rates. This risk impacts both the earnings of a bank and the economic value of its assets, liabilities and off-balance sheet instruments. The primary types of interest rate risk to which banks are typically exposed are: (1) repricing risk, which arises from timing differences in the maturity (for fixed rate) and repricing (for floating rate) of bank assets, liabilities and off-balance sheet positions; (2) yield curve risk, which arises from changes in the slope and shape of the yield curve; (3) basis risk, which arises from imperfect correlation in the adjustment of the rates earned and paid on different instruments with otherwise similar repricing characteristics; and (4) optionsality risk, which arises from the express or implied options imbedded in many bank assets, liabilities and off-balance sheet portfolios.

Summary Conclusions:

The quantity of interest rate risk is:

❑ Low	❑ Moderate	❑ High

The quality of interest rate risk management is:

❑ Strong	❑ Satisfactory	❑ Weak

Inspectors should consider both the quantity of interest rate risk and quality of interest rate risk management to derive the following conclusions:

Aggregate interest rate risk is:

❑ Low	❑ Moderate	❑ High

The direction is expected to be:

❑ Decreasing	❑ Stable	❑ Increasing

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Market Risk

Market risk is the current or prospective risk to earnings and capital arising from adverse movements in bond prices, security and commodity prices and foreign exchange rates in the trading book. This risk arises from market making, dealing, and position taking in debt and equity securities, currencies, commodities, and derivatives (bonds, securities, currencies, and commodities).

Risks arising under similar circumstances with regard to similar instruments in the banking book are addressed in other relevant categories of the risk assessment system.

Evaluation Factors

Supervisors should consider the following evaluation factors in making risk assessments. These evaluation factors are recommended criteria and may be expanded by supervisors, if necessary. They are an overview of issues that can assist the supervisor in making decisions within the RAS. The actual data of the ongoing risk assessment and control system existing at the bank are to make sure that management makes adequate and effective decisions and are considered by supervisors when assessing the bank's risk.

- The existence of an adequate, effective and communicated internal regulatory framework (policies, procedures, etc) for market risk management approved by the Supervisory Council (or its committee) and/or the Board of Managers and appropriate compliance practices.

- The source of market risk including interest rate, foreign exchange, commodity, and equity prices.

- The size, tenor, and complexity of positions.

- The components of market risk and price sensitivity of various products including under off-balance sheet arrangements (for instance, swaps, forwards, and options).

- The stability of trading revenues.

- The trend of earnings and capital at risk.

- The vulnerability of the bank under probable rate scenarios and stress environments (stress-testing).

- The ability to hedge or close risk positions existing at a given moment, including management's professional ability to conduct hedging transactions and the bank's access to appropriate markets.

- The size of open positions versus revenues generated and expected (i.e., risk versus reward).

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- The existence of timely, accurate, and comprehensive management information.
- The level and skill of management and staff.
- The existence of proper control mechanisms to monitor the accuracy of information, proper accounting treatment, and compliance with policies, limits, or laws.

Quantity of Market Risk

Review of those factors should allow supervisors to assess the quantity of market risk as:

Low	Moderate	High
Exposure reflects limited open or unhedged positions. As a result, when prices and rates change, the fluctuations of the size of earnings and capital would be minimal.	Exposure reflects moderate open or unhedged positions. As a result, when prices and rates change, the fluctuations of the size of earnings and capital would be moderate.	Exposure reflects significant open or unhedged positions. As a result, when prices and rates change, the fluctuations of the size of earnings and capital would be significant.
Exposures primarily arise from customer transactions, and involve liquid and readily manageable products, markets, and levels of activity.	Exposure originates primarily in conjunction with customer transactions. The bank has access to a variety of risk management instruments and markets at reasonable costs, given the size, tenor, and complexity of open positions.	High exposure may arise from transactions or positions that are taken as management's or trader's views of the market. The volume and terms and conditions of customer transactions are not adequate for the bank.
The tenor and size of open positions are expected to continue at, or decline from, current levels.	The tenor and size of open positions are expected to remain at current levels.	The positions may be difficult or costly to close out or hedge due to complexity; difficulty in readily accessing certain instruments, markets or tenors; or the general illiquidity of markets or products. The tenor and size of open positions are expected to continue at or increase beyond, current levels.

Quality of Market Risk Management

Review of those factors should allow supervisors to assess the quality of market risk management as:

Strong	Satisfactory	Weak
The Supervisory Council clearly defines the level and types of risk that the bank is willing to take and establishes clear authorities, conservative limits, and assigned responsibilities. Policies permit risk-taking authority consistent with the expertise of bank personnel.	The Supervisory Council defines the level and types of risk that the bank is willing to take and establishes clear authorities, reasonable limits, and assignment of responsibilities. Risk-taking authority is generally consistent with expertise of bank personnel.	The bank's internal regulatory framework reflects the Board of Managers' rather than the shareholders' attitude towards risk. No clear assignment of responsibilities. Risk-taking authority does not reflect the expertise of trading personnel.
Management, responsible officials and respective structural units fully understand all aspects of market risk	Management, responsible officials and respective structural units reasonably understand the key aspects of market risk	Management, responsible officials and respective structural units do not understand, or have chosen to ignore, key aspects of market risk
Management and responsible officials anticipate and respond timely and effectively to changes in market conditions.	Management and responsible officials adequately respond to changes in market conditions.	Management and responsible officials do not anticipate or take timely and appropriate actions in response to changing market conditions.
Measurement tools and methods are sophisticated, given the size and complexity of activities.	Measurement tools and methods have minor deficiencies, but are sufficient give the size and complexity of activities.	Measurement tools and methods are inadequate given the size or complexity of activities.
Management information is sufficient for a clear assessment of the potential volatility and aggregate risk-taking	Management information is generally sufficient for an assessment of the potential volatility and aggregate risk-taking	Management information does not accurately characterize potential volatility or aggregate risk-taking
Limit systems establish clear parameters of the risk to earnings and capital under a variety of defined and reasonable scenarios.	Limit systems establish clear parameters of the risk to earnings and capital under defined and reasonable scenarios.	Limits systems do not reflect a complete understanding of the risk to earnings and capital.
The function of measuring exposures and monitoring risk is independent from risk-taking activities.		The function of measuring exposures and monitoring risk is not independent from risk-taking activities.

Market Risk

Market risk is the current or prospective risk to earnings and capital arising from adverse movements in bond prices, security and commodity prices and foreign exchange rates in the trading book. This risk arises from market making, dealing, and position taking in debt and equity securities, currencies, commodities, and derivatives (bonds, securities, currencies, and commodities).

Risks arising under similar circumstances with regard to similar instruments in the banking book are addressed in other relevant categories of the risk assessment system.

Summary Conclusions:

The quantity of market risk is:

❑ Low	❑ Moderate	❑ High

The quality of market risk management is:

❑ Strong	❑ Satisfactory	❑ Weak

Inspectors should consider both the quantity of market risk and quality of market risk management to derive the following conclusions:

Aggregate market risk is:

❑ Low	❑ Moderate	❑ High

The direction is expected to be:

❑ Decreasing	❑ Stable	❑ Increasing

Foreign Exchange Risk

Foreign exchange risk is the current or prospective risk to earnings and capital arising from adverse movements in currency exchange rates and banking metal prices. Foreign exchange risk can be separated into:

- Transaction risk;
- Translation risk;
- Economic foreign exchange risk.

Transaction risk refers to the impact of adverse movements in currency exchange rates on the value of open foreign currency positions. However, since it generally arises from market making, dealing and position taking in foreign currencies it is covered in the market risk guideline. Translation risk refers to the variability in accounting values that result from variations in exchange rates which are used in translating carrying values in foreign currencies to base currency. Economic foreign exchange risk refers to changes in competitive strength of the financial institution or its entities in the foreign market due to fundamental changes in exchange rates.

Evaluation Factors

Supervisors should consider the following evaluation factors in making risk assessments. These evaluation factors are recommended criteria and may be expended by supervisors, if necessary. They are an overview of issues that can assist the supervisor in making decisions within the RAS. The actual data of the ongoing risk assessment and control system existing at the bank are to make sure that management makes adequate and effective decisions and are considered by supervisors when assessing the bank's risk.

- The existence of an adequate, effective and communicated internal regulatory framework (policies, procedures, etc) for FX risk management approved by the Supervisory Council (or its committee) and/or the Board of Managers and appropriate compliance practices.

- The volume of balance sheet and off-balance sheet items subject to revaluation from translation at a spot rate and translation at a forward rate.

- The structure of balance-sheet and off-balance-sheet items by:
  - Currency.
  - Products.
  - Tenor or anticipated duration of positions.
  - The size and maturity of cash flow mismatches.
  - The extent of positions in thinly traded currencies.

- The potential size of capital losses from translating accounts denominated in other currencies to their hrivna equivalent in case of change of currency exchange rates, taking into account recent trends and projections.

- The existence of timely, accurate, and informative management information.

- The level and skill of management and staff.

- The existence of proper control mechanisms to monitor the accuracy of information, proper accounting treatment, and compliance with policies or laws.

Quantity of Foreign Exchange Risk

Review of those factors should allow supervisors to assess the quantity of foreign exchange risk as:

Low	Moderate	High
The size of unhedged open FX positions is limited.	The size of unhedged open FX positions is moderate.	The size of unhedged open FX positions is significant.
Cash flows are predictable and are closely matched or hedged.	Cash flow mismatches are predictable and moderate in size.	Some positions may be denominated in relatively illiquid currencies, complicating the ease, speed, and cost of hedging.
There is negligible volatility to earnings or capital because of translation adjustments.	There is moderate volatility to earnings or capital due to translation adjustments.	There is substantial volatility to earnings or capital due to translation adjustments.

Quality of Foreign Exchange Risk Management

Review of those factors should allow supervisors to assess the quality of foreign exchange risk management as:

Strong	Satisfactory	Weak
The internal regulatory framework clearly and reasonably defines the limits of FX positions by currency, term and instrument.	The internal regulatory framework generally defines the limits of FX positions by currency, term and instrument.	There is no internal regulatory framework for FX risk or it is inadequate to the volume and nature of the bank's operations given management expertise, the bank's capital position, and/or volume of assets and liabilities denominated foreign currencies. Responsibilities are not clearly assigned.
Management, responsible officials and respective structural units fully understand all aspects of foreign exchange risk.	Management, responsible officials and respective structural units fully understand the key aspects of foreign exchange risk.	Management, responsible officials and respective structural units do not understand, or have chosen to ignore, key aspects of foreign exchange risk.
Management and responsible officials anticipate and respond timely and effectively to changes in market conditions.	Management and responsible officials adequately respond to changes in market conditions.	Management and responsible officials do not anticipate or take timely or appropriate actions in response to changes in market conditions.
Risk measurement tools and methods are sophisticated, given the size and complexity of activities.	Risk measurement tools and methods may have minor deficiencies, but are sufficient given the size and complexity of activities.	Risk measurement tools and methods are inadequate given the size or complexity of activities.
Management information is sufficient for a clear assessment of the potential market volatility and aggregate risk-taking.	Management information is generally sufficient for an assessment of the potential market volatility and aggregate risk-taking.	Management information does not accurately portray the potential market volatility or aggregate risk-taking.
Limit systems establish clear parameters of the risk to earnings and capital under a variety of defined and reasonable scenarios.	Limit systems establish clear parameters of the risk to earnings and capital under defined yet reasonable scenarios.	Limit systems do not reflect a complete understanding of the risk to earnings and capital.
The function of measuring exposures and monitoring risk is independent from risk-taking activities.		The function of measuring exposures and monitoring risks is not independent from risk-taking activities.

Foreign Exchange Risk

Foreign exchange risk is the current or prospective risk to earnings and capital arising from adverse movements in currency exchange rates and banking metal prices. Foreign exchange risk can be separated into:

- Transaction risk;
- Translation risk;
- Economic foreign exchange risk.

Transaction risk refers to the impact of adverse movements in currency exchange rates on the value of open foreign currency positions. However, since it generally arises from market making, dealing and position taking in foreign currencies it is covered in the market risk guideline. Translation risk refers to the variability in accounting values that result from variations in exchange rates which are used in translating carrying values in foreign currencies to base currency. Economic foreign exchange risk refers to changes in competitive strength of the financial institution or its entities in the foreign market due to fundamental changes in exchange rates.

Summary Conclusions:

The quantity of foreign exchange risk is:

❑ Low	❑ Moderate	❑ High

The quality of foreign exchange risk management is:

❑ Strong	❑ Satisfactory	❑ Weak

Inspectors should consider both the quantity of foreign exchange risk and quality of foreign exchange risk management to derive the following conclusions:

Aggregate foreign exchange risk is:

❑ Low	❑ Moderate	❑ High

The direction is expected to be:

❑ Decreasing	❑ Stable	❑ Increasing

Operations risk

Operations risk affects the long-term existence of a banking institution, and arises from breakdowns in corporate governance or internal controls. Such breakdowns can lead to financial losses through error, fraud, or failure to perform in a timely manner or cause the interests of the bank to be compromised in some other way, for example, by its dealers, lending officers or other staff exceeding their authority or conducting business in an unethical or risky manner. Other aspects of operations risk include major failure of information technology systems or events such as major fires or other disasters.

Evaluation Factors

Supervisors should consider the following evaluation factors in making risk assessments. These evaluation factors are recommended criteria and may be expanded by supervisors, if necessary. They are an overview of issues that can assist the supervisor in making decisions within the RAS. The actual data of the ongoing risk assessment and control system existing at the bank are to make sure that management makes adequate and effective decisions and are considered by supervisors when assessing the bank's risk.

- The existence of an adequate, effective and communicated internal regulatory framework (policies, procedures, etc) for operations risk management approved by the Supervisory Council (or its committee) and/or the Board of Managers and appropriate compliance practices.

- The number and complexity of processing of transactions in relation to the development and capacity of operational and control systems taking into account the historical performance record of these system, their current condition, and prospects for further improvement.

- The potential for technological and operational failures, breaches of authority by staff, inadequacies in the pre-transaction analysis and decision support, and failure (including temporary) to monitor and capture transactions with customers or counter parties.

- The existence and adherence by the bank to technological cards for conducting transactions.

- The existence, number, reasons and nature of violations of administrative and accounting control procedures.

- The potential for financial loss due to:
  -- Human error or fraud.
  -- Competitive disadvantage.
  -- Incomplete information.
  -- Operational disruption.

- The history of litigation related to operations and how the bank dealt with it.
- The volume and adequacy of controls over outsourcing arrangements.
- The existence of timely, accurate, and informative management information.
- The level and skill of management and staff.
- The existence of proper control mechanisms to monitor the accuracy of information, proper accounting treatment, and compliance with policies or laws.

Quantity of Operations Risk

Review of the following factors should allow supervisors to assess the quantity of operations risk as:

Low	Moderate	High
Client identification, pre-transaction analysis and procedures are standardized. No external service providers are used for data entry.	Client identification, pre-transaction analysis and procedures are difficult to standardize because of complexity of schemes of conducting transactions involving separate products. Some external providers are used for important data entry.	Client identification, pre-transaction analysis and procedures cannot be standardized because of complexity of schemes of conducting transactions involving separate products. A number of external service providers are used for important data entry.
The number of transactions and technological complexity of their processing is low and well supported by operational systems development.	The number of transactions and technological complexity of their processing expose the bank to some degree of risk. Operational systems development adequately supports the level of transaction processing.	The level of technological transaction processing and state of operational systems development are inconsistent and reflect weaknesses.
The bank fully meets the requirements to settlement and cash transactions. The schemes of conducting these transactions are simple, the average size and number of transactions conducted in different time zones are low.	There exist certain violations of settlement and cash discipline. The schemes of conducting transactions are characterized with certain complexity, the average size of transactions is significant, and the number of transactions conducted in different time zones is moderate.	There exist major violations of settlement and cash discipline. The schemes of conducting transactions are characterized as complex, the average size of operations is high, and the number of transactions conducted in different time zones is significant.
The expansion of the number and range of banking services is consistent with management's plans. Implementation plans are clear and followed.	The expansion of the number and range of banking services is generally consistent with management's plans. Implementation plans are evident although they are not always comprehensive.	The bank lacks adequate plans of expansion of the number and range of services.

Quality of Operations Risk Management

Review of the following factors should allow supervisors to assess the quality operations risk as:

Strong	Satisfactory	Weak
Management fully understands all aspects of operations risk. Management anticipates and responds well to market changes.	Management reasonably understands the key aspects of operations risk. Management adequately responds to changes of a market nature.	Management does not understand, or has chosen to ignore, key aspects of operations risk. Management does not anticipate or take timely and appropriate actions in response to market changes.
The bank has a history of sound operations. The likelihood of future transaction processing failures is minimal because of the presence of strong internal controls.	The bank has a history of adequate operations. The likelihood of future transaction processing failures is minimized by generally effective controls.	The bank may have a history of transaction processing failures (significant in number and/or consequences). The likelihood of future transaction processing failures is high because of the absence of effective internal controls.
The level of operational control at the bank is high. Internal controls, audit, and contingency plans are sound.	The level of operational control at the bank is adequate. Internal controls, audit coverage, and contingency plans are evident.	The level of operational control at the bank is inadequate. Serious weaknesses exist in internal controls, and audit coverage or contingency plans.
Management information is satisfactory.	Minor deficiencies may exist in management information on transaction processing activities.	Management information related to transaction processing activities exhibits significant weaknesses.
Current staffing is of excellent quantity and quality (both in terms of knowledge of market, qualifications and experience). No scarcity of qualified personnel in the market.	Current quantity and quality of staff is troublesome. Scarcity of required knowledge and experience in the market.	Current quantity and quality of staff is insufficient. Required knowledge and experience is hard to obtain in the market.
Management identifies weaknesses quickly and takes appropriate action.	Management recognizes weaknesses and generally takes appropriate action.	Management has not demonstrated a commitment to make the corrections required to improve operation risk controls.

Operations Risk

Operations risk affects the long-term existence of a banking institution, and arises from breakdowns in corporate governance or internal controls. Such breakdowns can lead to financial losses through error, fraud, or failure to perform in a timely manner or cause the interests of the bank to be compromised in some other way, for example, by its dealers, lending officers or other staff exceeding their authority or conducting business in an unethical or risky manner. Other aspects of operations risk include major failure of information technology systems or events such as major fires or other disasters.

Summary Conclusions:

The quantity of operations risk is:

❑ Low	❑ Moderate	❑ High

The quality of operations risk management is:

❑ Strong	❑ Satisfactory	❑ Weak

Inspectors should consider both the quantity of operations risk and quality of operations risk management to derive the following conclusions:

Aggregate operations risk is:

❑ Low	❑ Moderate	❑ High

The direction is expected to be:

❑ Decreasing	❑ Stable	❑ Increasing

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Reputation Risk

Reputation risk is the current or prospective risk to earnings and capital arising from adverse perception of the image of the financial institution by customers, counter parties, shareholders, or regulators. This affects the bank's ability to establish new relationships or services or service existing relationships. This risk may expose the institution to administrative, civil and criminal liability, financial loss or a decline in its customer base. Reputation risk exposure is present throughout the organization and, therefore, banks are obligated to exercise an appropriate treatment in dealing with its customers and with the community.

The public perception can be delineated as follows:

- Market perception: e.g. actual or potential customers or counter parties, or shareholders
- Regulatory perception: e.g. the National Bank of Ukraine, Securities and Exchange Commission, State Tax Administration, and other authorized bodies.

Evaluation Factors

Supervisors should consider the following evaluation factors in making risk assessments. These evaluation factors are recommended criteria and may be expanded by supervisors, if necessary. They are an overview of issues that can assist the supervisor in making decisions within the RAS. The actual data of the ongoing risk assessment and control system existing at the bank are to make sure that management makes adequate and effective decisions and are considered by supervisors when assessing the bank's risk.

- The market or public perception of management and the financial stability of the institution.

- The market or public perception of the products and services offered by the bank.

- Management's willingness and ability to adjust business strategies based on regulatory changes, market conjuncture, or other factors (for instance, termination or restriction of the validity of separate items in the license, change of the bank's status, etc.).

- The bank's practices of analyzing the prospects for expanding the range of products and services and developing an appropriate internal regulatory framework, including as it pertains to conducting due diligence. The prospects for maintaining such practices in future.

- The volume of fiduciary services and the terms and conditions of rendering them.

- The nature and volume of customer complaints and management's ability and willingness to respond to those complaints.

- The existence of highly visible or conspicuous litigation, which has affected the bank's image.

- Historical fines, penalties and other financial losses arising from administrative, civil and criminal liability incurred by the bank (or its managers).

- The findings of internal and supervisory reviews and management's willingness and ability to respond to these reviews.

- The bank's participation in the Household Deposit Insurance Fund.

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Summary Assessment

Review of those factors should allow supervisors to assess composite reputation risk as:

Low	Moderate	High
Management anticipates and responds well to changes of a market or other nature that impact its reputation.	Management adequately responds to changes of a market or other nature that impact its reputation.	Management does not anticipate or take timely or appropriate actions in response to changes of a market or other nature.
The existence of an officially developed and unofficial Code of Ethics, which is fully complied with.	The existence of an officially developed and unofficial Code of Ethics, which is generally complied with.	No Code of Ethics exists at the bank or it does not function.
The bank's internal discipline in risk management is maintained at a very high level.	The bank's internal discipline in risk management is maintained at an acceptable level.	The bank's internal discipline in risk management is not maintained.
Internal controls and audit are fully adequate.	Internal controls and audit are generally adequate.	Internal controls or audit are not effective in reducing exposure. Management has either not initiated, or has a poor record of, corrective action to address problems.
Franchise value is only minimally exposed by reputation risk. Exposure from reputation risk is expected to remain low in the foreseeable future.	The exposure of franchise value from reputation risk is controlled (for instance, through an effective public relations function). Exposure is not expected to increase in the foreseeable future.	Franchise value is substantially exposed by reputation risk shown in significant litigation against the bank and its managers, large dollar losses, or a high volume of customer complaints. Exposure is expected to continue in the foreseeable future.
The Household Deposit Insurance Fund insures a significant portion of total household deposits. The average amount of a deposit does not exceed the amount of guaranteed compensation.		The bank is not a participant of the Household Deposit Insurance Fund or is its temporary participant.

Reputation Risk

Reputation risk is the current or prospective risk to earnings and capital arising from adverse perception of the image of the financial institution by customers, counter parties, shareholders, or regulators. This affects the bank's ability to establish new relationships or services or service existing relationships. This risk may expose the institution to administrative, civil and criminal liability, financial loss or a decline in its customer base. Reputation risk exposure is present throughout the organization and, therefore, banks are obligated to exercise an appropriate treatment in dealing with its customers and with the community.

The public perception can be delineated as follows:

- Market perception: e.g. actual or potential customers or counter parties, or shareholders
- Regulatory perception: e.g. the National Bank of Ukraine, Securities and Exchange Commission, State Tax Administration, and other authorized bodies.

Summary Conclusions:

Aggregate reputation risk is:

☐ Low	☐ Moderate	☐ High

The direction is expected to be:

☐ Decreasing	☐ Stable	☐ Increasing

Legal Risk

Legal risk is the current or prospective risk to earnings and capital arising from violations or non-compliance with laws, rules, regulations, agreements, prescribed practices, or ethical standards, as well as from the possibility of dubious interpretation of effective laws or rules. Institutions are exposed to legal risk due to relations with a great number of stakeholders, e.g. customers, counter parties, intermediaries, etc., as well as regulators, tax authorities, and other authorized agencies. Legal risk can lead to fines and penalties, payment of damages, diminished reputation, deteriorating position in the market, reduced expansion potential, and lack of contract enforceability.

Evaluation Factors

Examiners should consider the following evaluation factors in making risk assessments. These evaluation factors are recommended criteria and may be expanded by supervisors, if necessary. They are an overview of issues that can assist the examiner in making decisions within the RAS. The actual data of the ongoing risk assessment and control system existing at the bank are to make sure that management makes adequate and effective decisions and are considered by supervisors when assessing the bank's risk.

- The existence of an adequate, effective and communicated internal regulatory framework (policies, procedures, etc) for legal risk management approved by the Supervisory Council (or its committee) and/or the Board of Managers and appropriate compliance practices.

- The number and significance of violations or nonconformance with prescribed standards or legal requirements (significance is determined by analysis of the frequency, dollar amount, and nature of noncompliance). The analysis should incorporate both current and historical perspectives.

- The history of complaints, claims and litigation by customers and others. The complaints, claims or litigation may involve:
    - Consumer rights protection in connection with receipt of banking services (lending, deposits, funds transfer, fee-based services, etc.).
    - Violation and enforcement of banking laws and regulations.
    - Other explicit or implied prudential and ethical standards, whether established internally or mandated by others.

- How policies and powers are communicated to management and staff.

- The existence of timely, accurate, and complete management information.

- The level and skill of management and staff (in particular, legal staff).

- The existence of appropriate controls (internal and external audit, appropriate procedures, etc.) to ensure compliance with the requirements of laws and regulations, the requirements of the internal regulatory framework and concluded agreements.

Summary Assessment

Review of those factors should allow examiners to assess aggregate legal risk as:

Low	Moderate	High
Management fully understands all aspects of legal risk and exhibits clear commitment to compliance.	Management reasonably understands the key aspects of legal risk.	Management does not understand, or has chosen to ignore, key aspects of legal risk.
Authority and accountability for compliance are clearly defined and enforced throughout the institution.	Authority and accountability for compliance are communicated throughout the institution, although some refinements may be needed.	Management has not established, has not communicated throughout the institution or enforced accountability for compliance performance.
Management anticipates and responds well to changes in the market or regulatory nature.	Management adequately responds to changes of a market or regulatory nature.	Management does not anticipate or take timely or appropriate actions in response to changes of a market or regulatory nature.
Legal considerations are incorporated into the product and system development process.	While compliance may not be formally considered when developing products and systems, issues are typically addressed before they are fully implemented	Legal considerations are not incorporated in product or systems development.
Violations or noncompliance issues are insignificant, as measured by their number or seriousness.	The frequency or severity of violations or noncompliance is reasonable.	Violations or noncompliance expose the company to significant impairment of reputation, value, earnings, or the bank's position in the market.
When deficiencies are identified, management promptly implements meaningful corrective action.	Problems can be corrected in the normal course of business without significant investment of money or management resources. Management is responsive when deficiencies are identified.	Errors are often not detected internally, corrective action is often ineffective, or management is unresponsive to identified deficiencies.
The institution has a good record of compliance. Appropriate controls and systems are implemented to identify potential legal issues, compliance problems and assess performance, which minimize the likelihood of numerous or serious future violations.	Compliance management systems are adequate to avoid significant or frequent violations or noncompliance.	Compliance management systems are deficient, reflecting an inadequate management commitment to risk management.
Training programs are effective and the necessary resources have been provided to ensure compliance.	Management provides adequate resources and training given the complexity of products and operations.	Management has not provided adequate resources or training.

Legal Risk

Legal risk is the current or prospective risk to earnings and capital arising from violations or non-compliance with laws, rules, regulations, agreements, prescribed practices, or ethical standards, as well as from the possibility of dubious interpretation of effective laws or rules. Institutions are exposed to legal risk due to relations with a great number of stakeholders, e.g. customers, counter parties, intermediaries, etc., regulators, tax authorities, and other authorized agencies. Legal risk can lead to fines and penalties, payment of damages, diminished reputation, deteriorating position in the market, reduced expansion potential, and lack of contract enforceability.

Summary Conclusions:

Aggregate legal risk is:

❑ Low	❑ Moderate	❑ High

The direction is expected to be:

❑ Decreasing	❑ Stable	❑ Increasing

Strategic Risk

Strategic risk is the current or prospective risk to earnings and capital arising from adverse business decisions, improper implementation of decisions, or lack of responsiveness to changes in the business environment. This risk is a function of the compatibility of a bank's strategic goals, the business strategies developed to achieve those goals, the resources deployed against these goals, and the quality of implementation. The resources needed to carry out business strategies are both tangible and intangible. They include communication channels, operating systems, delivery networks, and managerial capacities and capabilities. The organization's internal characteristics must be evaluated against the impact of economic, technological, competitive, regulatory, and other environmental changes.

Evaluation Factors

Supervisors should consider the following evaluation factors in making risk assessments. These evaluation factors are recommended criteria and may be expanded by supervisors, if necessary. They are an overview of issues that can assist the supervisor in making decisions within the RAS. The actual data of the ongoing risk assessment and control system existing at the bank are to make sure that management makes adequate and effective decisions and are considered by supervisors when assessing the bank's risk.

- The bank's mission, goals, corporate culture and values, and tolerance for risk.
- Management's practices of communicating, modifying, and implementing strategic plans.
- The status of implementation of strategic plans, the frequency and magnitude of changes in the bank's risk tolerance.
- Management information systems and controls available to monitor business decisions.
- Strategic choices relating to technological, product, and competitive environments and their impact on franchise value.
- Merger and acquisition plans and opportunities.
- The compatibility of strategic initiatives with available or planned resources.
- The bank's market position, including market penetration at both the product and geographic level.
- The bank's diversity in terms of products, geography, and demographics.
- The bank's past performance in offering new products and services.

Summary Assessment

Review of those factors should allow supervisors to assess aggregate strategic risk as:

Low	Moderate	High
Risk management practices are an integral part of strategic planning.	The quality of risk management is consistent with the strategic tasks confronting the organization.	Risk management practices are inconsistent with strategic tasks. A lack of strategic direction is evident.
Strategic goals, objectives, corporate culture, and behavior are effectively communicated and consistently applied throughout the institution. The effectiveness of implementation of strategic tasks is enhanced by the depth of management qualifications at all levels.	Management has demonstrated the ability to implement goals and objectives and successful implementation of strategic tasks is likely.	Strategic tasks are inadequately supported by the bank's internal regulatory framework. The structure and qualifications of the staff of the organization do not support long-term strategies.
The bank has a good record of accomplishing goals and implementing strategic tasks. Strategic plans do not pose a threat of destabilization of the bank's condition.	The bank has a reasonable record of accomplishing goals and implementing strategic tasks. Strategic plans pose a minor and generally manageable threat of destabilization of the bank's condition.	The bank demonstrates its inability to accomplish goals and to implement strategic tasks. The implementation of the bank's strategic plans may cause destabilization of its condition.
Management information systems effectively support strategic tasks.	Management information systems reasonably support short-term strategic tasks.	Management information systems supporting strategic tasks are seriously flawed or do not exist.
The bank's strategic plan implementation tactics are consistent with the defined strategy, are supported by capital and pose only nominal possible effects on earnings volatility. Decisions can be easily changed with reasonable expenses.	The bank's strategic plan implementation tactics are generally consistent with the defined strategy and are basically supported by capital and operating systems. Decisions are not likely to have a significant adverse impact on earnings or capital. If necessary, the decisions or actions can be reversed without significant cost or difficulty.	The impact of strategic decisions is expected to significantly affect franchise value. The bank's tactical actions to implement strategic plans are aggressive and/or incompatible with the defined strategy. Decisions are either difficult or costly to reverse in the process of their implementation.

Strategic Risk

Strategic risk is the current or prospective risk to earnings and capital arising from adverse business decisions, improper implementation of decisions, or lack of responsiveness to changes in the business environment. This risk is a function of the compatibility of a bank's strategic goals, the business strategies developed to achieve those goals, the resources deployed against these goals, and the quality of implementation. The resources needed to carry out business strategies are both tangible and intangible. They include communication channels, operating systems, delivery networks, and managerial capacities and capabilities. The organization's internal characteristics must be evaluated against the impact of economic, technological, competitive, regulatory, and other environmental changes.

Summary Conclusions:

Aggregate strategic risk is:

❑ Low	❑ Moderate	❑ High

The direction is expected to be:

❑ Decreasing	❑ Stable	❑ Increasing

Information Technology (IT) Risk

IT risk is the current or prospective risk to earnings and capital arising from inadequate information technology and processing in terms of manageability, exclusivity, integrity, controllability, and continuity. Further, IT risk arises from an inadequate IT strategy and policy, and from inadequate use of the information technology.

Evaluation Factors

Supervisors should consider the following evaluation factors in making risk assessments. These evaluation factors are recommended criteria and may be expanded by supervisors, if necessary. They are an overview of issues that can assist the supervisor in making decisions within the RAS. The actual data of the ongoing risk assessment and control system existing at the bank are to make sure that management makes adequate and effective decisions and are considered by supervisors when assessing the bank's risk.

- The existence of an adequate, effective and communicated internal regulatory framework (policies, procedures, etc.) for IT risk management approved by the Supervisory Council (or its committee) and/or the Board of Managers and appropriate compliance practices in order to avoid IT risk.

- Daily turnovers of balance sheet and off-balance sheet transactions conducted with the help of information systems relative to the bank's capital.

- The number of transactions relative to the information system's capacity.

- The complexity (for example, compatibility of system components, network branching, possibility of system support with in-house resources) of hardware and software systems and stability (current and projected) of these systems.

- The potential for significant financial loss due to:
    - Inadequacy of existing information systems.
    - Impossibility of timely identification of human error or fraud.
    - Impossibility of timely restoration of information systems after operational disruption.

- The adequacy of controls over outsourced software and its maintenance and other services.

- Adequacy of IT strategy. IT strategy should address current and foreseen business requirements, and take into consideration hardware, telecommunications, software, data and network structure, and data integrity.

- A process exists for:
    - Identifying information needs to manage the corporation efficiently.

- Defining the systems architecture for transaction processing and for delivering products and services.
- Assuring the reliability and retention of information (e.g., data creation, processing, storage, and delivery). This includes business continuity planning.
- Providing the timely production and use of management information.

Quality of IT Risk Management

Review of those factors should allow supervisors to assess the Quality of IT Risk Management as:

Strong	Satisfactory	Weak
Management and responsible officials fully understand all aspects of IT risk. The bank has comprehensive IT policies.	Management and responsible officials reasonably understand the key aspects of IT risk. The bank has generally adequate IT policies.	Management and responsible officials do not understand, or have chosen to ignore, key aspects of IT risk. The bank has no IT policies or they are inadequate.
IT strategy appropriately covers hardware, telecommunications, software, data and network structure and data integrity.	IT strategy may possess some deficiencies in covering hardware, telecommunications, software, data and network structure, and data integrity.	The IT strategy is not or poorly defined or strongly deficient.
The IT strategy and policy are fully complied with and supported by adequate resources.	The IT strategy and policy are generally complied with and supported by generally adequate resources.	The IT strategy and policy are not complied with and/or not supported by appropriate resources.
The number of transactions and technological complexity of their processing is low and well supported by the state of systems development.	The number of transactions and technological complexity of their processing expose the bank to a degree of risk.	The level of transaction processing and state of systems have major deficiencies, which may expose the bank to significant damage to reputation or loss of earnings or capital.
The institution has a history of sound operations.	Possible losses to reputation, earnings or capital exist, but are mitigated by adequate internal controls	The institution may have a history of transaction processing failures (significant in number and/or consequences)
Full restorability of information and information processing after operational disruption.	Adequate restorability of information and information processing after operational disruption.	Information and information processing often take a lot of time to restore after operational disruption.
Sound user authorizations to change static data and read confidential data. Hardly any unauthorized accesses.		Instances of unauthorized accesses.
Systems, internal controls, audit and contingency plans are sound.	Adequate information systems, audit coverage, and contingency plans are evident.	Serious weaknesses exist in operating and information systems, internal controls, internal and external audit coverage, or contingency plans.
Management identifies weaknesses quickly and takes appropriate action.	Management identifies and measures the most significant IT risks and takes appropriate action.	Management has not demonstrated a commitment to make the corrections required to improve transaction processing and IT risk controls.

Information Technology (IT) Risk

IT risk is the current or prospective risk to earnings and capital arising from inadequate information technology and processing in terms of manageability, exclusivity, integrity, controllability, and continuity. Further, IT risk arises from an inadequate IT strategy and policy, and from inadequate use of the information technology.

Summary Conclusions:

Aggregate IT risk is:

❑ Low	❑ Moderate	❑ High

The direction is expected to be:

❑ Decreasing	❑ Stable	❑ Increasing

Comprehensive Program for the Development of the Banking System of Ukraine for the years 2003-2005

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Comprehensive Program for the Development of the Banking System of Ukraine for the years 2003-2005

Preamble

International experience has convincingly demonstrated that economic growth and ensuring of effective conditions for the development of the private sector and improvement of the social protection and welfare of the population are conditional upon the effective development of the banking system as a key element of a market economy.

The building of the banking sector bears a comprehensive and systemic nature and requires the coordination of the efforts of all the participants of the process – the banks, the NBU, and legislative and executive government authorities.

The NBU is coming up with an initiative of transition to qualitatively new and more targeted approaches to the building of the kind of banking system, which would stimulate the development of the economy, have public confidence and be competitive in external markets.

The first priorities should be to ensure systemic stability, to mitigate the vulnerability of the banking system to external and internal factors of destabilization, and to increase the quality and effectiveness of its activity.

The development of the banking system should be aimed at increasing the volumes of services to businesses and individuals in all the regions of the country. Loans should become affordable and attractive. Banking services should become diversified in type and terms and conditions. The banks should become active participants in the development of the financial and insurance markets.

Banking activity should be based on the principles of openness, transparency, equality and impartiality, adherence to business ethics, and responsibility to the client, the public and the state.

The state should profess the usage of market mechanisms of influence on the entities of the banking sector, including the application of modern prudential supervision standards. All effectively operating banks regardless of their size should have equal chances of becoming market participants and finding their niche and their client. Government-owned banks should also be gradually reoriented at market principles of operation.

It is this vision of the development and building of the banking sector, which can be achieved by meeting the stated goals and implementing a consistent and comprehensive government action program, that the Comprehensive Program for the Development of the Banking Sector of Ukraine for the Years 2003 – 2005 (hereinafter – the Comprehensive Program) is built upon.

The Comprehensive Program defines key goals and priorities of the further building of the banking system, ways and directions of their implementation, sufficient preconditions for the successful fulfillment by the banking system of the tasks facing it at the current stage of development of the economy of Ukraine.

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SECTION 1. CURRENT CONDITION OF THE BANKING SYSTEM AND PROBLEMS OF ITS DEVELOPMENT

Over the last years in Ukraine there have been achieved certain elements of stabilization of the banking system with the preservation of its market orientation and ability to play an important role in strengthening stabilization processes and making structural transformations in the economy on the whole. This has been promoted by economic growth and financial stabilization.

The stimulating factors of development of the banking system have also included the creation of modern banking law oriented at EU law and current international practices; conversion of the banking system to an accounting system based on International Financial Reporting Standards; introduction of a household deposit insurance system; creation of a national payment system based on advanced computer technology; and creation and constant improvement of a bank supervision function.

Over the period of 2000 – 2002 the capital of the banking system has grown by 2.3 times up from UAH 4.5 billion to UAH 10.1 billion. Over this period, funds due to businesses have grown by 2.5 times and reached UAH 20 billion. Funds due to individuals in the banking system have increased by 4.4 times up from UAH 4.3 billion to UAH 19.1 billion. Loans to businesses over the same period have grown by 3.4 times, including long-term by 4.5 times.

In the meantime, the banking system of Ukraine has certain deficiencies.

Most problems affecting the development of the banking system lie outside the stratum of the banking system. Among them it is necessary to single out first of all the following:

- Slow pace of market transformation and restructuring of the real sector of the economy;
- Manifestations of administrative influence on the part of government authorities on the activity of individual banks, refusals to meet their obligations to banks, forcing banks to perform operations being alien and financially unjustified to them;
- Weak and insufficiently transparent financial condition of a significant number of businesses, and low payment discipline;
- Excessive tax pressure and existence of numerous tax privileges;
- Weak development of land and real estate market infrastructure, and legislative restrictions on operations in this market;
- Weakness of legal protection of creditor rights, including serious deficiencies in enforcement.

In addition, the development of the banking system of Ukraine is restrained because of problems inherent in the banking system itself. Among them are:

- Inadequate capitalization level of the banking system;
- Absence in most banks of effective mechanisms and tools for risk management, planning, and development strategies;
- Low return on bank assets because of generally low asset quality, the high proportion of nonearning assets in the total assets of the banks, and the unjustifiedly high cost of business;
- Low level of bank management and corporate governance;
- Inadequate effectiveness of bank supervision, in particular, in the area of risk-based supervision.

The building of the banking system has to be an integral part of the common efforts of the legislative, the executive, the judicial, and the NBU in the area of strengthening the economy of the state. The development of the banking system and the fulfillment by it of the objectives and priority tasks assigned are conditional upon:

- Ensuring the sustainable development of the economy of the state;

- Removing disproportions in the structure and pace of development of the economy of Ukraine and its banking system;
- Implementing an effective macroeconomic policy, which envisages:
  - balanced budget policy based on the timely drafting and approval of real budgets of all levels and their strict fulfillment;
  - prudent fiscal policy aimed at reducing tax pressure and addressing the practice of tax privileges;
  - monetary-credit policy adequate to the general economic situation.
- Coordinating the actions of government authorities with regard to the banking system;
- Developing legislation in a comprehensive and systemic manner in order to address collisions and loopholes and to improve enforcement practices;
- Developing financial markets;
- The payment system operating in a continuous and effective way.

The key monetary precondition for achieving the goals of further development of the banking system is the stability of the hryvnia. Given this, monetary-credit policy in Ukraine will be implemented first of all taking into account the need to maintain the stability of the national currency and to improve the resistance of the monetary-credit system to possible internal and external destabilizing factors.

A gradual liberalization of the current system of foreign exchange regulation will be done taking into account the situation in the domestic and foreign financial markets to create conditions for expanding the range of operations of banks and their customers in the foreign exchange market and will be viewed by the NBU not only as a means of improvement of the mechanisms and procedures of foreign exchange rate policy, but also in the context of actions on the formation of a more sophisticated transmission mechanism of monetary-credit policy.

The NBU's liberalization actions in the foreign exchange segment of the money-credit market will be accompanied with measures to increase the effectiveness of the discount rate and other instruments of monetary-credit policy, which have a significant influence on economic processes. The discount rate will be established by the NBU at a level being positive in relation to inflation.

Given the high level of openness of the economy of Ukraine and its vulnerability to various internal and external shocks, which makes it more difficult to accurately predict the consequences of application of particular actions, the NBU will take any actions on monetary stimulation of the development of the banking sector in a gradual, predictable and transparent manner for financial market participants.

SECTION 2. MAJOR GOALS AND PRIORITY TASKS OF DEVELOPMENT OF THE BANKING SYSTEM

Sustainable development of the banking sector is highly topical from a standpoint of development prospects of the state's economy.

Favorable macroeconomic dynamics and the NBU's monetary, foreign exchange rate and regulatory policies have created necessary conditions for the growth of capital, assets, and funds attracted by banks, and strengthening of the financial condition of bank institutions. This has contributed to the strengthening of the market orientation of the banking sector and its gradual approximation to the best international banking practices.

However, currently the participation of the banking system in the development of the state's economy is limited and insufficient. Given this, the major goals of further development of the banking system of Ukraine are:

- To strengthen the banking system of Ukraine, increase its resistance to crises;
- To strengthen confidence in the banking system on the part of depositors and investors;
- To make banks more active in attracting funds and transforming them into loans to the real sector of the economy;
- To deepen the integration of the banking system of Ukraine into the global financial environment.

In order to achieve the stated goals in the period of 2003-2005, the following priority tasks need to be fulfilled:

- To increase the capitalization level of banks;
- To improve the quality of corporate governance at banks;
- To improve risk management and internal control systems;
- To improve the practices of regulation and supervision of banking activity;
- To ensure the transparency of operation of the banking system;
- To legally ensure the protection of the rights of creditors, depositors and borrowers;
- To expand the range and increase the volume of products and services in the banking and financial markets;
- To prevent and counteract the legalization of funds obtained in a criminal way and the financing of terrorism;
- To continue the work on the adaptation of the banking law of Ukraine to EU law and the recommendations of the Basel Committee on Banking Supervision and other international organizations.

SECTION 3. PRINCIPLES AND AREAS OF INTERACTION OF GOVERNMENT AUTHORITIES WITH THE BANKING SYSTEM

Government policy in respect of the banking system of the country is based on the rule of law, the preservation and strengthening of market principles of banks' operation, and the usage of mostly indirect methods of influence on the processes going on in the banking sector.

Influence of the state on the banking sector is made by forming an appropriate legislative and regulatory framework for the operation of banks and the financial services market and for the realization of control over compliance with effective requirements.

The state is present in the capital of some banks and participates in their management.

In order to maintain a competitive environment in the financial sector, there has been designed a legal framework for the creation and operation of nonbank financial institutions and there has been created a State Commission on the Regulation of Financial Services Markets, which is to regulate the activity of such institutions.

In the meantime, the absence of a systemic and comprehensive approach to the development and adoption of legislative acts has led to collisions and loopholes in the current legislation and numerous errors in enforcement, which has a negative influence on the development of the banking system.

The further development of the banking system of Ukraine is based upon the following principles and areas of interaction of government authorities with the banking system:

3.1. Ensuring on the part of government authorities of:
- Strict adherence by central and local government authorities to the requirements of legislation on nonintervention in the activity of banks;
- Creation of equal conditions of operation for all banks;

3.2. Improving the legal framework for economic activity by drafting new and making amendments and supplements to effective laws and regulations (according to Attachment 2);

3.3. Improving the system of taxation of banks and bank operations, in particular:
- Optimizing the tax law with regard to expenses on formation of reserves for active operations by banks and the procedure for charging-off debt through such reserves;
- Barring the introduction of a tax on personal income from deposits and certificates of deposit;
- Addressing the issue of taxation of accrued income of banks on a cash basis and of transition towards the determination of a tax assessment basis using deferred tax procedures;
- Taking measures to bar banks from being assigned fiscal functions.

3.4. Ensuring the transparent operation of business entities, first of all, by means of a fuller application of International Financial Reporting Standards and International Standards on Auditing.

3.5. Repaying to banks problem debts guaranteed by the government.

3.6. Repaying the debts of budgets of all levels to business entities and on social payments.

3.7. Taking measures aimed at improving the creditworthiness of business entities, to which end:
- To legislatively increase the requirements to the level of corporate governance of business entities;
- To increase the requirements to the accuracy of financial statements and their compiling in compliance with International Financial Reporting Standards.

3.8. Reducing the list of entities, which are not subject to privatization, which will make it possible to use their property as collateral.

3.9. Introducing a mechanism of declaring liquid produce of agriculture with using it as collateral in lending (warehouse certificates, etc.).

3.10. Creating conditions for the development of nonbank financial institutions:
- Creating institutional and legislative frameworks and strengthening the mechanisms of legal regulation and supervision of credit unions, insurance organizations, pension funds, and other nonbank financial institutions;
- Ensuring the independence and effectiveness of operation of the State Commission on the Regulation of Financial Services Markets.

3.11. Enhancing the role of the Household Deposit Insurance Fund, including:
- Ensuring the equality of terms and conditions for compensation of funds to depositors of all the banks participating in the Fund;
- Accelerating reserves accumulation by the Fund;
- Strengthening the participation of the state in the formation of the Fund's funds;
- Increasing the amount of guaranteed compensation on a step-by-step basis.

3.12. Gradually introducing a mechanism of compensation of funds to depositors of the State Savings Bank of Ukraine.

3.13. Determining priority areas of social-economic activity, which need credit support and government mechanisms of their stimulation.

3.14. Promoting the stable operation of government-owned banks:

- Ensuring the financial capacity and increasing the capitalization of government-owned banks;
- Addressing at the legislative level the issue of proper corporate governance of government-owned banks by the Cabinet of Ministers of Ukraine.

3.15. Introducing a procedure for selecting banks to service government programs only through public tenders with the determination and publication of requirements to applying banks;

3.16. Introducing effective rules and procedures for counteracting the legalization of funds obtained in a criminal way and the financing of terrorism:

- Drafting implementing regulations aimed at fulfilling the provisions of anti-money laundering legislation;
- Designing and introducing at banks of internal programs for counteracting the legalization of money obtained in a criminal way, which would include the designing of internal control procedures (financial monitoring) and organization of personnel training programs;
- Holding appropriate educational and informational events among the population and business entities.

3.17. Creating a national register of titles to real estate and a land cadastre.

3.18. Creating conditions to revitalize the activity of the stock and insurance markets, in particular:

- Improving the legislation determining the conditions of their operation;
- Further developing the government securities market;
- Ensuring a transparent system of operation of exchanges;
- Unrolling an effective system of supervision over insurance activity;
- Further developing the National Depositary System, creating a single securities depositary (except for government securities) and introducing a mechanism of execution of securities contracts according to the "delivery against payment" principle, including using guaranteed settlements.

3.19. Creating conditions to bar monopolism in the market of armed security services for bank institutions.

SECTION 4. IMPROVING THE STRUCTURE OF THE BANKING SECTOR

Structure of the banking system of Ukraine and universal functional capacities of banks defined by current legislation meet basic needs of economy and provide for the favorable environment for the banking system development. Specialization of banking institutions in certain types of activities, geographical regions, operations or services is feasible within the framework of universal status of banks. Strategies selected by banks - specialization or universality, search for the most suitable organizational and legal form of ownership and management are defined by basic market driving forces - demand and supply of banking products and services and capital flow in the search of the best investment alternatives. State regulation of these processes happens only indirectly and market methods are applied.

At the same time, there exist certain disproportions in development pace between the financial sector and the real sector of the national economy. Large enterprises that are of strategic importance for Ukraine need sizable banking products and services that can only be provided by large banks the number of which is not sufficient in Ukraine. In addition, an important segment of the national economy is small and medium-sized businesses that are not viewed by large banks as attractive customers and that have to go for products and services to smaller banks, which cannot always fully meet their needs.

Optimization of the structure of the banking system may be achieved by:

4.1. Setting up conditions and facilitating the organization and functioning of a viable system of universal and specialized banks;
4.2. Introducing an effective system of management and operation of government-owned banks;
4.3. Consolidating the banking sector through processes of reorganization of banks and establishment of banking groups;
4.4. Creating preconditions for the opening of branches of foreign banks with the introduction of an appropriate system of licensing of their activity;
4.5. Ensuring a harmonious co-existence of large banks with small and medium-sized banks on the basis of equality of requirements as to their compliance with prudential supervision standards, as well as of banks and nonbank financial institutions;
4.6. Creating a Ukrainian Bank for Promoting Development.
4.7. Preventing the banking system from being used to perform illegal and doubtful operations, including fraud, legalization of funds received in a criminal way, and financing of terrorism.

SECTION 5. IMPROVING THE SOUNDNESS OF THE BANKING SYSTEM AND ENSURING THE TRANSPARENCY OF ITS OPERATION

As of the beginning of 2003, in Ukraine there are observed no significant risks, which may lead to a systemic banking crisis. Given the importance of further maintenance of stability, the NBU exerts close surveillance over banks, where a large proportion of the assets, liabilities and capital of the banking system is concentrated.

The stability of the banking system largely depends on the level and quality of management of risks inherent in banking, with credit risk being the most important of them, in particular, risk of insider operations. Currently, the sensitivity of banks to other risks – liquidity, interest rate, FX – is rather low, which, even given the imperfection of practices of their management, does not pose a significant threat to the soundness of the banking system.

On the other hand, the soundness of the banking system and confidence in it are closely related to its transparency. Ukrainian banks are legally obliged to disclose their annual financial statements and annual consolidated financial statements with an external auditor's opinions, as well as their interim financial statements. However, the disclosure of information on risks in banking operations in the official reports of banks, even though it generally complies with International Financial Reporting Standards, is insufficient for a complete assessment of the soundness and viability of the institution, as well as the effectiveness of its risk management.

In addition to disclosure problems, the banking system also faces other equally important issues, which impede strengthening its soundness. The most important of these is inadequate capitalization, a low quality of assets and deficiencies in their classification by risk of non-repayment, unreasonably high level of banking expenses, imperfect resource base structure where expensive attracted funds dominate.

In order to strengthen the soundness of the banking system and ensure its transparency, the following needs to be done:

5.1. Improve the quality of corporate governance and internal audit at banks by:
- Strengthening the requirements to the qualifications and business reputation of the members of the Supervisory Council of the bank;
- Increasing the responsibility of the owners of the bank for its activities;

- Broadening the functions of the Supervisory Council with regard to the determination of the bank's development and operating strategy, its organizational structure, comprehensive risk management system, risk limits, approval of internal policies, etc.;
- Raising the status and role of internal audit and risk management functions;
- Improving the procedure for reviewing the business reputation, education and work experience of the managers of the bank and its structural units, when they are appointed to their positions and in the process of their work.

5.2.To strengthen the role and quality of external audit based on the implementation of International Standards on Auditing and to toughen requirements to audit firms.

5.3.Take actions aimed avoiding conflicts of corporate interests.

5.4.Implementation in banks of efficient risk management systems, including:
- procedures for identification, monitoring and control of banking risks, in particular, operational, interest rate and market risks;
- models for measuring risks;
- contingency planning;
- work aimed at training qualified experts in the risk management area.

5.5. Ensure transparency in banks' activities by means of:
- Strengthening requirements to the content and format of publications of annual and interim financial reports, including to their re-publication of reports where material deficiencies were disclosed. Banks must publish profound and detailed information on their financial condition, owners, management structure, major investments and volumes of reserves, sources of income, risks taken by the bank and the quality of their management;
- Strengthening responsibility of bank management for accuracy and timeliness of reports, as well as accuracy of commercials;
- Continuing the work on the implementation of International Financial Reporting Standards, including those concerning recognition of financial instruments, and International Standards on Auditing;
- Implementing Basle Committee requirements to the disclosure of quantitative and qualitative information on the condition and performance of banks;
- Educating on approaches to the interpretation of financial reports;
- Expansion of the network of rating agencies as independent experts in risk assessment.

5.6. To increase the level of capitalization of banks by means of:
- Ensuring an inflow of capital to the banking system;
- Improving assets quality, more active problem debt collection efforts;
- Profitability growth, including through the growth in the range of risk free commission operations;
- More optimum structure of expenses, in particular, more reasonable approach to operating and administrative costs;
- Strengthening NBU control over bank's compliance with capital adequacy requirements.

5.7. Increase responsibility for illegal disclosure of banking secrecy.

5.8.Address at the legislative level the protection of the rights of creditors by means of:
- Creation and maintenance of a register of titles to real estate as tied the land plot;
- Establishment of priority title of the first creditor to the property pledged by means of the registration of property liens;
- Establishment of credit history bureaus in order to accumulate and exchange information on the creditworthiness of bank borrowers;
- Simplification of formal collateral procedures and the sale of collateral;
- Determining various conditions and ways of the sale of collateral;
- Sale of collateral, when the borrower is bankrupt, before other creditor claims;
- Restrictions on the use by the debtor in his/her benefit of the moratorium on meeting legitimate claims of creditors.

5.9. Address at the legislative level the protection of depositors' rights, including:

- improving the bank liquidation procedure;
- improving the system of individual deposits insurance.

5.10. Make sure that banks, whose activity threatens the interests of depositors or creditors, exit the market on a timely basis;

5.11. Enhance the professional level of management and key owners of banks.

SECTION 6. INCREASING VOLUMES AND EXPANDING THE SPECTRUM OF BANKING PRODUCTS AND SERVICES FOR THE REAL SECTOR OF ECONOMY AND POPULATION

During the period of the development of the banking system of Ukraine, banking products and services for legal entities and individuals typical for market economy were developed and launched.
The majority of them, volume and mix-wise, are credit products. As of 2002 year end, the share of interest income of banks from loans to legal entities and individuals was over 60% of the total amount of banking income.
At the same time, the spectrum and volumes of credit services are rather limited – mostly this is direct short-term lending – whereas current business conditions require new forms and methods of credit support.
Over the last years the trend of expanding the spectrum and increasing volumes of transactions that form the resource base of banks is observed. This translates into the development of new, more flexible from the point of view of satisfying customer needs, deposit products.

Recently banks started to focus on expanding the list of transactions that generate fee income.

In spite of large volumes of lending, the needs of economy in credit support still remain mostly unsatisfied. To a large extent this is due to high level of interest rates. The problem of the high price of loans is caused by the following factors:

- Interest rates have to cover risk of bad loans, including loans taken by other borrowers;
- Inefficient cost structure of banks, when interest income does not only compensate for interest expense, but also is almost the only source of covering administrative expenses;
- Inefficient practices of credit risk management, the absence of credit risk mitigation tools in particular;
- Insufficient competition in the banking services market and high costs of attracted funds.

Inadequate satisfaction of needs of economy shows itself in the short list of credit services mix for different groups of clients.

Currently it is very important for banks to be able to consistently follow a new direction of expansion of services range, improvement of their quality that includes introduction of advanced banking technologies.

In order to expand the range and volumes of credit products and services and to stir up bank lending to the real sector of economy and to population, it is necessary to:

6.1. To expand the forms of lending to SMEs by:
- Creating conditions for the co-existence of large, small and medium-sized banks that would satisfy the credit needs of SMEs;
- Strengthening the role of nonbank financial institutions in supporting SMEs.

6.2.Expand the sphere of application of mortgage lending by:
- Improving laws and regulations related to the implementation of this type of lending and efficient functioning of primary and secondary markets of mortgage financing;
- Developing and introducing a universal mechanism of mobilization of long-term non-budget financial resources for the market of mortgage loans (market of collateralized and emission mortgage securities);
- Creating an infrastructure that provides for efficient interaction among all participants of the mortgage loans market;

- Ensuring (at the legislative level) real possibilities of taking possession of collateral by the creditor and sale of pledged property, setting up conditions for shortening the procedures used at courts for considering cases related to taking possession of pledged property;
- Ensuring a reliable system of land registration, developing a state land cadastre and a register of real estate.

6.3.More actively use syndicated lending and, to this end, improve existing laws and regulations that regulate syndicated lending.

6.4.Expand the spectrum and territorial coverage of credit services for individuals, including:

- Lending to young people for buying housing and financing education;
- Consumer lending.

6.5.Use leasing schemes of lending more actively, in particular, to support enterprises of agricultural and service sector;

6.6. Develop a system of disclosure of information on how borrowers meet their obligations to banks and, to this end, provide for:

- Developing a system of independent rating agencies;
- Developing credit bureaus.

In order to keep trends of increasing volumes and spectrum of passive bank operations, it is necessary to:

6.7. More fully use international experience of application of accumulative investment schemes, including:

- Pension accounts;
- Accounts to pay for education;
- Accounts to purchase housing;
- Other schemes.

6.8. Increase the role of banks in performing fiduciary transactions, in particular, in managing mutual funds.

In order to decrease dependence of bank revenues on risky operations, fee-generating operations should be more actively developed and used, including:

6.9.Disseminating successful experience of salary and pension projects based on the National System of Mass Electronic Payments (NSMEP) and international payment cards;

6.10. Expanding the list of cash and settlement transactions, in particular, for the population, in trade and services industries;

6.11. Increasing volumes of other fee-generating banking services, in particular, financial consulting, collection and transfer of valuables, securities underwriting, etc.

Widening the spectrum and increasing volumes of banking products and services is not feasible without appropriate technological development of banking operations, development and implementation of highly technological financial instruments using the Internet, and creation of supermarkets of financial Internet services. For the purpose of dynamic development of the domestic financial services market, banks should create Internet banking systems and integrate them into the effective payment systems, as well as promote the introduction of other systems of distance customer servicing (telebanking, mobile banking, etc.). This envisages the creation of appropriate information protection systems in providing services in banking and financial markets in order to prevent the possibility of making fraudulent actions with banking electronic documents.

SECTION 7. ENHANCEMENT OF THE EFFICIENCY OF BANKING SUPERVISION AND REGULATION

The main objective of banking supervision in Ukraine is ensuring soundness and stability of the banking system, protection of interests of depositors and creditors. During recent years a significant progress has been achieved in Ukraine in improving banking supervision and regulation and bringing it closer to international standards and practices.

In the beginning of 2001 the Law On Banks and Banking was enacted, which includes a number of new principles of legal regulation of banking operations, based on international standards of banking and banking supervision.

Under the requirement of this law as well as taking into consideration Basle Principles and the EU Directives, the NBU has developed and is implementing a series of regulations which are a methodological base for the regulation of banks' activities.

The NBU collaborates with international organizations in the area of control of the fulfillment of programs related to the reforms in the banking sector.

The joint mission of the WB and IMF on the assessment of the financial sector in May 2002 stated that there were positive results in the area of banking supervision and regulation.

At the same time, there are a number of deficiencies observed in the area of banking supervision, which have a negative effect on its efficiency and pose an obstacle to a fuller compliance with the Basle Principles.

Given the above, the current tasks in the area of bank supervision are:

7.1. Raising the role and quality of work of Bank Supervision;

7.2. Implementation of risk-based supervision by means of:

- Strengthening control of the processes of implementation of risk management systems on the part of supervision;
- Pursuing supervision that consists of the identification of risks, their measuring, assessments of risk management systems in banks and the development of supervisory strategies on banks based on the quantity of risks and their assessment;
- Developing methodological recommendations on the identification and assessment of risks of banking activity and on the introduction of mechanisms of their management and hedging.

7.3. Implementation of consolidated supervision which includes:

- Introducing mechanisms of obtaining information on the full composition of the participants of the consolidated group;
- Assessing the impact of each group member on the soundness of the bank's work;
- Assessing the general soundness of the consolidated group.

7.4. Improving the bank supervision system with an orientation, first of all, at preventive controls over banking activity and early warning;

7.5. Improving the effectiveness of application of enforcement actions to banks for violations of banking legislation;

7.6. Strengthening control over operations with related parties;

7.7. Strengthening control of significant owners and changes in ownership, for which it is necessary to:

- Enhance the verification of sources of funds used to acquire the shares of a bank in order to identify its real owners;

- give the NBU authority to refuse to issue permission to acquire or increase an essential participation in a bank, to refuse to register a bank, as well as changes to bylaws, when it is impossible to identify real owners, founders and shareholders of the bank, i.e. there is a lack of a transparent ownership structure.

7.8. Optimizing the procedure for registering bank branches by:

- Simplifying the procedure for registering branches;
- Strengthening control over the provision by banks of timely information on the opening of branches.

7.9. Simplifying the procedures for licensing banking operations while simultaneously toughening the requirements as to availability of appropriate conditions for performing particular operations.

7.10. Expanding and more clearly defining the list of reasons for the revocation of a banking license and application of other enforcement actions.

7.11. Strengthening control over the fulfillment by banks of recommendations and demands of supervisors.

7.12. Exercising proper control over availability in banks of policies, practices and procedures on the counteraction of banking fraud, money laundering, and financing of terrorism. To this end, it is necessary to:

- establish legal requirements to banks concerning the mandatory development and implementation of rules and procedures to prevent fraud, usage of the banking system for money laundering, and financing of terrorism;
- implement "know your client" procedures;
- taking into consideration changes in law, improve the procedures of examination and control of actions taken by subjects of primary financial monitoring to prevent money laundering.

7.13. Maintaining by regulatory bodies of regular relations with management of banks, whose frequency should depend on the extent of risk and existence of problems at the bank.

7.14. Strengthening the legal protection of banking supervisors in order to ensure their legitimate and safe work and independence in decision-making.

7.15. Improving the information and analytical base of banking supervision in line with the needs for efficient supervision and regulation of banks' activity, which includes the following steps:

- Revising the number of reporting forms, contents of information, dates and frequency of their submission, in order to get high quality and accurate information, which reflects the true financial condition of the bank;
- Improving the methods of evaluation of the financial condition of banks;
- Improving the early warning system.

7.16. Improving the procedures of appointment and conducting of provisional administration of a bank.

7.17. Improving the procedures of bank reorganization and liquidation:

- Implementing regulations ruling the procedures of reorganization of banks performed based on a decision of the bank's general shareholders' meeting;
- Developing procedures of supervision of banks under reorganization and liquidation;
- Introducing legal responsibility of executives of banks under liquidation for the transfer of property and documentation of this bank, as well as responsibility of the managers of liquidation commissions for delays in the performance of bank liquidation procedures.

7.18. Ensuring proper interaction of the bank supervision function and external auditors of banks;

7.19. Interaction with banking associations, government regulatory agencies, in particular:

- Cooperation with banking associations in the area of development and implementation of a regulatory framework for banks' activity and other issues;
- Cooperation with the State Commission on the Regulation of the Financial Services Market, the Antimonopoly Committee, the Department of Financial Monitoring, the Securities and Exchange Commission, the State Tax Administration, and other government authorities.

7.20.Collaboration with international organizations and the central banks of other countries in the banking supervision area:

- making bilateral agreements with the central banks of other counties on cooperation in the banking supervision area in order to perform cross-border supervision;
- further developing collaboration in the banking supervision area with international financial organizations, the Basle Committee, Group of Banking Supervision of Central and Eastern Europe, etc.

7.21.Improving programs of training and enhancement of qualifications of banking supervisors with the participation of highly qualified Ukrainian and foreign trainers and practical experts.

SECTION 8. INTEGRATION OF THE BANKING SYSTEM INTO THE INTERNATIONAL FINANCIAL ENVIRONMENT

The banking system of Ukraine is an open type system. In Ukraine equal conditions have been created for the registration and functioning of domestic banks and banks with foreign capital, including the procedures for permitting banking operations and their taxation. Data on the development of the national economy and banking system are published in the IMF statistical journal "International Financial Statistics". Legal restrictions on the maximal level of foreign capital participation in the Ukrainian banking system, which existed in the first years of its development, have been cancelled. Banks have the legal right to enter the international financial environment, including by means of opening branches abroad.

The main forms of integration are:

- Presence of foreign capital in the Ukrainian banking system;
- Presence of Ukrainian banks on the territory of other countries by creating branches, subsidiary banks, and representative offices;
- Opening and maintaining direct correspondent accounts between Ukrainian and foreign banks to support foreign economic activities of business entities and to perform their own functions;
- Membership of Ukrainian banks in international banking organizations and international payment systems;
- Cooperation at the level of the NBU and the central banks of other countries and international financial organizations.

In the meantime, the adaptation of Ukrainian law to EU legislation needs to be continued.

A deeper integration of the banking system of Ukraine into the global financial system is prevented by the inadequate level of the sovereign credit rating of the country, which keeps serious foreign investors away.

On the background of globalization of international economic processes, the relatively low competitiveness of the Ukrainian banking system compared to the banking systems of other countries and international communities is a concern.

An increasingly pressing problem in international financial market globalization is the fight against money laundering and financing of terrorism. The Ukrainian banking system may not stay away from these processes. Therefore, the problem of compliance with FATF and Basel Committee requirements as to customer identification and preventing banks from being used to undertake unfair financial practices is of special significance.

In order to improve preconditions for the integration of the Ukrainian banking system into the global financial environment, it is necessary to:

8.1. Continue the adaptation of Ukraine's legislative and regulatory framework to the requirements of EU legislation and the Basel Committee on Banking Supervision;

8.2. Continue the work on the implementation of International Financial Reporting Standards and International Standards on Auditing in the practices of the activity of Ukrainian banks;

8.3. Strictly follow the requirements of the IMF Special Data Dissemination Standard;

8.4. Improve the methodology of compilation of monetary and banking statistics in accordance with international standards;

8.5. Increase the volume and frequency of publication of data on the activities of the NBU and the Ukrainian banking system, enhance the quality of this information;

8.6. Introduce an effective system of prevention and counteraction of money laundering and financing of terrorism and complete the implementation of 40 FATF recommendations and Basle Committee "know your client" requirements;

- Continue cooperation with the central banks and government authorities of other countries;
- Continue and expand cooperation with international financial organizations.

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Attachment 1

Actions to Implement the Comprehensive Program for the Development of the Banking System of Ukraine for the Years 2003-2005

To Section 3. ***Principles and areas of interaction of government authorities with the banking system***

#	Action	Responsible authority	Deadline
3.1.	Initiate the introduction of changes to the Law of Ukraine "On the NBU" to enable the NBU to carry out a more flexible interest rate policy in regulating the liquidity of the banking system.	NBU	2003, December
3.2.	Make changes to current regulations and develop new regulations introducing additional instruments to support banks' liquidity and to expand the range of deposit operations of the NBU.	NBU	Within 2003 – 2004
3.3.	Promote the introduction of changes to the Law of Ukraine "On banks and banking activity" to improve the practices of corporate governance in government-owned banks	CMU, NBU	By the adoption of the Law
3.4.	Develop a concept and a program of government participation in the capital of government-owned banks	CMU	2003, December
3.5.	Determine priority areas of social-economic activity, which need credit support	CMU	2003, June
3.6.	Determine government mechanisms of stimulation of the priority areas of social-economic policy	CMU	2003, December
3.7.	Initiative the introduction of changes to the Budget Code of Ukraine to reconcile the terms of development of forecasted macroeconomic and monetary indicators	CMU, NBU	Within 2003 – 2004

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#	Action	Responsible authority	Deadline
3.8.	Promote the adoption of the Tax Code of Ukraine, taking into account the NBU's position, to prevent banks from being assigned fiscal functions and to bar the introduction of a tax on personal income from deposits and certificates of deposits	CMU, NBU	By the adoption of the Code
3.9.	Initiate the introduction of changes to the Law of Ukraine "On the taxation of profit of enterprises" pertaining to the inclusion in gross expenses of the full amount of banking expenses, which is directed to form reserves for active operations (lending operations, securities operations, accounts receivable, accrued income, and balances of correspondent accounts in other banks)	NBU, Association of Ukrainian Banks (AUB) (with its consent)	2003, June
3.10.	Initiate the introduction of changes to the Law of Ukraine "On the taxation of profit of enterprises" to simplify the procedure for charging-off debts on active operations through reserves	NBU, AUB (with its consent)	2003, June
3.11.	Initiate the introduction of changes to the Law of Ukraine "On the taxation of profit of enterprises" to improve the procedure for taxing exchange rate differences in foreign exchange operations	NBU, AUB (with its consent)	2003, June
3.12.	Ensure information exchange among government authorities on the issues of compliance by subjects of foreign economic activity with foreign exchange law and on the application (cancellation) to subjects of foreign economic activity of sanctions in accordance with Article 37 of the Law of Ukraine "On foreign economic activity", as well as on authorized banks, which may conduct settlements related to foreign economic operations of their clients	CMU, State Tax Administration of Ukraine, State Commission on the Regulation of Financial Services Markets, NBU	Within 2003 – 2005
3.13.	The state Customs Service of Ukraine is to create a single	CMU, NBU	Within 2003 –

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#	Action	Responsible authority	Deadline
	electronic information base on movement of foreign exchange valuables across the customs border of Ukraine		2004
3.14.	Make changes to the NBU regulation to cancel the obligation of authorized banks to obtain special permissions to bring into Ukraine banknotes of foreign states and blank checks with keeping records of their importation	NBU	2003, December
3.15.	Initiate the introduction of changes to the Law of Ukraine "On the NBU" pertaining to the procedure for distributing NBU profit and direction a portion of it to the Household Deposit Insurance Fund.	NBU	2003, December
3.16.	Inform the population about the activity of the Household Deposit Insurance Fund, in particular, cover in mass media and separate information campaigns the procedure for compensating for inaccessible deposits, the size of guaranteed compensation amounts, and the list of the banks participating in the Fund.	Household Deposit Insurance Fund, CMU	On an ongoing basis
3.17.	Inventory the debt on the expenses of budgets of all levels of the state to specific business entities, including banks, and on social payments. Publish in central periodicals information on the size of the debt, the government's specific obligations to repay the debt, and the envisaged sources of repayment of these debts in the budgets of all levels within 1-2 years.	CMU	2003, June
3.18.	Promote the acceleration of the review of the NBU's draft law making changes to the Law of Ukraine "On the restructuring of the debt obligations of the Cabinet of Ministers of Ukraine to the National Bank of Ukraine" for the Ministry of Finance to repay its debt to the NBU and pertaining to the issues, which	NBU	By the adoption of the Law

#	Action	Responsible authority	Deadline
	arose in connection with the financing of the deficit of the State Budget in 1992-1996.		
3.19.	Improve the system for administering government debt	CMU	On an ongoing basis
3.20.	Adopt a Program for the development of the market of medium- and long-term government debt obligations for the years 2003 – 2005, which would envisage the introduction of an institution of agent banks and the support of liquidity in the secondary market of government securities.	CMU, SEC, NBU	According to the timeframes as envisaged in the program (2003 – 2005)
3.21.	Promote the adoption by the Verkhovna Rada of Ukraine of the draft Law of Ukraine "On simple and double warehouse certificates"	CMU, NBU	By the adoption of the Law
3.22.	Develop a mechanism for using warehouse certificates as collateral in lending to agricultural producers	CMU	Within three months after the adoption of the Law
3.23.	Create an appropriate regulatory and legislative framework for the regulation and supervision of the activity of nonbank financial institutions.	State Commission on the Regulation of Financial Services Markets	2003, December
3.24.	Initiate the introduction of changes to regulations to assign to nonbank financial institutions the responsibility of performing the functions of agents of foreign exchange control over the operations of their clients	State Commission on the Regulation of Financial Services Markets, CMU	2003, June
3.25.	Develop regulations needed for the registration of and issuance of permission to domestic nonbank payment systems to perform money transfer activity	NBU	2003, June

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#	Action	Responsible authority	Deadline
3.26.	Improve and unify the methodology for calculating macroeconomic indicators on the performance of economic entities, in particular, profitability and work productivity indicators, and publishing them.	CMU	2003, December
3.27.	Improve the methodology for calculating the consumer price index.	CMU	2003, December
3.28.	Develop a methodology for calculating the base inflation rate.	CMU	2003, December
3.29.	Gradually increase the guaranteed compensation amount.	Deposit Insurance Fund, CMU, NBU	On a permanent basis
3.30.	Complete the work on the automation of the process of transferring data on individual deposits in case of bankruptcy of banks and keeping the register of depositors.	Deposit Insurance Fund	2003, December
3.31.	Gradually introduce a mechanism of redemption of funds to depositors the State Savings Bank of Ukraine.	CMU	Within 2003 – 2005
3.32.	Allocate funds in the State Budget of Ukraine to pay compensation for the depreciated savings of population in accordance with the Law of Ukraine "On the government guarantees of restoration of the savings of citizens of Ukraine".	CMU	Annually
3.33.	Develop regulations on the procedure for Ukrainian banks to provide information on a financial transaction, which is subject to financial monitoring or which is connected with, related to or indented for financing terrorist activity, terrorist acts or terrorist organizations, including the procedure for Ukrainian banks to register such financial transactions.	NBU, CMU, AUB (with its consent)	2003, June
3.34.	Develop an NBU regulation on the procedure for the NBU to provide to the State Department of Financial Monitoring (Financial Intelligence Unit) information on the performance of	NBU, CMU	2003, December

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#	Action	Responsible authority	Deadline
	financial monitoring by it.		
3.35.	Promote the development and implementation in the banks of rules of internal financial monitoring and programs for its performance in line with the law on the actions to counteract the legalization (laundering) of income obtained in a criminal way.	NBU, AUB (with its consent)	2003, December
3.36.	Hold educational and informational events among the population and business entities on the fight against the legalization of income obtained in a criminal way.	Financial Intelligence Unit, State Committee on Information, NBU	Within 2003 – 2005
3.37.	Determine a procedure for authorized banks to exercise control over the performance by residents and nonresidents, being under special sanctions imposed in accordance with Article 37 of the Law of Ukraine "On foreign economic activity", of foreign exchange operations through these banks.	NBU, CMU	2003, December
3.38.	Promote the adoption of the draft Law of Ukraine "On amending some legislative acts of Ukraine" to lift the moratorium on forced sale of property.	CMU, NBU	By the adoption of the Law
3.39.	Promote the adoption of the draft Law of Ukraine "On amending some legislative acts of Ukraine" to protect the rights of creditors whose claims are backed by collateral.	NBU, AUB (with its consent)	By the adoption of the Law
3.40.	Draft a Law of Ukraine "On credit history bureaus".	NBU, CMU	2003, June
3.41.	Promote the adoption of the draft Law of Ukraine "On the backing of creditor claims and registration of liens".	CMU, NBU	By the adoption of the Law
3.42.	Promote the adoption of the draft Law of Ukraine "On the state land cadastre".	CMU, NBU	By the adoption of the Law
3.43.	Redraft the draft Law of Ukraine "On derivative securities" to clearly define the concepts and interpret the terms related to the	SEC, CMU, NBU	2003, June

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#	Action	Responsible authority	Deadline
	classification of relevant transactions as types of derivative securities.		
	Adoption of new versions of the Regulation on depositary activities of the NBN and of the Regulation on operations on placing government bonds (T-bills).	NBU	June 2003
	Amending the Resolution of the Cabinet of Ministers of Ukraine on "Issuing interest-bearing government bonds (T-bills) of the year 2000" from September 22, 2000 # 1455 in the part that reviews the mechanism of defining interest income from interest-bearing government bonds (T-bills) that are in the NBU's portfolio, for the year 2003 and following years.	Cabinet of Ministers of Ukraine, NBU	June 2003
	Developing a unified information network for transferring data on organized stock markets	State Securities and Exchange Commission, National Depository, Anti-Monopoly Committee, Security Service of Ukraine, State Communication Committee, NBU	December 2004
3.47	Developing efficient supervision system over insurance companies	State Commission of Financial Markets Regulation	During 2003 – 2004
	Initiating changes to the Law of Ukraine "On the National depositary system and specifics of electronic circulation of securities in Ukraine" related to the introduction of the	State Securities and Exchange Commission, Cabinet	During 2003

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#	Action	Responsible authority	Deadline
	centralized system of accounting for securities issued by entrepreneurial entities on the basis of central depositary functioning and provision of services to non-residents by custodians exclusively.	of Ministers of Ukraine, National Depository, Anti-Monopoly Committee, Security Service of Ukraine, State Communication Committee, NBU	
	Development and introduction of mechanisms of operations with securities according to the principle "delivery against payment", including guaranteed settlements.	State Securities and Exchange Commission, National Depository	During 2003
	Development of information exchange mechanism between the National Bank of Ukraine and the State Commission of Financial Services Markets Regulation	NBU, State Commission of Financial Services Markets Regulation, State Securities and Exchange Commission of Ukraine	During 2003
3.51	Initiating changes to laws and regulations related to registration of foreign investments made in any form	Cabinet of Ministers of Ukraine	December 2003
3.52	Facilitating drafts of laws of Ukraine "On weapons" and "On security activity" taking into consideration the NBU's proposals related to repeal of monopoly rights of the state on the market of security and guardian services and cash collection	NBU	Before laws are passed
3.53	Initiating changes to the Law of Ukraine "On Banks and	NBU	Before laws are

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#	Action	Responsible authority	Deadline
	Banking" in the part that talks about equipment of the banks' own security and collection services by appropriate types of weapons		passed
3.54	Implementing and releasing retrospective recalculations of main statistical indicators according to the State Statistical Classification of types of economic activities (CTEA).	Cabinet of Ministers of Ukraine, NBU	December 2003

To Section 4 Improving the structure of the banking sector

#	Action	Responsible authority	Deadline
4.1	Initiate the introduction of changes to the Law of Ukraine "On banks and banking activity" in the area of creation and operation of banking groups.	NBU	2003, December
4.2	Develop and implement NBU regulations governing the activity of banking groups.	NBU	Within three months after the adoption of the Law
	Initiate the introduction of changes to the Law of Ukraine "On banks and banking activity" to give foreign banks the right to establish branches on the territory of Ukraine.	NBU	2003, June
	Facilitate the creation of a Ukrainian Bank for the Promotion of Development".	CMU, NBU	2003, December

To Section 5. Improving the soundness of the banking system and ensuring the transparency of its operation

#	Action	Responsible authority	Deadline
5.1.	Develop and implement national corporate governance standards (code) for joint stock companies.	SEC, CMU, State Property Fund	Within 2003 -2005

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#	Action	Responsible authority	Deadline
5.2.	Initiate the introduction of changes to the Law of Ukraine "On banks and banking activity" to have the internal audit function of banks report to the Council of the bank.	NBU	2003, December
5.3.	Make changes to NBU regulations to strengthen the requirements to bank management to take into account the proposals of internal audit.	NBU	Within three months after the adoption of the Law
5.4.	Initiate the introduction of changes to the Law of Ukraine "On banks and banking activity" to expand the functions of the Supervisory Council in the area of determining the bank's development and operating strategy, its organizational structure, approving the bank's internal policies, comprehensive risk management system, and risk limits.	NBU	2003, December
5.5.	Initiate the introduction of changes to the Law of Ukraine "On banks and banking activity" to improve bank reorganization and liquidation procedures.	NBU	2003, December
5.6.	Draft a Law of Ukraine "On amending some legislative acts of Ukraine" to establish criminal liability for the illegal collection, transfer, usage, disclosure or divulgation of information constituting banking secrecy.	NBU	2003, June
5.7.	Make changes to NBU regulations to improve asset qualification by risk degree and to expand the list of risks, which are taken into account in determining necessary reserves for active operations.	NBU	2004, December
5.8.	Make changes to NBU regulations to introduce a mechanism of ongoing control over the business reputation of the members of the Council of a bank, including to envisage a possibility of removing Council members, who do not meet the business and	NBU	Within three months after the adoption of the Law

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#	Action	Responsible authority	Deadline
	professional reputation criteria as established by the NBU.		
5.9.	Initiate the introduction of changes of the Law of Ukraine "On banks and banking activity" to improve the procedure for reviewing the business reputation, education and experience of the managers of a bank and its structural units when appointing them and in the process of them performing their functions.	NBU	2003, December
5.10.	Create and constantly update the list of owners of essential participation in banks.	NBU	2003, December, and on an ongoing basis
5.11.	Initiate the introduction of changes to the Law of Ukraine "On banks and banking activity" to prohibit participants from withdrawing capital from their banks, whose activity poses a threat to the interests of creditors and depositors, in order to increase the responsibility of bank owners for its activity.	NBU	2003, December
5.12.	Introduce a "Banking Risk Management" course at higher educational institutions in training specialists in the specialty "Banking".	Ministry of Education	2003, December
5.13.	Hold seminars to train specialists of risk management units of banks in methods and procedures of risk measurement, analysis, management and control.	NBU	Within 2003 – 2005
5.14.	Develop and implement ongoing mechanisms of surveying the needs to train employees of banks of Ukraine in risk management.	NBU	2003, June
5.15.	Initiate the introduction of changes to the Law of Ukraine "On accounting and financial reporting" to define more exactly the dates of publication of financial reports.	NBU, AUB (with its consent)	2003, March
5.16.	Make changes to the Rules of Organization of Statistical Reports, which are submitted to the NBU to revise the formats of bank	NBU	2003, December

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#	Action	Responsible authority	Deadline
	reports and the economic indicators included in them for optimization purposes.		
5.17.	Develop and implement NBU regulations introducing a register of audit firms entitled to perform an audit of banks.	NBU	2003, June
5.18.	Initiate the introduction of changes to the Law of Ukraine "On audit activity" to determine a procedure for developing national external audit standards.	CMU, NBU	2003, December
5.19.	Initiate the introduction of changes to the Law of Ukraine "On banks and banking activity" pertaining to the mandatory procedure for refuting inaccurate reporting information.	NBU	2003, December
5.20.	Initiate the introduction of changes to the Code of Ukraine on administrative offenses to establish administrative liability of bank managers for publishing inaccurate information.	NBU	2003, December
5.21.	Study the possibility of implementing the recommendations of the Basel Committee on Banking Supervision pertaining to the disclosure by banks of quantitative and qualitative information on financial condition, bank owners, management structure, key investments and volumes of formed reserves, sources of income, risks taken by the bank, and the quality of risk management systems.	NBU	2003, December
5.22.	Make changes to regulations pertaining to annual financial statements of Ukrainian banks to take into account the new requirements of International Financial Reporting Standards.	NBU	2004, December
5.23.	Develop new and make changes to current NBU regulations to improve the procedure for accounting financial instruments in banks.	NBU	2004, December
5.24.	Develop and implement a Policy on the organization of operating	NBU	2003, December

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#	Action	Responsible authority	Deadline
	work in Ukrainian banks.		
5.25.	Promote the development of rating agencies.	CMU, NBU, AUB (with its consent)	On an ongoing basis
5.26.	Hold seminars and meetings to clarify to bank management the risk-management-based approach to managing a bank.	NBU	On an ongoing basis

To Section 6 Increasing the volumes and expanding the spectrum of banking products and services for the real sector of economy and population

#	Action	Responsible authority	Deadline
6.1.	Promote the adoption of a Law of Ukraine "On mortgage".	CMU, NBU	By the adoption of the Law
6.2.	Develop Laws of Ukraine "On the features of creation and operation of mortgage institutions", "On mortgage-backed securities".	CMU, NBU	2003, December
6.3.	Initiating changes to the Law on Ukraine On the Use of Registrars of Settlements in Trade, Catering and Services in order to implement cash payments for retail and customer services with payment cards of the National System of Mass Electronic Payments (NSMEP)	Cabinet of Ministers (CM), Tax Administration (TA), NBU	December, 2003
6.4.	Initiating changes to the Law On State Regulation of Securities Market in Ukraine to promote custodian operations and investment consulting	State Securities and Stock Market Commission, National Depositary, CM, NBU	During 2003

#	Action	Responsible authority	Deadline
6.5.	Promoting the adoption of the Law On State Support of Insurance and Export Lending	NBU	December, 2003
6.6.	Negotiating between KfW and the Government of Ukraine of a draft international agreement on preferential credit line terms to finance agriculture through the German-Hungarian Fund	CM, NBU	June, 2003
6.7.	Promoting the adoption of the Law on Micro-Credit	CM, Association of Ukrainian Banks (AUB) (on agreement), NBU	Within three month after the Law is passed
6.8.	Expanding the list of banks participating in the Uniform Information System " Register of Borrowers"	NBU, AUB (on agreement)	On an on-going basis
6.9.	Studying and use of international experience in the area of accrual investment schemes (e.g. pension accounts, education accounts, housing accounts, etc.)	NBU, AUB (on agreement)	On an on-going basis
6.10.	Approval of the Concept of the NSMEP development and of the state Program of the NSMEP implementation	CM, TA, Anti-monopoly Committee, State Commission of Financial Services, NBU	December, 2003
6.11.	Pursuing the policy of support to local manufacturers of NSMEP component parts	CM	On an on-going basis
6.12.	Ensuring a stage by stage implementation of NSMEP payment cards in the retail and service industry	CM, TA, NBU	2003 – through 005
6.13.	Public promotion of NSMEP payment cards and explanation of their use in state-owned mass media	CM	On an ongoing basis
6.14.	Implementation of an industrial use regime in the system of urgent (term) wire transfers	NBU	March, 2004

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#	Action	Responsible authority	Deadline
6.15.	Establishment of principles of the analysis of operational risks related to the use of information technologies in banks	NBU	December, 2003
6.16.	Finalizing and updating NBU regulations on the protection of information in banks concerning the reduction of operational risks, including regulations on the use of modern technologies and the issues of the information protection	NBU	2003- through 2005
6.17.	Amendments to NBU regulations in order to give individual residents the right to borrow in FX from non-resident and authorized banks.	NBU	During 2003
6.18.	Promoting the adoption of the Law on Electronic Digital Signatures.	NBU	Until the Law is passed
6.19.	Development of a procedure of cash collection from banks via collection boxes	NBU	2003 – through 2004
6.20.	Promotion of the adoption of the Law On The System Of Foreign Currency Regulation and Control.	NBU	December, 2003
6.21.	Amendments to NBU regulations in order to reduce the 5-day term of holding funds in a separate analytical account, when being transferred to a non-resident via the correspondent account in a non-resident bank	NBU	March, 2003
6.22.	Amendments to NBU regulations to cancel the requirement to banks to establish registers and have them approved by tax authorities when buying FX.	NBU	March, 2003
6.23.	Amending NBU regulations in order to cancel the requirement of approval of cargo customs declarations by customs authorities during the hard FX purchase.	NBU	March, 2003
6.24.	Amending NBU regulations in order to improve the functioning of the banking metal market, in particular:	NBU	

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#	Action	Responsible authority	Deadline
	- introduce trading in banking metals at the Inter-bank FC Market of Ukraine;		March, 2003
	- increasing the range of operations with banking metals;		June, 2003
	- investigate the possibility of canceling restrictions on the sale of banking metals to individuals.		2004
6.25.	Amending NBU regulations in order to simplify the procedure of FX wire transfers and taking FX outside Ukraine by individuals.	NBU	March, 2003
6.26.	Amending NBU regulations in order to cancel the requirement to authorized banks to register credit agreements with non-residents, made for the term exceeding 12 months.	NBU	March, 2003
6.27.	Amending NBU regulations in order to cancel the requirement that the margin charged by banks for FX trading operations may not exceed .5% of the official NBU exchange rate	NBU	September, 2003
6.28.	Amending NBU regulations in order to cancel the requirement to residents to submit to the tax authorities confirmation while buying FX and for settlements with non-residents in UAH	NBU	December, 2003
6.29.	Amending NBU regulations in order to introduce in the FX market of Ukraine some types of FX derivative operations	NBU	2004
6.30.	Amending NNBU regulations in order to review the mechanism of the FX market functioning, in particular, the necessity of the trading session.	NBU	2004
6.31.	Amending NBU regulations in order to gradually decrease the norm of the compulsory FX sale.	NBU	2004
6.32.	Amending NBU regulations in order to:	NBU	
	- further simplify the procedure of wire transfers and taking FX and payment cards outside/in Ukraine by resident individuals		2004
	- introduce a procedure of bringing UAH in Ukraine by non--		2005

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#	Action	Responsible authority	Deadline
	resident individuals.		
6.33.	Amending NBU regulations in order to lift restrictions on selling FX by banks through the exchange bureau network only in the volume, which may not exceed the volume of FX cash purchased.	NBU	2005
6.34.	Amending NBU regulations in order to expand the UAH use in settlements with non-residents in relation to foreign trade operations and non-trading wire transfers.	NBU	2005
6.35.	Training seminars on hedging risks for bankers	NBU, AUB (on agreement)	2003 – through 2004

To Section 7 Enhancement of the efficiency of banking supervision and regulation

#	Action	Responsible authority	Deadline
7.1.	Development of NBU regulations on the improvement of human resource management procedures , including the verification and confirmation of knowledge and qualifications of bank supervision employees (accreditation).	NBU	December, 2003
7.2.	Development of an NBU Procedure for ensuring integrated supervisory actions aimed at monitoring of the condition and performance of banks, conducting onsite inspections, control of the fulfillment of regulatory requirements and the application of enforcement actions when these requirements are failed to be fulfilled.	NBU	December, 2003
7.3.	Studying the possibility to improve the methodology of the regulatory capital calculation, taking into consideration Basle Committee proposal on special capital charges for market risks.	NBU	December, 2004
7.4.	Initiating changes to the Law on Banks and Banking in order to	NBU	December, 2003

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#	Action	Responsible authority	Deadline
	prohibit preferential treatment of related parties		
7.5.	Amending NBU regulations in order to include country risk in the methodology of the calculation of reserves for active operations.	NBU	December, 2003
7.6.	Development of the NBU regulations on risk management systems in banks.	NBU	March, 2004
7.7.	Amending Onsite Manual in order to improve control of related party lending.	NBU	December, 2003 Amending Onsite Manual
7.8.	Amending Onsite Manual examination procedures for interest rate, liquidity and operational risks management	NBU	2004 – through 2005
7.9.	Improvement of offsite supervision and analysis of information from third party sources (mass media publications, etc.), which may be important for risk identification.	NBU	On an ongoing basis
7.10.	Introduction of regular consultations with bankers on the improvement of banking supervision and regulation.	NBU, AUB (on agreement)	On an ongoing basis
7.11.	Initiating changes to the Law on Banks and Banking to expand the list of events subject to be informed to the regulatory body.	NBU	December, 2003
7.12.	Initiating changes to the Law on Banks and Banking to cancel restrictions on the number of onsite examinations of banks and the introduction of the requirement to go onsite depending on the general risks level and trends.	NBU	December, 2003
7.13.	Initiating changes in the Law on Banks and Banking to ensure, that during onsite examinations banking supervisors receive information and explanations, as needed, from all bank managers and members of councils.	NBU	December, 2003
7.14.	Developing methodological recommendations as to supervision	NBU	2004, June

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#	Action	Responsible authority	Deadline
	on a consolidated basis		
7.15.	Introducing changes to the Methodological Instructions on Bank Inspections in Ukraine (On-site Manual) regarding development of methodology of inspection of related persons during the supervision on a consolidated basis.	NBU	2004, December
7.16.	Introducing changes to the NBU regulations regarding enhancing control over the failure by banks to timely submit and to submit official reports, as well as over submission of unreliable reports, in order to unify practices to define administrative responsibility of banks' managers.	NBU	2003, December
7.17.	Initiating changes to the Law of Ukraine *On Banks and Banking* as to the ban for individuals to hold senior management positions in banks in case their actions in the past caused a bank liquidation.	NBU	2003, December
7.18.	Initiating changes to the Law of Ukraine *On Banks and Banking* as to setting requirements to the qualification of the bank Supervisory Council members.	NBU	2003, December
7.19.	Initiating changes to the NBU regulations with regards to making consolidated financial reports, particularly with regards to setting clearer criteria for defining participants to a consolidated group as well as the size of their participation.	NBU	2003, December
7.20.	Elaborating the NBU regulation on the requirements to banks' risk management systems.	NBU	2004, March
7.21.	Prepare methodological recommendations on risk management for the banks' risk managers.	NBU	2004, March
7.22.	Improvement and expansion of functions of the automated information system "Banks Dossier" by means of:	NBU	2003, December

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#	Action	Responsible authority	Deadline
	• Creating a module "Bank Passport" • Creating a module „Data on establishing correspondent relations by banks" • Providing for automatic loading of banking reports files into the data base in order to exclude "the human element" • Connecting territorial offices to the automated information system "Banks Dossier" • Designing a new system module "Forecasting"		2004, December 2005, December
7.23.	Initiating changes to the Law of Ukraine *On Banks and Banking* with regards to improvement of procedures of work of the Provisional Administrator and the Bank Liquidator.	NBU	2003, December
7.24.	Introducing changes to the NBU regulation with regards to improvement of procedures of appointing and carrying out provisional administration of banks.	NBU	Within three months upon the Law Enactment
7.25.	Introducing changes to the NBU regulations with regards to providing for a special procedure of closing clients' accounts in the process of reorganization and liquidation of banks and their branches.	NBU	2003, December
7.26.	Develop the procedure of notifying the STA by banks of the closure of clients' accounts in the process of reorganization and liquidation of banks and their branches.	STA, NBU	2003, December
7.27.	Elaborating Regulations (Bylaws) of supervision over the banks under liquidation.	NBU	2004, May
7.28.	Making an Agreement on cooperation in the sphere of bank supervision with central banks and supervisory agencies of other countries.	NBU	Through 2003 – 2005

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#	Action	Responsible authority	Deadline
7.29.	Introducing changes to the NBU regulations with regards to improvement of the procedure of granting permits to buy and/or increase essential participation in banks and methods of its calculation.	NBU	2003, December
7.30.	Initiating changes to the Law of Ukraine *On Banks and Banking* with regards to conferring powers on the NBU to determine beneficial owners of banks – individuals – and the origin of the source of funds spent to buy stock (shares) of banks.	NBU	2003, December
7.31.	Initiating changes to the Law of Ukraine *On Banks and Banking* with regards to the procedure of registration of bank branches.	NBU	2003, December
7.32.	Initiating changes to the NBU regulation with regards to setting the procedure of opening branches by banks upon a prior notification of the NBU on compliance of activity of such units with the regulatory requirements.	NBU	Within three months after the Law enactment
7.33.	Initiating changes to the Law of Ukraine *On Banks and Banking* with regards to simplifying licensing procedures with the simultaneous raising of requirements as to performing operations and defining the grounds to convoke a bank license.	NBU	2003, December
7.34.	Introducing changes to the regulations with regards to simplifying licensing procedures with the simultaneous raising of requirements as to performing operations.	NBU	Within three months after the Law enactment
7.35.	Introducing changes to the NBU regulation with regards to a clearer determination of the grounds to convoke a bank license.	NBU	Within three months after the Law enactment
7.36.	Introducing changes to the NBU regulation with regards to raising requirements to banks regulatory capital level in order to obtain a written permission to perform separate high risk operations, in	NBU	2003, June

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#	Action	Responsible authority	Deadline
	particular, on the international market.		
7.37.	Introducing changes to the Methodological Instructions on Bank Inspections in Ukraine (On-Site Manual) with regards to improving procedures of examination and control over the actions taken by banks to counteract legalization of the proceeds from crime taking into account legislative changes.	NBU	2003, December
7.38.	Elaborating Regulations on banks reorganization.	NBU	2003, June
7.39.	Preparation of Regulations of supervision over banks under reorganization.	NBU	2004, March
7.40.	Elaborating Methods (techniques) of the bank financial condition evaluation using early warning system indicators.	NBU	2004, December
7.41.	Introducing changes to the NBU regulation with regards to improving the functioning and access to the Integrated Information System "Register of Borrowers".	NBU	2003, December
7.42.	Reviewing and determining an optimal amount of early warning indicators and their boundary values.	NBU	Once a year
7.43.	Elaborating methods (techniques) of the comprehensive analysis of the bank financial condition.	NBU	2004, June
7.44.	Holding seminars and other training arrangements pursuant to the Program of training of personnel of the NBU system and Ukraine's banks for professional development of the bank supervision staff.	NBU	Within 2003 – 2005
7.45.	Organizational arrangements for the NBU bank supervision staff training under the Dutch Grant Program.	NBU	Through the term of the Grant validity
7.46.	Exploring opportunities for the bank supervision staff training at the expense of donor programs of the international organizations.	NBU	Ongoing exercise

#	Action	Responsible authority	Deadline
7.47.	Developing the program to prepare auditors of banking institutions for certification exams based on the IFRS (International Financial Reporting Standards) and ISA (International Standards on Auditing).	NBU	2003, September
7.48.	Elaborating and launching the program to prepare auditors of banking institutions based on the IFRS (International Financial Reporting Standards) and ISA (International Financial Reporting Standards) and ISA (International Standards on Auditing) in higher educational institutions.	NBU	2004, May

To Section 8 Integration of the banking system into the international financial environment

#	Action	Responsible authority	Deadline
8.1.	Creation and putting into operation of the e-data base of the EU regulations on banking.	NBU	2004
8.2.	Initiating changes to the Law of Ukraine *On Banks and Banking* with regards to harmonization of separate terms defining money-and-credit relations in line with the generally accepted international practice.	NBU	2003, December
8.3.	Elaborating the NBU regulations regarding the procedure of operations by authorized banks and financial institutions on Ukraine's territory with documentary letters of credit, operations against contractual guarantees, collection operations as payments under foreign economic operations.	NBU	Through 2003 – 2004
8.4.	Informing central international financial authorities, FATF Secretariat, Europe's central banks and the world leading commercial banks of the actions being made by Ukraine to	Cabinet of Ministers, NBU	Ongoing exercise

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#	Action	Responsible authority	Deadline
	combat with the legalization of the proceeds from crime.		
8.5.	Improving the methods of monetary and banking statistics in accordance with the international standards.	NBU	2004, June
8.6.	Elaborating general methodology and methodological comments as to the indicators that are being distributed in accordance with the IMF SDDS (Special Data Dissemination Standard).	NBU	2003, April
8.7.	Improving the structure of the NBU web-site in the Internet.	NBU	2003, December
8.8.	Compliance with the requirements of data dissemination in accordance with the IMF SDDS (Special Data Dissemination Standard) in order to ensure transparency of information on the development of financial and foreign economic sector of the economy.	NBU	2003 – 2005
8.9.	Coordinating and signing an agreement on cooperation with banks of the European Union countries and the European Central Bank.	NBU	Through 2003 – 2005
8.10.	Signing an agreement on cooperation in the area of the NBU staff training with the central banks of Germany, the Netherlands, France for the year 2003.	NBU	2003, April
8.11.	Organizational arrangements to provide for the NBU staff training under the technical assistance programs in the IMF institutions, United Vienna Institute, central banks and other international institutions.	NBU	Through 2003
8.12.	Expand the area and extend the terms of cooperation under the Dutch Grant.	NBU	2003, June
8.13.	Preparation and realization of the new economic program *Precautionary Stand-By Arrangement* jointly with the IMF.	Cabinet of Ministers, NBU	Through 2003 – 2005
8.14.	Preparation and realization, jointly with the World Bank, of the	Cabinet of Ministers,	Through 2003 –

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#	Action	Responsible authority	Deadline
	second and third stages of the *Programmatic Adjustment Loan*.	NBU	2004
8.15.	Preparation and realization, jointly with the World Bank, of the Village (Rural) Financing Project.	Cabinet of Ministers, NBU	Through 2003 – 2005
8.16.	Finalizing work on the Financial Sector Evaluation Program jointly with the World Bank and the IMF.	Cabinet of Ministers, NBU	2003, June
8.17.	Within the CIS Interstate Foreign Exchange Committee, work out the issues related to the development of the Concept of coordination of the policy by the CIS country members in the sphere of foreign exchange and the Mechanism of convertibility of the national currencies within the CIS countries.	NBU	2004, December

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Attachment 2

List of draft laws whose adoption would promote the further strengthening of the legal foundations of the activity of the banking system

1. Law of Ukraine "On the National Bank of Ukraine"
2. Law of Ukraine "On banks and banking activity"
3. Law of Ukraine "On the taxation of profit of enterprises"
4. Budget Code
5. Tax Code
6. Code of Ukraine on administrative offenses
7. Law of Ukraine "On the system of foreign exchange regulation and foreign exchange control"
8. Law of Ukraine "On the restructuring of the debt obligations of the Cabinet of Ministers of Ukraine to the National Bank of Ukraine"
9. Law of Ukraine "On simple and double warehouse certificates"
10. Law of Ukraine "On the government guarantees of restoration of the savings of citizens of Ukraine"
11. Law of Ukraine "On credit history bureaus"
12. Law of Ukraine "On the backing of creditor claims and registration of liens"
13. Law of Ukraine "On the state land cadastre"
14. Law of Ukraine "On derivative securities"
15. Law of Ukraine "On the National Depository System and the features of electronic circulation of securities in Ukraine"
16. Law of Ukraine "On weapons"
17. Law of Ukraine "On security activity"
18. Law of Ukraine "On accounting and financial reporting"
19. Law of Ukraine "On audit activity"
20. Law of Ukraine "On mortgage"
21. Law of Ukraine "On the features of creation and activity of mortgage institutions"
22. Law of Ukraine "On mortgage-backed securities"
23. Law of Ukraine "On the usage of registrars of settlement transactions in the area of trade, public catering and services"
24. Law of Ukraine "On the state regulation of the securities markets in Ukraine"
25. Law of Ukraine "On the state support of insurance and crediting of exports"
26. Law of Ukraine "On microcredit"
27. Law of Ukraine "On electronic digital signature"
28. Law of Ukraine "On amending some legislative acts of Ukraine":
    - To establish criminal liability for illegal collection, transfer, usage, disclosure or divulgence of information constituting banking secrecy;
    - To lift the moratorium on forced sale of property.

Comments on the Comprehensive Program for the Development of the Banking System

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BearingPoint.
Formerly KPMG Consulting

MEMO

TO: Oleksandr Shlapak, Deputy Governor

FROM: Karen Wilson, Senior Policy Advisor
Frank Blimling, Chief of Party and Senior Consultant

CC: Vadym Pushkaryov, Director Bank Supervision Department
Nataliya Ivanenko, Deputy Director Bank Supervision Department
Task Force for Development of the Comprehensive Program

DATE: February 10, 2003

REF: Comments on the Comprehensive Program for the Development of the Banking System

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We appreciate the opportunity to comment on the Comprehensive Program for the Development of the Banking System. We are impressed at the speed with which the task force has been able to put together a high quality document, which is indeed comprehensive. The actions indicated are the steps that we feel are necessary to further developing the banking system in Ukraine. We are particularly pleased to see that there is a commitment to facilitating the development of risk management systems in banks and to move to risk based supervision. The emphasis on creating conditions that allow market forces to better operate and resolve problems is especially endorsed. In this regard, increasing the transparency of the banking system through high quality and expanded information is critical and in accordance with the current emphasis in international supervisory standards.

In this memo we would like to discuss a couple of broad areas that I think need to be included or given more emphasis. These areas include the Rule of Law, Enforcement and Bank Closures, Strategy on State Banks, Systemic Risk, Money Laundering, and Technology. We have provided detail feedback to Alex Kutsenko, a member of the task force on these issues and smaller issues of wording.

The preamble provides a good statement of the vision for the banking industry and the areas for change. We did feel that there should be some performance indicators that should be used in conjunction with this statement to convey the extent of change that is anticipated through implementation of this program. This also provides an excellent mechanism to measure the success of the program and to communicate with outside parties. We understand that the need for such indicators has already been recognized and is being worked on.

RULE OF LAW

The program addresses the development of new and revised laws and regulations in a number of areas. How these laws and regulations are implemented and interpreted within the judicial system is not addressed. Over the last several years, new and revised laws and regulations have been put in place. They have not always achieved their intent due to the failure of the judicial system to properly interpret them due to lack of understanding or for other reasons. Therefore, it is important for the program to also include efforts to educate those in the judiciary and ensure that the goals of the laws are achieved.

ENFORCEMENT AND BANK CLOSURES

Although progress has been made in the area of enforcement over the last several years, efforts need to continue to ensure consistent implementation of current regulations. In addition, if the NBU is going to shift their focus to ensuring that banks have adequate risk management systems, enforcement regulations will need to be revised. The current enforcement process focuses primarily on violations of laws/normatives and dealing with well-defined problems in banks. The enforcement process needs to also take into account action by the NBU when banks have weak management systems and controls. These are currently commented upon in inspection reports, but enforcement actions have not generally been directed at these exceptions. Enforcement actions should be taken prior to the development of serious problems as reflected in the financial condition of the bank or a situation where laws/normatives are violated. Supervision by risk should identify potential problems at an early stage. It should be preventative. Therefore, the enforcement process needs to be revised so that action can be taken at an earlier stage.

In the past, enforcement and the decisions to close banks have been subject to political pressure. Actions are necessary to ensure that the supervision process is isolated from political influence to the full extent possible. Exceptions to NBU enforcement policies should be approved at a very senior level and reported to the Board of Directors, if not the Supervisory Council. The timely closure of insolvent banks is critical to ensure a competitive environment that is equitable, prevents the wastage of resources and over time will result in increased confidence in the regulatory and banking systems. Another reason that bank closures are not always timely is that the enforcement and rehabilitation processes start too late. Closure has in the past been delayed in order to give management time to resolve the bank's problems, rehabilitate or recapitalize. It is reasonable to give management time to correct the situation, but this should occur before the bank is seriously troubled. Taking enforcement actions at an earlier stage as mentioned above, should resolve this issue. Delay in the closure of insolvent banks in the past has lead to their assets being stripped by insiders and resulted in greater losses to the bank's depositors and creditors. A more timely and better controlled closure process should lead to an increase in the amount of funds returned to uninsured depositors and creditors. This will clearly over time increase the level of confidence in the regulatory process and the banking system.

Once a bank is closed it is critical that insured deposits are paid out promptly. Procedures need to provide for co-ordination between the NBU and insurance fund so that insured deposits can ideally be paid out as of the next business day. Implementation of such a goal would greatly enhance bank customers' confidence in the deposit insurance system.

STRATEGY ON STATE OWNED BANKS

There needs to be a clear strategy for dealing with the state owned banks. In order to have a more equitable competitive environment, these banks, if they are to be allowed to operate as commercial banks, should be subject to the same rules and restrictions as other banks. It is recommended that the long-term goal should be to privatize these institutions; if it is determined that this is feasible. In the case of Savings Bank, this will first require an extensive rehabilitation of the bank and recapitalization. Over time the government guarantee of deposits should be removed. This government guarantee puts the rest of the banking system at a significant competitive disadvantage. It has also resulted in deposits flowing to an institution that in the past has not been capable of productively using these resources and maximizing their benefit to the economy. Our knowledge of UkrEXIM Bank is outdated, but in the past it appeared that privatization of that institution in the short term was feasible.

If it is determined that it is critical to maintain these state institutions, they should become specialized institutions that are limited in their powers. Their purpose should be clear and it should be determined whether or not their purpose can be met by the commercial banking industry. If not, a determination should be made whether steps should be taken to remove the barriers that exist to having the banking industry serve these needs. If they are to continue, a judgment should be made on whether they need to be banks and whether their funding should be through deposits or other means.

We understand that there is a proposal to establish a Reconstruction and Development Bank. Although we have gotten an overview of what the bank is to do, we have not seen a detailed proposal on it. We and US AID do question the advisability of this action. World experience with such banks has been negative. We question whether it will achieve its stated purpose or be another source of problems.

SYSTEMIC RISK

NBU bank supervision should have a process that evaluates systemic risk, determines potential impact on the banking industry and results in supervisory strategies to deal with such risks to minimize their impact. Risk can be externally driven, such as the Russian banking crisis, which impacted Ukrainian banks or can be the result of concentrations within the banking industry. The economics department should identify macro economic issues, which may have a significant effect on the banking industry. Either they or supervision should model the impact of such items on the industry to determine whether there is a need for action. Action may be directed at the industry as a whole or be directed at individual banks that are most vulnerable. The banking industry's sensitivity to the key risks, i.e., interest rate, FX, should be projected on a regular basis. An example of a systemic risk from US experience was the deregulation of interest rates in the 1980s. OCC started to work with commercial banks to recognize the risk and develop new methodologies for managing interest rate risk prior to deregulation. The effort was successful and almost no banks had serious problems when interest rates were finally deregulated. Unfortunately, the thrift regulator did not take any action and the result was one of our worst financial institution crises.

The paper indicates that there are no significant risks, which may lead to a systemic banking crisis. I believe the intent was to say that there are not banks or set of banks that are sufficiently large and tied to other bank to cause a systemic crisis. As they rightly point out, credit risk is high. Credit risk does represent a systemic risk and many of the actions in the paper are directed to dealing with that risk, i.e., improved collateralization process.

ANTI-MONEY LAUNDERING

The discussion in the paper on money laundering focuses on the banking industry and NBU bank supervision. This is an effort that needs to be government-wide and include the entire financial industry. I think the paper needs to reflect this. Although I recognize that the paper is directed at the development of the banking industry, segments do discuss the broader financial industry. In reality the paper should probably be a comprehensive program for the development of the financial services industry, especially as many of the actions are directed at the development of non-bank entities and many of the actions benefit both banks and other financial service providers. In the area of anti-money laundering, it is critical that action be a government wide effort. If not, NBU is doomed to failure. This area is an example of where the banks and NBU have had problems with the judicial system in taking action to comply with the new Law on Banks and Banking. I also think it is a mistake to create the impression that the banking industry is the only portion of the financial industry that may be tainted by money laundering.

TECHNOLOGY

Technology is one of the major forces affecting the economy, the banking industry and all of our lives. The paper does make reference to the use of some new technologies by the banking industry, but the treatment of this area is far short of comprehensive. In addition to the potential for banking products, there is also the potential for technology to be used to improve the efficiency and effectiveness of bank supervision. An area related to risk management in banks is the various tools/models that have been developed through the use of technology to better quantify the level of risk and its impact. We suspect that laws relating to technological advances have not been kept up to date and therefore, will need regular adjustment. The area of computer fraud and security is a critical one that should be addressed. I am not sure that there is any area or group of the NBU that is charged with looking at the potential impact/uses and risks associated with technology. If not, we recommend that this be considered.

In this memo we have briefly discussed major areas that we think need to be more fully covered. We have not commented on all of the things that are right and positive in the program. Overall, the program is very thoughtful and I believe incorporates most of the major issues we have commented upon in the past.

I know that the NBU departments are in the process of proposing actions, assigning responsibility and setting priorities and timeframes. We are; however, concerned that the goals and actions proposed are in many instances the primary responsibility of others. There should be an attachment to the plan that takes each item and assigns responsibility for leading the effort to a single agency of the government. A second column would then indicate those other agencies, which are to be involved in the process. NBU should be a catalyst for change and provide leadership on many of these issues, but clearly cannot control the outcome in many of the areas.

The job set out in the document is daunting. We do have a concern with the capacity of the NBU and other agencies of the government to be able to follow through on all of these issues. Several of the issues may well take beyond the timeframes of the document to fully implement. This document conveys a sense that all of these actions are to be completed not just begun. At this stage the document does not provide any indication of which items are the key priorities. This needs to be incorporated. We would hate to see resources so fragmented that many things are started but few completed and fully implemented.

As mentioned above, all of these items and other more minor items have been discussed with Alex Kutsenko, who is a member of the task force and can provide additional insight. Frank Blimling will be available to discuss any of these items. Karen Wilson is back in the States, but will be back in March if you wish to discuss any of these items with her. Input was received from US AID and incorporated in this document.

Status of Audit Profession in Ukraine

5

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MEMO

To:	**Frank Blimling**, Chief of Party, Ukraine Bank Supervision Development Project
CC:	**Project Members**
From:	**Alex Kutsenko**, Economic Specialist
Data:	**March 28, 2003**
Re:	***Status of Audit Profession Development in Ukraine***

The purpose of this document is to provide background lay down the facts about and problems inherent to audit profession in Ukraine. It also covers major initiatives by audit self-regulated bodies and government agencies to promote and develop the profession.

External Audit

Background Information

External audits in Ukraine are governed by Audit Act of 1993 (Attachment 1). This Act provides legal framework for both bank audits and audits of other business, including non-bank financial institutions.

Below is the summary of the most important for the purpose of this memo provisions of the Audit Act:

- In Ukraine, any Ukrainian citizen who holds a University diploma in Economics (including Accounting, Banking, Finance and other Economics-related spheres) or in Law is eligible to become a certified auditor. In order to be honored a Certificate a person has to have specified experience[1], go through specified training and pass a written test;
- There are two types of Audit Certificates: Certificate A for auditors of non-bank entities (general business, including non-bank financial institutions), and Certificate B for bank external auditors. Holders of both Certificates receive a combined AB Certificate;
- A person needs to complete two steps before he or she can start practicing audits. The first step is to acquire a Certificate, the second step is to purchase a license (see Certifications vs. Licensing section of this memo);
- Certain institutions – in particular banks and listed companies – are required to pass annual statutory audits. In addition, some non-recurring events might trigger a statutory external audits;
- The Act calls for Audit Chamber of Ukraine as an independent self-regulating agency for audit profession. The Audit Chamber (another official name – Chamber of Auditors of Ukraine) enjoys the exclusive rights to adopt National Audit Standards. However, other agencies – in particular, the Union of Auditors – can initiate preparation of such standards and solicit Chamber's approval.

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[1] Minimum experience requirements differ for bank and non-bank auditors and vary from three to five years.

In 1998 the Audit Chamber adopted so called National Normatives of Audit. In fact this was a Ukrainian translation of International Standards of Audit (ISA). There are three major concerns in respect to these Normatives:

- At the time of adoption, the Audit Chamber was not a member of IFAC, and therefore its efforts to promulgate ISA is questionable. This issue remains unsolved;
- The Normatives are outdated by now. IFAC has recently adopted several important Standards that have not been incorporated into Ukrainian Normatives;
- Many experts have noticed material drawbacks in translation that significantly impede the understanding and use of the Normatives.

Statutory vs. Voluntary Audits

There are two types of external bank audits in Ukraine – statutory and voluntary. Statutory audits are demanded by the law and include, among other things, audit of bank annual financial statements before their publication and submission to NBU. There are also additional events of non-recurring nature that trigger statutory audits like bank merger or liquidation. Other audit-related services like consulting, audit follow-up etc are deemed to be voluntary at bank's discretion.

From the regulation standpoint, there is no difference between statutory and voluntary audits since both these types of activities are subject to the same level of regulatory scrutiny.

Licensing vs. Certification[2]

These two terms refer to absolutely different concepts in both the Audit Act of 1993 and other regulations. Despite of this, they have been misused and used interchangeably by outside parties that lead to many misunderstandings.

Licensing refers to issuance of a document that allows a person to practice audit. To be licensed a person needs to hold a certificate first. Both individual auditors and audit companies can be licensed. Maximum validity of a license is five years.

Certification calls for identification of whether an individual person has enough knowledge, skills and abilities to act as an auditor. Term "certification" can never be applied to audit companies. Maximum term of validity for a certificate is five years. Holding of a certificate does not give a right to practice audit. This is because an auditor can decide not to practice audit in his or her own but rather as a partner of an audit company.

Hence, from regulatory standpoint, licensing only implies a procedural check (both through an interview and checking documents) and keeping a registry. Such activity does not involve significant resources and can be done routinely, just like keeping a registry of bank branches.

However, certification implies testing individual's ethic standards and education, including relevant experience. Certification calls for a written test that shall be a natural extension of a training process. Since the law allows several attempts to pass the test, certification demands

[2] Also the Audit Act of 1993 uses the term "licensing" in respect to issuance of a document to certified auditors to allow them practicing audit, recently they started to avoid this term in open discussion. The reason is that there is a list of business and professional activities that are subject to licensing requirements, and audit is not in this list. Respectively, in current NBU documents term "registration" is used to identify the concept of allowing someone to practice audit.

significant resources, both financial and personnel, to develop, implement, and keep up-to-date training programs, including test questions, databases and so one.

Individual Auditors vs. Audit Companies

There is another problem on how to interpret the Law. This is problem of what individual auditors can do vs. what audit companies can do. The essence of the issue is that the Audit Act does not explicitly say what can an individual auditor practice and what can only an audit company practice. This confusion is present in both bank audits and non-bank audits.

The law sets forth that an audit company can practice audit only if at least one auditor is certified. However, it is not clear that such person shall be a full-time employee or a partner in the company. Therefore one auditor can work for or even own several audit companies at the same time. If this person does a poor audit on one company and such company is put under supervisory or any other sort of scrutiny, there are good chances that the same auditor can continue in other companies. This make the issue or ensuring good quality of audits very questionable.

Internal Audits

There is no law or act in Ukraine that would regulate internal audits. The Audit Act of 1993 does not have any special term "internal audit", nor does Accounting Act of 1999. Therefore technically there is no general rule that would govern internal audits.

This creates a handful of legal and related problems. For example, in many companies terms "internal controls" and "internal audit" are used interchangeably and the same units within an organization are responsible for putting internal controls in place and perform internal audit.

In the area of bank this issue is somewhat more developed. In particular, Bank and Banking Act calls for an internal audit department to be in place in every bank. However there is a confusion to whom this department shall report and be accountable – to the Board of Directors or to the Management Board. This is in fact a problem with internal audit independence. Recently the NBU has elaborated amendments to the law to propose subordination of the internal audit to Board of Directors. Among others, there is also a proposal to hold bank managers responsible for prompt and appropriate reaction to the recommendations of internal auditors.

In addition, there is an existing problem of how competent internal auditors are. This issue can be solved through training.

In some banks recently internal auditors were empowered with related, also not usual functions, in particular, risk management.

Audit Agencies and Initiatives

Chamber of Auditors of Ukraine

Chamber of Auditors of Ukraine is the major player for the audit profession. In fact, it should be the leader in all initiatives in the area of audit. Unfortunately, the theory does not always come true.

Currently, there are three major efforts initiated by the Chamber of Auditors: (1) Certification of auditors; (2) publication of Ukrainian translation of International Standards of Audit, and (3) development of National Standards of Audit.

Certification of Auditors

Certification of non-bank auditors (Certificate "A") remains to be the biggest job for the Chamber. There is a on-going training and testing process for individuals wishing to become non-bank auditors. The training is in-house and provided by recognized accountants and auditors. The test is a combination of multiple choice and a case study. Many experts complained that the pass threshold is low – an applicant can fail 16 out of 40 questions.

Individual auditors who's Audit Certificates expire shall pass the mandatory test like a new auditor, but can chose not to undergo training.

The statistics of how many non-bank auditors have been certified so far and how many of them a practicing auditors were not found during the preparation of this memo.

Publication of Ukrainian Translation of International Standards of Audit

This is a significant project undertaken by the Chamber. Recently the Chamber purchased a right to translate International Standards of Audit into Ukrainian and publish it in order to promulgate these Standards in Ukraine. Supposedly the Chamber hired a good translation team to avoid any mistranslation problems currently present in National Normatives of Audit.

It is expected that the Ukrainian translation of ISA will come out by May 2003.

Latter the Chamber is expecting to issue a set of commentary papers to suggest the best practical implementation of the ISA in Ukraine. The dead line for this initiative is December 2003.

Elaboration of National Standards of Audit

This is the most controversy effort to be initiated by the Chamber. As it stands now the Chamber wants to remain the exclusive agency to elaborate and issue National Standards of Audit. However, as it turns out, in case the Chamber issues the Standards, there will be questions concerning their recognition by international community. This issue is discussed in a separate memo to Mr. Shlapak and Mr. Puskariov dated February 28, 2003 (attached).

This issues has a direct relation with the next initiative discussed below.

Acquisition of Membership in IFAC

There is one major initiative that the Chamber has to implement in near future in order to preserve its status-quo. The Chamber has to acquire membership in International Federation of Accountants (IFAC). There should be a due-diligent process in place to control how the Chamber is planning to undergo this initiative.

The National Bank of Ukraine is fully aware of the problem and wants to resolve it. In the latest correspondence to banks NBU openly stated that the Chamber is supposed to promulgate International Standards of Audit by publishing the Ukrainian translation and elaborate National Standards of Audit to be recognized by international community. Shall the Chamber fail to do this, the NBU will require Ukrainian banks to use only international audit companies to do annul audit of banks' financial statements.

Federation of Professional Accountants and Auditors of Ukraine

Federation of Professional Accountants and Auditors of Ukraine (FPAAU or UFPA – Ukrainian Federation of Professional Accountants and Auditors) is a non-government not-for-profit organization. The membership is voluntary. Members can enjoy consultation cervices and similar type of support from the organization.

The major initiative of the Federation is the certification of accountants. The certification is done in conformance with IFAC and UNCTAD requirements, including International Educational Guidelines on initial and continuous education. This initiative was conducted with assistance provided from USAID contractors – IBTCI and than Cemonex. The contractors have developed training materials and test procedures to be then passed on to the Federation and fully administrated by it. At the moment of preparation of this memorandum the training part of the certification program was delivered by Ukrainian trainers hired through open bids. Such training is for fee and a person has to pass training of several modules before he or she will be allowed to pass any test. The test process was still administrated by USAID contractors and there was a plan to make is self-sustainable and fully passed to the Federation.

The Certificate of Professional Accountant is not required by any government or professional organization as an eligibility criteria for a job or practice. However, some accounting companies, especially those involved in the outsourcing of accounting, do require their accountants to hold such Certificate. In addition, there is a movement to require such Certificate to be held by Senior Financial Officers of listed companies.

Other initiatives administrated by the Federation are related to general development and promotion of accounting profession, as well as providing the accountants and auditors with comments and practical guidelines. For this purpose the Federation issues bulletins and holds ad-hoc conferences.

Institute of Internal Auditors

The Institute of Internal Auditors is a non-government not-for-profit professional organization that joints internal auditors in order to help them overcome difficulties in their practice and provide consistent guidelines and methodological support. The Institute is a member of the International Institute of Internal Auditors and being such is eligible to promulgate the best practice of internal audit in Ukraine.

Also technically the Institute joints the internal auditors from all types of companies, it currently emphasizes mostly on bank internal auditors. The reason for this has been discussed above – only for bank there is an explicit requirement to have internal audit.

The major initiative undertaken by the Institute is to issue Ukrainian translation of Standards for the Professional Practice of Internal Auditing that include Statement of Internal Auditing Standards, Statement of Responsibilities of Internal Auditing and Code of Ethics.

Since there is no regulation on the internal audit, nor on who can regulate this profession (in fact, it is not even recognized yet as a profession) the Institute can effectively declare that such translation becomes official Ukrainian National Standards of Internal Auditing.

National Bank of Ukraine

National Bank of Ukraine is a specialized government agency that operates under the National Bank Act (1999).

According to the Act, the National Bank is empowered to certify bank external auditors. Currently the NBU does not exercise its powers due to the lack of a clear vision how to use them and respective interpreting regulations and resources.

There are the following major problems vis-à-vis NBU certifying bank external auditors:

1) There is no clear vision on what shall be done – certification (the initial step that implies training of individuals) or just licensing (the ultimate step that implies only due-diligent knowledge test for individuals and eligibility criteria for companies).
2) There was no study done to find out whether NBU has enough resources, primary people, to accomplish the function it is entitled to.
3) In any case (no matter what steps NBU will be willing to exercise) there is an issue that NBU can not charge individuals for rendering services to them (including for training). Some experts believe that if NBU were to be allowed to charge this could open doors for corruption.
4) If NBU indeed starts certifying external bank auditors this can create an unwanted precedent for other government agencies – especially for the Security and Exchange Commission – that will want to regulate auditors in their areas of jurisdiction. This can lead to defragmentation of regulatory oversight and possible even to vanishing of such control. Another side effect is this will make it extremely difficult to individual auditors to acquire a universal certificate.

The initiatives undertaken by NBU in respect to bank audits are covered in memos prepared by Mr. Chuck Canfield in late 2002 – early 2003.

Conclusion

As it has been revealed during the meetings and study, currently there is a number of problems that impedes development of audit. The major problems are:

- Unclear laws and regulation that govern audit process;
- Conflict of interest inherent at many stages of audit regulation;
- Lack of willingness to make a difference.

In addition to these, there has been no central initiative to reform audit profession that lead to unawareness of the parties involved about what the other agencies are doing. If the situation continues, the effectiveness of any initiative to promote bank internal and external audits will remain poor.

Problems and Future of External Audit

BearingPoint.
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MEMO

To:	**Olexandr Shlapak,** Deputy Governor, NBU **Vadym Pushkariov,** Director, General Department of Bank Supervision
CC:	**Group of Economic Advisors to NBU Governor**
From:	**Alex Kutsenko,** Economic Specialist, USAID Bank Supervision Project
Date:	**February 28, 2003**
Re:	***Problems and Future of External Audit***

The purpose of this document is to present our opinion concerning the existing problems vis-à-vis audit developments in Ukraine, in particular bank audits, and concerning immediate and long-run proposals on how to overcome these problems.

Generally, we see the following problems in the audit area and ways how to eliminate them:

- **National Audit Normatives do not comply with International Standards of Audit (ISA).** It is be possible to eliminate such problem by declaring that ISA are becoming Ukrainian National Standards of Audit (NSA);
- **The Ukrainian Chamber of Auditors** (UCA) **is the only organization** that by law has the **power to adopt National Standards of Audit.** However, the UCA is not a member of the International Federation of Accountants (IFAC) and therefore **international organizations will not recognize National Standards adopted by the UCA** even if they repeat ISA word-by-word. It is possible to eliminate the problems either by amending the law to cancel the UCA's exclusive rights to issue NSA and allowing other self-governed organizations that are or will be members of the IFAC; or by forcing the UCA to acquire membership in the IFAC in order to make sure that any Standards issued by the UCA will be recognized in the world;
- **Bank auditors have not been certified for three years now** since Banks and Banking Act came into effect. The ACU does not have the powers to issue certificates for bank external auditors any more, whereas the National Bank has not made its position clear whether or not it will certify external auditors due to lack of resources. In addition, **if the NBU decides to certify auditors it will expose itself to a reputation risk** in case of the NBU certified auditor do a poor job in the future. It is possible to solve the problem in two steps. The transitional step is to create an independent body to certify bank auditors and introduction in the NBU a registry of audit companies entitled to perform bank audits. The final step is to transit from certifying auditors to certifying accountants.

All these problems and proposals are discussed in details below in this document.

National Normatives of Audit Do Not Comply with International Standards of Audit

As it has been noted many times in official documents and recommendations of World Bank and International Monetary Fund, the existing National Normatives of Audit (NNA) issued by Chamber of Auditors in 1998, do not comply with existing International Standards of Audit. The discrepancy is caused by the fact that NNA do not include those significant ISAs issued after 1998.

It shall be mentioned that even if now, in the year of 2003, the Chamber of Auditors adds respective ISA to NNA, this is only going to solve the problem for a while since IFAC has been constantly following up on ISA development and almost every year new Standards are issued[1]. International experts share a common opinion that both the frequency and substance of changes are going to be increased in response to recent corporate scandals. Therefore the Chamber of Auditors (or anyone responsible for ISA promulgation in Ukraine) shall make sure that there is a system in place to follow up the development of National Normatives or Standards. The lack of such system in the past is one of roots for the existing problem – in 1998, when issued, the NNA fully complied with ISA since in fact were their summarized Ukrainian translation. It means that it is not a substance discrepancy but rather a "timing difference".

*There are two alternative ways to approach the problem. The first one is to develop National Standards based upon International Standards. The second is **to declare the full text of International Standards of Audit (in Ukrainian translation) as National Standards.***

In our opinion the second choice is more desirable due to the following:

- Since now ISA do not have alternative treatments or recommendations on a single issue, there is no need to select from such alternatives in National Standards[2];
- Standards of Audit actually guide the process how audit as a professional activity is to be performed, and only to some extent they concern about the final product – audit report and management letter. Therefore there is no need to make sure ISA comply with national legal requirements, a more prudent step would be to make sure that national legal guidelines underlying audit process are in line with ISA.

In addition, if ISA are pronounced as National Standards this would solve the "timing difference" deficiency reducing it from several years to several months – the time it takes to translate annual changes to ISA into Ukrainian and publish them.

The importance of self-governed audit organization will continue if approaching the problem in this way. Such organization would still have to promulgate the Standards by issuing interpretations, position papers, training programs, etc.

Domestic and International Status of the Ukrainian Chamber of Auditors

The major problem that impedes the above proposal to declare ISA as Ukrainian National Standards of Audit is the domestic and international status of Chamber of Auditors.

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[1] International Standards of Audit, just like International Financial Reporting Standards (IFRS), are issued annually in the first quarter of each year. Usually national authorities and auditors are given some time make sure their requirements and practice comply with the new standards.

[2] However, this statement is not intended to say that such alternative treatments are not going to emerge in the future, also now this possibility seems to be remote.

In accordance to the Audit Act of 1993 the Ukrainian Chamber of Auditors is the only organization that can legally issue National Standards of Audit. The Chamber exercised this power in 1998 when it issued National Normatives of Audit. In addition, the Audit Act sets forth that other self-governed professional organizations can elaborate draft Standards but still have to submit them to the Chamber for official approval. Therefore domestically Chamber's status is absolutely lawful and exclusive.

From the other hand, in accordance to the Preface to International Standards of Audit, these Standards can only be promulgated at a national level by IFAC members. The Chamber of Auditors is not a member to IFAC. Now there is only one Ukrainian organization – Ukrainian Federation of Professional Accountants and Auditors – that is an associate member to IFAC. Therefore internationally the Chamber is not a recognized organization and hence any guidelines it issues are not going to be recognized by international investors as compliant to ISA.

*There are two approaches to this problem of legal formalities. First, the Audit Act can be amended to allow any self-governed Ukrainian audit organization that is a member to IFAC to issue National Standards. Second, **there can be a legal or other requirement issued to the Chamber of Auditors to force it to join the IFAC.***

In our opinion also the fist suggestion makes more sense from the standpoint or government non-intervention into self-governed organizations and avoidance of monopoly, the second option now is more adequate. In order to join IFAC, the Chamber has to comply with certain qualification and financial requirements. It is likely that some rotation of Chamber members will have to occur in order to meet qualification requirements, including enrolling to the Chamber auditors certified in other countries by IFAC member organizations. The time it takes for the Chamber to join the IFAC is dictated by IFAC procedures and it is unlikely to speed up the process. However, this is something that the UCA should have already done immediately after incorporation in early 90th. In addition, once a member of the IFAC, the UCA would be able to influence elaboration of ISA that equals to development of National Standards.

Certification and Registration of Bank External Auditors

Since Banks and Banking Act came into effect in 2000 there was no certification of any new bank auditor in Ukraine. The Chamber that used to issue Certificates B pursuant to Audit Act of 1993 has lost its power due to general subordination of the laws – any newer law automatically cancels conflicting requirements of any older law. The National Bank that has acquired the legal right to certify external auditors[3], does not have enough resources to introduce a full cycle of certification starting with development of training programs and tests, continuing with delivering the training and holding tests, and ending with issue of certificates and follow-up reviews of the work performed by a certified auditor that can trigger certificate revocation.

[3] This right is not clearly stated in the law causing legal disputes. In particular, it is not clear whom NBU shall certify – private auditors or audit companies.

Under this circumstances valid Certificates B issued by the Chamber in different times for maximum five years have not been void and automatically renewed without their holders passing any knowledge test. It shall be reminded that this happened during the times when accounting experienced fundamental reforms – banks were finishing transition towards IFRS, and businesses started to introduce the National Accounting Standards. Therefore there has been no real check of knowledge of bank auditors in Ukraine for at least three years. Adding the facts that (1) International Educational Guidelines are not followed in Ukraine[4] that has been criticized by IMF and WB missions many times; and (2) inadequate licensing requirements for audit companies[5], puts the quality of bank audits in Ukraine in question.

In our opinion, the NBU has to honestly assess its resources and the risk inherent to audit certification and refuse the idea of certifying auditors. There are the following arguments to support the refusal:

- There are no adequate resources, starting with personnel, that would enable NBU to do a comprehensive and on-going certification process[6];
- NBU is exposed to legal risk in front of general public for the performance of auditors holding a NBU Certificate;
- There is an issue of how the training and test expenses are going to be covered since the NBU as a government agency can not bill individuals for rendering services to them.

The certification problem can be approached in two steps. The first one, immediate step, is to set up an independent body – Audit Supervisory Board – that would assume the functions of training and certifying individual auditors and to have NBU to introduce a Registry of audit companies eligible to audit bank annual financial statements. The second step is to transit in long-run from certifying auditors to certifying accountants.

More detailed recommendations concerning Audit Supervisory Board can be found in memos prepared by Mr. Charles Canfield who in December 2002 and January 2003 worked on audit issues under Dutch Grant. However, Mr. Canfield mentioned in a discussion that such Board can only solve the problem for a while and can be treated as precedent of government agencies pulling apart the audit profession in the areas they regulate. In the other hand, to introduce a Registry of the companies eligible to audit bank annual financial statements[7] is the optimal way to overcome the problem of NBU licensing and controlling the quality of auditors.

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[4] In particular, IEG 2 "Regular Professional Education and Continued Education".
[5] In particular, the minimum permanent professional staff requirement (30% of permanent staff have to be certified auditors) is ignored by keeping the lowest possible number of official staff and hiring uncertified auditors on part-time basis.
[6] This issue can be solved if training programs for certification of auditors are developed under Dutch Grant.
[7] We strongly recommend this exact name for the Registry since other audit cervices that are not presented to the general public – outsourcing of internal audit or financial consultations – can be done by other companies or even individual auditors.

However, in the future it is desirable to study the possibility to transit from certifying auditors to certifying accountants. Such certification can be done by Universities and professional organizations[8]. A certified accountant shall have the right to practice accounting and audit. However in those areas of his or her practice that are of a special interest to the public – external audit of banks and listed companies (if allowed), managing internal audit departments in banks and non-bank financial institutions – there shall be Registries similar to the one discussed, but for individual eligible auditors. This will establish clearer segregation of responsibilities between self-governed organizations, individual auditors and government agencies. In addition it is going to satisfy the principle of the government staying away from professional activities while having effective controls over the quality of such activities.

[8] In fact, a Master Degree in Accounting and Audit shall be deemed an equivalent to Accounting Certificate. In addition, the Ukrainian Federation of Professional Accountants and Auditors initiated certification of accountants pursuant to IFAC and UNCTAD requirements.

Licensing Requirements and Risk-management Systems: Situation in Ukraine and International Practice

BearingPoint.
Formerly KPMG Consulting

MEMO

TO:	Frank Blimling, Senior Advisor Karen Wilson, Senior Advisor Geary Vance, Senior Advisor
FROM:	Gary Gegenheimer, Senior Legal Advisor Yevhen Telychko, Legal and Económic Specialist
CC:	Alex Kutsenko, Economic Specialist Marina Antonova, Program Specialist Raya Ladokhina, Program Specialist
DATE:	March 28, 2003
REF:	Licensing Requirements and Risk-management Systems: Situation in Ukraine and International Practice

LICENSING REQUIREMENTS AND RISK-MANAGEMENT SYSTEMS: SITUATION IN UKRAINE AND INTERNATIONAL PRACTICE.

One of important components of risk-based supervision is effective licensing requirements ensuring that a bank has all necessary prerequisites for efficient risk-management system already at the stage of licensing. This should include suitability of major shareholders, transparency of ownership structure and source of initial capital, "fit and proper" directorate and management, appropriate operational structure, risk-management polices and internal control procedures adequate to the scope, and degree of sophistication of the proposed activities of the bank (Principle 3, EC5, EC9, Core Principles of Effective Bank Supervision).

More information on international practice of licensing (risk-management system focus) as well as some specific wording can be found in Attachment 1 "International practice".

Registration and licensing of banks in Ukraine is regulated by Chapter 3 "State Registration and Licensing of Banks" (Art.17-22) of Law on Banks and Banking Activity (BBL), NBU Regulations #375 "On procedure for creation and state registration of banks, opening their branches, representative offices, divisions", and NBU Regulation #275 "On procedure for issuance of banking licenses, written permits and licenses for performance of certain operations to banks".

Law on Banks and Banking Activity (BBL) dated December 7, 2000.

BBL provides for two stages of "bringing a bank into life": 1) state registration and 2) licensing.

1. State Registration

The first stage is actually registration of a bank as a legal entity. At this stage, persons authorized by founders are required to provide the NBU with necessary documents that include (BBL Art 17):

1) Registration application.
2) Founding Agreement (with the exception of State bank).
3) Bank statute.
4) Decision on bank establishment (minutes of the foundation meeting), or a Resolution of the Cabinet of Ministers on the establishment of a State bank.
5) Business plan identifying types of activity planned for the following year and a strategy of bank's activities for the next three years, in accordance with requirements, established by the National Bank of Ukraine.
6) Information on the financial position of those participants that will hold an essential participation in the bank. In case the bank founder is a legal entity, information should be provided on members of the Board of Directors and holders of essential participation in this legal entity.
7) Accounting, reporting and financial statements for legal entities that will hold an essential participation in the past four reporting periods (quarters), and for individuals that will hold an essential participation - a statement from the State Tax Administration on income for the last reporting period (year).
8) Information on the composition of the Supervisory Council, Board, and Revision Committee.
9) Copy of the payment document confirming payment of the registration fee established by the National Bank of Ukraine.
10) Notarized copies of founding documents of members, that are legal entities and would hold essential participation in the bank.
11) Copies of a report on the holding of open subscription to shares - for banks established as an open joint stock company.
12) Data on professional skills and business reputation of the bank Chairman and members of the Board and the Chief Accountant of the bank.

Working group of General Department of Bank Supervision on amendments to BBL suggested new wording for points 6, 7, 10, 12 and additional point 13. Those amendments should ensure a better disclosure of information on suitability of essential participants and members of Board and Supervisory Council.

"6) Information on the financial position and business reputation of those participants that will hold an essential participation in the bank. In case the bank founder is a legal entity, information should be provided on members of the Supervisory Council and persons that are actual beneficial owners of this legal entity.

7) Financial accounts confirmed by auditor for the past four reporting periods (quarters) - for participants-legal entities; reference from the State Tax Administration of Ukraine on incomes over

last period under review (year) - for participants-individuals; or other documents confirming origine of incomes (funds)"
"10) notarised copies of statutory documents of participants which are legal entities, and of their owners of essential participation;"
"12) information on professional suitability and business reputation of Board members and bank's chief accountant."
13) information on business reputation of Supervisory Council members."

It would be better to expand point 13 to include also professional suitability requirement: "information on business reputation and professional suitability of Supervisory Council members".

The issue of whether it is necessary to put some professional requirements for Supervisory Council members is controversial at the NBU. Some people say that things should remain as they are in a current law – no requirements for professional suitability of Supervisory Council members. They explain this point by saying that it is up to shareholders to determine their requirements for supervisory council members, and supervisory agency must not interfere in this process. Others stress that banking is a very specific sphere and members of supervisory council should be subject to very strict requirements as regards their professional skills, experience, etc.

Core Principles of Effective Bank Supervision in this respect say the following:

Principle 3, EC7: The licensing authority evaluates proposed directors and senior management as to expertise and integrity (fit and proper test). The fit and proper criteria include: (1) skills and experience in relevant financial operations commensurate with the intended activities of the bank and (2) no record of criminal activities or adverse regulatory judgements that make a person unfit to uphold important positions in a bank.

Principle 3, AC 2. At least one of the directors must have a sound knowledge of each of the types of financial activities the bank intends to pursue.

With this in mind, the GDBS working group recommended the following changes in BBL Art. 42 "Requirements for Bank Managers"

Article 42. Requirements for Bank Managers Managers of a bank shall be the chairman, his deputies and members of the Bank Council, the chairman, his deputies and members of the Board (Board of Directors), chief accountant, his deputy and managers of bank separate structural divisions. Managers of banks shall be competent individuals who meet the following requirements: 1) Higher education in the field of economics, law or management, as appropriate for the position to be occupied (this requirement does not apply to Supervisory Council members). 2) Banking experience on relevant position, not less than three years (this requirement does not apply to	To amend Part 1 as follows: "Managers of a bank shall be the chairman, his deputies and other members of the bank's Supervisory Council, the chairman, his deputies and members of the bank's Board (Board of Directors), the chief accountant and his deputies, and the head and the chief accountant of the representative office (their deputies)." To add Part 2 as follows: "Members of the Supervisory Council of a bank shall be capable natural persons who meet the following requirements: 1) Skills and experience in the relevant area of financial operations that correspond to the bank's future operations (at least one member must have deep knowledge of such operations). 2) Impeccable business reputation".

Supervisory Council members). 3) Impeccable business reputation. The Chairman of the Board (Board of Directors) of the bank and the Chief Accountant shall take office after the National Bank of Ukraine gives its consent in writing The Chairman of the Board (Board of Directors) of the bank and the Chief Accountant should have previous bank managerial experience.	**To consider Part 2 as Part 3 and amend it as follows:** "Managers of a bank shall be capable natural persons. Managers of the bank, except for members of the Supervisory Council, must meet the following requirements: 1) Higher education in economics or law and experience of managerial work related to banking operations of at least two years (if there is no special education—experience of such managerial work of at least three years). 2) Impeccable business reputation". **To consider Part 3 as Part 4 and amend it as follows:** "Bank managers, except for the head and the chief accountant of the representative office and their deputies, shall take office after the National Bank of Ukraine gives its consent in writing." **To add Part 6 as follows:** "Bank managers may not be persons: 1) who were dismissed on request of the National Bank, or to whom the court prohibited engaging in such activity; 2) who were convicted of theft, bribery and other mercenary crimes; 3) who have outstanding debt obligations to any bank or other natural person or legal entity; 4) whose illegal actions in the past resulted in bankruptcy or liquidation of a bank or other legal entity; 5) who are involved in entrepreneurial activity (except for members of the bank's Supervisory Council)."

2. <u>Licensing</u>

A bank is entitled to perform banking activities only upon obtaining a banking license. BBL Art. 19 specifies the following:

"The banking license shall be issued by the National Bank of Ukraine upon the petition of a bank, provided there are documents confirming the following:

the availability of paid-in and registered subscribed bank capital in the amount, established by the present Law;

the bank has appropriate banking equipment, computers, software, and premises in compliance with NBU requirements;

there are at least three persons, appointed members of the Board (Board of Directors) of the bank, who have an appropriate education and experience necessary to manage the bank."

Working group of General Department of Bank Supervision on amendments to BBL suggested to amend paragraph 4 and introduce new paragraphs 5-7:

... provided there are documents confirming the following: ... 4) "availability of bank's managers (Chairman and members of bank' Supervisory Council, Chairman, deputy Chairmen and members of the Board (Board of Directors), chief accountant and his deputy), managers of bank's divisions and appropriate specialists who have proper education and experience necessary to manage and conduct activity for which a bank obtains a license.

availability of divisions, including those of internal audit and and risk-management that carry out apropriate operations and functions;

availability of internal policies regulating performance of activity according to a banking license issued, including policies on bank's internal audit and on risk-management system in line with current legislation in Ukraine, requirements of the National bank of Ukraine and bank's Statute;

business plan that is an executive document and determines kinds of activity that a bank plans to carry out over next year and strategy for bank's activity for next three years according to requirements established by the National bank of Ukraine."

Article 44 of the LBBA requires banks to establish standing units for analysis and management of risks. These units are responsible for setting limits in respect to specific operations, risk limits for counterparts, countries of contra parties, and balance sheet structure in accordance with resolutions of the Board (Board of Directors) on the issues of risk policy and profitability of bank operations.

The legislative structure could be improved on two points: First, although banks are required to establish risk management units once they commence operations, there is no requirement in the LBBA that the bank have suitable risk management policies and procedures as a condition of obtaining state registration or receiving a banking license. It would be preferable to include this requirement, and the NBU should have the authority to refuse state registration or the banking license if the proposed bank's risk management policies are not satisfactory (see Basle Committee, EC 8 and 9, and examples from legislation of Basle Committee countries, attached). Second, the responsibility for establishing risk management policies should be on the bank's supervisory council, not the Board. The council should be expected to develop and approve the bank's risk management policies, and to take steps to ensure that the day-to-day management officials (the Board) are implementing those policies. These requirements could be included as a condition for either state registration or the actual license; the point is that the NBU should have the authority to determine the suitability of the proposed bank's risk management and internal control procedures at some point before the bank actually commences operations.

NBU Regulation #375 "On the procedure of creation and state registration of banks and opening of their branches, representative offices and divisions" dated August 31, 2001

Point 3.1 of Article 3 "Procedure for submission of documents for the state registration of a bank" specifies the list of documents provided to the NBU for the state registration of banks. The list includes among other things:

"f) information on the composition of the Supervisory Council, the Board, and the Revision Commission;

g) documents making it possible to draw a conclusion about the irreproachable business reputation of the Chairman, his Deputies, and members of the Supervisory Council of the bank, including:

statements of the banks, from which loans have been received, about the status of their repayment;

a questionnaire according to Attachment 12 hereto;

statements of the police about the absence (existence) of criminal record on the territory of Ukraine;

j) documents making it possible to draw a conclusion about the professional eligibility and irreproachable business reputation of the Chairman and his Deputies, and members of the executive body (Board) and the Chief Accountant and his Deputies, whose candidacies meet the following requirements:

higher economic, legal or management education – for the Chairman and his Deputies, and members of the Board, and higher economic or accounting education – for the Chief Accountant and his Deputies;

the experience of the Chairman, his Deputies and members of the Board of the bank, the Chief Accountant and his Deputies in the banking system in the corresponding specialty is not less than three years, including for the Chairman of the Board and the Chief Accountant– not less than one year in managerial positions;

an irreproachable business reputation;

no criticism from the corresponding NBU Regional Office and no instances of violations of the banking law of Ukraine and bank internal documents during the time of work at banking institutions;

The information about the Chairman and his Deputies, members of the Board of the bank, the Chief Accountant and his Deputies and their business reputation is submitted in the form of:

an abstract from the *labor book* and a copy of the diploma certified by the NBU Regional Office wherever the bank is located, or notarized;

statements of the banks from which loans have been received on the status of their repayment printed on the official letterhead of the bank and certified with an imprint of the bank's seal;

three references from individuals working in the banking system, whose candidacies were earlier approved by the NBU or its Regional Offices for the purpose of their approval in the corresponding positions at other banks (including one from the previous employer, if it is a banking institution). A reference is written on a blank sheet of paper signed by the referee, which is certified by the personnel department of the banking institution, where this individual works, and an imprint of the seal of the institution. The reference should contain information about the business reputation, managerial and professional qualities of the candidate;

a questionnaire (attachment 3);

information from the NBU Regional Office, which supervises the activity of the banking institutions where the said individuals worked, on the absence in their work of abuses and violations of the law of Ukraine on banking activity, NBU regulations and bank internal documents (if they worked in other regions of Ukraine);

statements of the police on the absence (existence) of criminal record on the territory of Ukraine.

In every specific case, if foreign citizens are appointed for the positions of the Chairman and his Deputies or members of the Board (Board of Directors), the Chief Accountant and his deputies, a decision to approve the candidacy recommended by the founders is made by the NBU taking into account the documents submitted (their duly certified copies), which confirm economic education (not lower than a Bachelor's degree) and experience in managerial positions in the banking system in the corresponding specialty of not less than three years, and information of the Central Bank or another body of the corresponding country, which exercises control over the commercial banks or the commercial bank, where the candidate worked, on the absence of violations in his work. In addition, an authorized person has to submit to the NBU documents, which confirm the legitimacy of the stay of such foreign citizens on the territory of Ukraine, and in cases as stipulated in the current law of Ukraine, - an employment permission issued by the Government Center for Employment of the Ministry of Labor and Social Policy of Ukraine or under its instruction by the corresponding Center for Employment of the Autonomous Republic of Crimea, oblasts, and the cities of Kiev and Sevastopol, unless otherwise stipulated in international treaties whose binding nature has been approved by the Verkhovna Rada of Ukraine.

The managers of a bank may not be individuals as specified in Part 3 of Article 23 of the Law of Ukraine "On business companies".

In addition, there may not be appointed for managerial positions at banks individuals specified in subitem f and the first paragraph of this subitem of item 3.1, who do not have an irreproachable business reputation and whose professional and managerial skills do not meet the requirements of the Law, including:

who failed to meet debt repayment obligations to any bank or other individual or legal entity;

whose illegal actions in the past caused a bankruptcy or liquidation of a bank or other legal entity;

who were the Chairman of the Supervisory Council and the Board (Board of Directors), the Chief Accountant of a bank, as to which a decision on bankruptcy or liquidation was made;

who are relatives to members of the Supervisory Council of the bank (parents, children, native brothers and sisters, spouses);

who were dismissed at the request of the NBU or were held criminally accountable;"

As we can see, in terms of requirements towards members of Supervisory Council and Board of the bank, Reg#375 was developed in line with provisions of BBL in effect. There are no requirements for professional suitability of members of Supervisory Council.

The Regulation also lays down some requirements towards owners of essential participation in a bank:

1.7. The participants of a bank may be legal entities and individuals, residents and nonresidents, as well as the government represented by the Cabinet of Ministers or bodies authorized by it.

The owners of an essential participation in a bank must have an irreproachable business reputation and satisfactory financial condition.

The participants of a bank may not be legal entities, where the bank has an essential participation, citizens' associations, religious and charitable organizations.

It also establishes restrictions for acquiring or increasing essential participation in a bank:

"5.19. The NBU does not grant a permission to acquire an essential participation in a bank or to increase it, if:

a) the entity, which is acquiring or increasing an essential participation, does not have an irreproachable business reputation. If the entity is a legal entity, this requirement is applicable to the members of the executive body and the supervisory council of the legal entity, as well as the owners of an essential participation who are individuals.
b) the entity, which is acquiring or increasing an essential participation, does not have the own funds to make the declared contribution;
c) the acquisition or increase of an essential participation would threaten the interests of the depositors and other creditors of the bank or the development of a competitive environment in the banking system."

NBU Regulation #275 "On procedure for issuing banking licenses, written permissions and licenses for performance of specific operations to banks" dated 07/17/2001.

Chapter 1 of the Regulation specifies the following:

"1.3. Bank has the right to carry out banking activity only upon obtaining a banking license.
Bank has the right to start carrying out banking operations only if it complies with requirements of current laws of Ukraine and rules and regulations of the National Bank of Ukraine that lay down requirements for carrying out corresponding operations (including those related to technical conditions in place, specialized divisions, their managers, proper specialists and internal policies that regulate the procedure for conducting operations)".

Later, p.1.7. says that "after obtaining a banking license, a bank is obliged to observe licensing requirements, including those towards regulatory capital, during all the period the banking license is in effect".

Chapter 3 "Conditions whose observance entitles banks to obtain a banking license" does not mention risk management units or policies at all. Latter, Chapter 7 "Special documents to be submitted by a bank to obtain a banking license" requires submission of "description of and data on management and organizational structure of a bank (including units of internal audit and risk management and analysis, their subordination, decision-making procedure)".

Chapter 4 "Conditions for obtaining a written permission" indicates among such conditions (д) "presence of risk management and analysis unit in charge of establishing limits for specific operations, limits for counterparties' risks, risks of counterparties' countries, balance sheet structure according to decisions of the Management Board on issues of policy as to riskiness and profitability of bank's activity." Regulation establishes requirements for the unit head (4e, Attachment 1, Chapter 5) - higher financial/economic education, at least 3-year experience in banking system by a relevant profession, untarnished business reputation, no violations of banking legislation or/and NBU rules and regulations during tenures with banks.

Chapter 4 (ж) requires bank's policies regulating assets and liability management, credit and investment policy.

Chapter 8 "Documents to be submitted to obtain a written permission" requires, along with other documents, policy on the unit of risk analysis and management.

Chapter 13, p. 13.4 indicates that "All policies (with amendments and additions) a bank submits to the National Bank to obtain a banking license, written permission and licenses for performance of specific operations, are used by NBU employees during on-site examinations of banks and considered to be in effect. ". P.13.5 further says that "Failure to meet requirements of Regulation towards a bank, bank's managers, owners of essential participation, is subject to enforcement measures pursuant to BBL Art. 73 and relevant NBU rules and regulations"

CONCLUSION

Licensing requirements in Ukraine already have some provisions related to risk-management systems. In particular, BBL clearly requires risk-management unit in place and establishes some requirements towards managers of banks (untarnished business reputation, professional skills), members of Supervisory Council (untarnished business reputation), and essential participants in a bank. Those requirements are further elaborated in the NBU Regulations #275 and #375.

Unfortunately, those requirements are not complete enough. In particular, there should also be requirements for professional qualification of members of Supervisory Council (not only for their untarnished business reputation), which will bring them in compliance with Basel "fit and proper" requirements.

Another serious drawback in legislation is absence of specific requirement for banks to have internal policies on risk-management systems approved by the Supervisory Council already at the stage of obtaining a banking license. Point 3.1 of NBU Reg 275 requires "internal policies that regulate the procedure for conducting operations", but it is not a specific requirement for risk-management policies.

For banks that are obtaining NBU written permission for some certain operations (like FX, corresponding accounts, trust operations, etc), there is a requirement for having asset and liabilities management policies as well as policy on risk-management unit in place. Usually, they would have some description of risk-management system and risk limitations therein, but again there is no such specific requirement in law. If bank's policy does not establish risk limitations or a policy on risk-management unit does not describe the process of risk-management in the bank, it will be legally qualified as acceptable and sufficient for obtaining written permission, and applying enforcement measures is hardly possible in this case.

CORE PRINCIPLES OF EFFECTIVE BANK SUPERVISION

Principle 3: The licensing authority must have the right to set criteria and reject applications for establishments that do not meet the standards set. The licensing process, at a minimum, should consist of an assessment of the banking organisation's ownership structure, directors and senior management, its operating plan and internal controls, and its projected financial condition, including its capital base; where the proposed owner or parent organisation is a foreign bank, the prior consent of its home country supervisor should be obtained.

Essential criteria

1. The licensing authority has the right to set criteria for licensing banks. These may be based on criteria set in law or regulation.

2. The criteria for issuing licences are consistent with those applied in ongoing supervision.

3. The licensing authority has the right to reject applications if the criteria are not fulfilled or if the information provided is inadequate.

4. The licensing authority determines that the proposed legal and managerial structures of the bank will not hinder effective supervision.

5. The licensing authority determines the suitability of major shareholders, transparency of ownership structure and source of initial capital.

6. A minimum initial capital amount is stipulated for all banks.

7. The licensing authority evaluates proposed directors and senior management as to expertise and integrity (fit and proper test). The fit and proper criteria include: (1) skills and experience in relevant financial operations commensurate with the intended activities of the bank and (2) no record of criminal activities or adverse regulatory judgements that make a person unfit to uphold important positions in a bank.

8. The licensing authority reviews the proposed strategic and operating plans of the bank. This includes determining that an appropriate system of corporate governance will be in place.

9. The operational structure is required to include, *inter alia*, adequate operational policies and procedures, internal control procedures and appropriate oversight of the bank's various activities. The operational structure is required to reflect the scope and degree of sophistication of the proposed activities of the bank.

10. The licensing authority reviews pro forma financial statements and projections for the

proposed bank. This includes an assessment of the adequacy of the financial strength to support the proposed strategic plan as well as financial information on the principal shareholders of the bank.

11. If the licensing authority and the supervisory authority are not the same, the supervisor has the legal right to have its views considered on each specific application.

12. In the case of foreign banks establishing a branch or subsidiary, prior consent (or a statement of "no objection") of the home country supervisor is obtained.

13. If the licensing, or supervisory, authority determines that the licence was knowingly based on false information, the licence can be revoked.

Additional criteria

1. The assessment of the application includes the ability of the shareholders to supply additional financial support, if needed.

2. At least one of the directors must have a sound knowledge of each of the types of financial activities the bank intends to pursue.

3. The licensing authority has procedures in place to monitor the progress of new entrants in meeting their business and strategic goals, and to determine that supervisory requirements outlined in the licence approval are being met.

USA: National Bank Act (USA)

Section 71 :

Election

The affairs of each association shall be managed by not less than five directors, who shall be elected by the shareholders at a meeting to be held at any time before the association is authorized by the Comptroller of the Currency to commence the business of banking; and afterward at meetings to be held on such day of each year as is specified therefor in the bylaws. The directors shall hold office for one year, and until their successors are elected and have qualified.

Section 72 :

Qualifications

Every director must, during his whole term of service, be a citizen of the United States, and at least a majority of the directors must have resided in the State, Territory, or District in which the association is located, or within one hundred miles of the location of the office of the association, for at least one year immediately preceding their election, and must be residents of such State or within one-hundred-mile territory of the location of the association during their continuance in office, except that the Comptroller may, in the discretion of the Comptroller, waive the requirement of residency. Every director must own in his or her own right either shares of the capital stock of the association of which he or she is a director the aggregate par value of which is not less than $1,000, or an equivalent interest, as determined by the Comptroller of the Currency, in any company which has control over such association within the meaning of section 1841 of this title. If the capital of the bank does not exceed $25,000, every director must own in his or her own right either shares of such capital stock the aggregate par value of which is not less than $500, or an equivalent interest, as determined by the Comptroller of the Currency, in any company which has control over such association within the meaning of section 1841 of this title. Any director who ceases to be the owner of the required number of shares of the stock, or who becomes in any other manner disqualified, shall thereby vacate his place.

Section 73 :

Oath

Each director, when appointed or elected, shall take an oath that he will, so far as the duty devolves on him, diligently and honestly administer the affairs of such association, and will not knowingly violate or willingly permit to be violated any of the provisions of title 62 of the Revised Statutes, and that he is the owner in good faith, and in his own right, of the number of shares of stock required by title 62 of the Revised Statutes, subscribed by him, or standing in his name on the books of the association, and that the same is not hypothecated, or in any way pledged, as security for any loan or debt. The oath shall be taken before a notary public, properly authorized and commissioned by the State in which he resides, or before any other officer having an official seal and authorized by the State to administer oaths, except that the oath shall not be taken before any such notary public or other officer who is an officer of the director's bank. The oath, subscribed by the director making it, and certified by the notary public or other officer before whom it is taken, shall be immediately transmitted to the Comptroller of the Currency and shall be filed and preserved in his office for a period of ten years.

Section 76 :

President of bank as member of board; chairman of board

The president of the bank shall be a member of the board and shall be the chairman thereof, but the board may designate a director in lieu of the president to be chairman of the board, who shall perform such duties as may be designated by the board.

Code of Federal Regulations, Title 12, section 5.20 – Organizing a Bank

Subsection (f)(i)(2) *Policy considerations.* (i) In evaluating an application to establish a national bank, the OCC considers whether the proposed bank:...

(B) Has competent management, including a board of directors, with ability and experience relevant to the types of services to be provided;

(D) Can reasonably be expected to achieve and maintain profitability; and

(E) Will be operated in a safe and sound manner.

(ii) The OCC may also consider additional factors listed in section 6 of the Federal Deposit Insurance Act, 12 U.S.C. 1816, including the risk to the Federal deposit insurance fund, and whether the proposed bank's corporate powers are consistent with the purposes of the Federal Deposit Insurance Act and the National Bank Act.

[Note: Section 6 of the Federal Deposit Insurance Act entails a determination of the "general character and fitness" of the management of a depository institution that is applying for deposit insurance.]

Subsection (g) *Organizing group* -- (1) *General.* Strong organizing groups generally include diverse business and financial interests and community involvement. An organizing group must have the experience, competence, willingness, and ability to be active in directing the proposed national bank's affairs in a safe and sound manner. The bank's initial board of directors generally is comprised of many, if not all, of the organizers....

(3) *Financial resources.* (i): Each organizer must have a history of responsibility, personal honesty, and integrity. Personal wealth is not a prerequisite to become an organizer or director of a national bank. However, directors' stock purchases, individually and in the aggregate, should reflect a financial commitment to the success of the national bank that is reasonable in relation to their individual and collective financial strength. A director should not have to depend on bank dividends, fees, or other compensation to satisfy financial obligations.

Subsection (h) *Operating plan* -- (1) *General.* (i) Organizers of a proposed national bank shall submit an operating plan that adequately addresses the statutory and policy considerations set forth in paragraphs (e) and (f)(2) of this section. The plan must reflect sound banking principles and <u>demonstrate realistic assessments of risk</u> in light of economic and competitive conditions in the market to be served. ...

(6) *Safety and soundness.* The operating plan must demonstrate that the organizing group (and the sponsoring company, if any), is aware of, and understands, national banking laws and regulations, and safe and sound banking operations and practices. The OCC will deny an application that does not meet these safety and soundness requirements.

UK: Financial Services and Markets Act 2000 – conditions for permission to carry on regulated activities

Section 41. (1) "The threshold conditions", in relation to a regulated activity, means the conditions set out in Schedule 6.

(2) In giving or varying permission, or imposing or varying any requirement, under this Part the Authority must ensure that the person concerned will satisfy, and continue to satisfy, the threshold conditions in relation to all of the regulated activities for which he has or will have permission.

Schedule 6

Suitability

5. The person concerned must satisfy the Authority that he is a fit and proper person having regard to all the circumstances, including-

(a) his connection with any person;

(b) the nature of any regulated activity that he carries on or seeks to carry on; and

(c) the need to ensure that his affairs are conducted soundly and prudently.

FSA Handbook of Rules and Guidance – Supervision Handbook on Threshold Conditions (COND)

2.5.2

Threshold condition 5 (Suitability), requires the firm to satisfy the FSA that it is 'fit and proper' to have Part IV permission having regard to all the circumstances, including its connections with other persons, the range and nature of its proposed (or current) regulated activities and the overall need to be satisfied that its affairs are and will be conducted soundly and prudently (see also PRIN and SYSC).

The FSA will also take into consideration anything that could influence a firm's continuing ability to satisfy this threshold condition. Examples include the firm's position within a UK or international group, information provided by overseas regulators about the firm , and the firm's plans to seek to vary its Part IV permission to carry on additional regulated activities once it has been granted that permission by the FSA

2.5.3

(1) The emphasis of this threshold condition is on the suitability of the firm itself. The suitability of each person who performs a controlled function will be assessed by the FSA under the approved persons regime (see AUTH 6 (Approved persons), □SUP 10 (Approved persons) and FIT). In certain circumstances, however, the FSA may consider that the firm is not suitable

because of doubts over the individual or collective suitability of persons connected with the firm.

2.5.7

In determining whether a firm will satisfy and continue to satisfy threshold condition 5 in respect of having competent and prudent management and exercising due skill, care and diligence, relevant matters, as referred to in □COND 2.5.4G(2), may include, but are not limited to whether:

(5) the firm has made arrangements to put in place an adequate system of internal control to comply with the requirements and standards under the regulatory system (see □SYSC 3.1 (Systems and Controls));

(6) the firm has approached the control of financial and other risk in a prudent manner (for example, by not assuming risks without taking due account of the possible consequences) and has taken reasonable care to ensure that robust information and reporting systems have been developed, tested and properly installed (see □SYSC 3.2.10 (Risk assessment));

Financial Services and Markets Act – fit and proper persons

Section 59. - (1) An authorised person ("A") must take reasonable care to ensure that no person performs a controlled function under an arrangement entered into by A in relation to the carrying on by A of a regulated activity, unless the Authority approves the performance by that person of the controlled function to which the arrangement relates.

(2) An authorised person ("A") must take reasonable care to ensure that no person performs a controlled function under an arrangement entered into by a contractor of A in relation to the carrying on by A of a regulated activity, unless the Authority approves the performance by that person of the controlled function to which the arrangement relates.

(3) "Controlled function" means a function of a description specified in rules.

(4) The Authority may specify a description of function under subsection (3) only if, in relation to the carrying on of a regulated activity by an authorised person, it is satisfied that the first, second or third condition is met.

(5) The first condition is that the function is likely to enable the person responsible for its performance to exercise a significant influence on the conduct of the authorised person's affairs, so far as relating to the regulated activity.

(6) The second condition is that the function will involve the person performing it in dealing with customers of the authorised person in a manner substantially connected with the carrying on of the regulated activity.

(7) The third condition is that the function will involve the person performing it in dealing with property of customers of the authorised person in a manner substantially connected with the carrying on of the regulated activity.

Section 61. - (1) The Authority may grant an application made under section 60 only if it is satisfied that the person in respect of whom the application is made ("the candidate") is a fit and proper person to perform the function to which the application relates.

(2) In deciding that question, the Authority may have regard (among other things) to whether the candidate, or any person who may perform a function on his behalf-

(a) has obtained a qualification,

(b) has undergone, or is undergoing, training, or

(c) possesses a level of competence,

required by general rules in relation to persons performing functions of the kind to which the application relates.

FSA Handbook of Rules and Guidance – Supervision Handbook (SUP), Section 10 (Approved persons):

A "controlled function" includes, among others, the function of a director, a non-executive director, and a chief executive. Thus, every director, including a non-executive director, of a U.K. "Authorised Person" (which includes a deposit-taking entity) must be an "Approved Person," i.e., he must be approved by the FSA and must meet the "fit and proper person" test.

FSA Handbook on Fit and Proper Criteria for Approved Persons (FIT), Section 1.3:

The *FSA* will have regard to a number of factors when assessing the fitness and propriety of a *person* to perform a particular *controlled function*. The most important considerations will be the *person's* :

(1) honesty, integrity and reputation;

(2) competence and capability; and

(3) financial soundness.

In assessing fitness and propriety, the FSA will also take account of the activities of the firm for which the controlled function is or is to be performed, the permission held by that firm and the markets within which it operates.

The criteria listed in FIT 2.1 to FIT 2.3 are *guidance* and will be applied in general terms when the *FSA* is determining a *person's* fitness and propriety. It would be impossible to produce a definitive list of all the matters which would be relevant to a particular determination.

In determining a *person's* honesty, integrity and reputation, the *FSA* will have regard to matters including, but not limited to, those set out in □FIT 2.1.3 G which may have arisen either in the *United Kingdom* or elsewhere. The *FSA* should be informed of these matters (see □SUP 10.13.16 R), but will consider the circumstances only where relevant to the requirements and standards of the *regulatory system*.

FSA Handbook on Fit and Proper Criteria for Approved Persons (FIT), Section 2.1 – Honesty, Integrity and Reputation:

2.1.1G

In determining a person's honesty, integrity and reputation, the FSA will have regard to matters including, but not limited to, those set out in □FIT 2.1.3 G which may have arisen either in the United Kingdom or elsewhere. The FSA should be informed of these matters (see □SUP 10.13.16 R), but will consider the circumstances only where relevant to the requirements and standards of the regulatory system.

2.1.2G

In considering the matters in □FIT 2.1.1 G, the FSA will look at whether the person's reputation might have an adverse impact upon the firm for which the controlled function is or is to be performed and at the person's responsibilities.

2.1.3G

The matters referred to in □FIT 2.1.1 G to which the FSA will have regard include, but are not limited to:

(1) whether the person has been convicted of any criminal offence; this may include, where relevant, any spent convictions under the Rehabilitation of Offenders Act 1974; particular consideration will be given to offences of dishonesty, fraud, financial crime or other offences under legislation relating to banking and financial services, companies, insurance and consumer protection;

(2) whether the person has been the subject of any adverse finding or any settlement in civil proceedings, particularly in connection with investment or other financial business, misconduct, fraud or the formation or management of a body corporate;

(3) whether the person has been the subject of, or interviewed in the course of, any existing or previous investigation or disciplinary proceedings, by the FSA, by other regulatory authorities (including a previous regulator), clearing houses and exchanges, professional bodies, or government bodies or agencies;

(4) whether the person is or has been the subject of any proceedings of a disciplinary or criminal nature, or has been notified of any potential proceedings or of any investigation which might lead to those proceedings;

(5) whether the person has contravened any of the requirements and standards of the regulatory system or the equivalent standards or requirements of other regulatory authorities (including a previous regulator), clearing houses and exchanges, professional bodies, or government bodies or agencies;

(6) whether the person has been the subject of any justified complaint relating to regulated activities;

(7) whether the person has been involved with a company, partnership or other organisation

been connected with that organisation or within one year of that connection;

(10) whether the person, or any business with which the person has been involved, has been investigated, disciplined, censured or suspended or criticised by a regulatory or professional body, a court or Tribunal, whether publicly or privately;

(11) whether the person has been dismissed, or asked to resign and resigned, from employment or from a position of trust, fiduciary appointment or similar;

(12) whether the person has ever been disqualified from acting as a director or disqualified from acting in any managerial capacity;

(13) whether, in the past, the *person* has been candid and truthful in all his dealings with any *regulatory body* and whether the *person* demonstrates a readiness and willingness to comply with the requirements and standards of the *regulatory system* and with other legal, regulatory and professional requirements and standards.

Section 2.2 Competence and Capability

2.2.1

In determining a person's competence and capability, the FSA will have regard to matters including but not limited to:

(1) whether the person satisfies the relevant requirements of the FSA's Training and Competence sourcebook (TC) in relation to the controlled function the person performs or is intended to perform;

(2) whether the person has demonstrated by experience and training that the person is able, or will be able if approved, to perform the controlled function.

2.2.2

A person may have been convicted of, or dismissed or suspended from employment for, drug or alcohol abuses or other abusive acts. This will be considered only in relation to a person's continuing ability to perform the particular controlled function for which the person is or is to be employed.

Section 2.3 Financial Soundness

2.3.1

In determining a person's financial soundness, the FSA will have regard to any factors including, but not limited to:

(1) whether the person has been the subject of any judgment debt or award, in the United Kingdom or elsewhere, that remains outstanding or was not satisfied within a reasonable period;

(2) whether, in the United Kingdom or elsewhere, the person has made any arrangements with his creditors, filed for bankruptcy, been adjudged bankrupt, had assets sequestrated, or been involved in proceedings relating to any of these.

2.3.2

The FSA will not normally require the candidate to supply a statement of assets or liabilities. The fact that a person may be of limited financial means will not, in itself, affect his suitability to perform a controlled function.

France: The Banking Act

Article 15 :

Before starting business, credit institutions must obtain authorization from the Comite establissements de Credit et des Entreprises d'Investissement referred to in Article 29. The Comites_establissements de Credit et des Entreprises d'Investissement shall verify whether the applicant undertaking meets the requirements laid down in Articles 16 and 17 of the present Act and the appropriateness of the undertaking's legal form to the activity of a credit institution. <u>It shall take into account the programme of operations of the undertaking, its proposed technical and financial resources and the suitability of the persons investing capital and, where applicable, their guarantors</u>.

The Committee shall also assess the applicant undertaking's capacity to achieve its development objectives <u>in a manner that is compatible with the smooth working of the banking system and offers sufficient safety for its customers</u>. The Committee may limit the authorization it delivers to the exercise of certain operations defined by the applicant's corporate purpose. (Act 99-532 of 25 June 1999, Article 34)

Germany: Banking Act

Section 32. Granting the licence

(1) Anyone wishing to conduct banking business or to provide financial services in Germany commercially or on a scale which requires a commercially organised business undertaking requires a written licence from the Federal Financial Supervisory Authority. The application for the licence must contain the following particulars: ...

> 5. a viable business plan showing the nature of the planned business, the organisational structure and the planned internal monitoring procedures of the institution;

(2) The Federal Financial Supervisory Authority may make the granting of the licence subject to conditions which must be consistent with the purpose pursued by this Act. It may limit the licence to certain types of banking business or financial services.

Section 33. Refusing the licence

(1) The licence shall be refused if : ....

> 7. the institution is not prepared or not in a position to make the organisational arrangements necessary for the proper operation of the business for which it is seeking a licence.

(3) The Federal Financial Supervisory Authority may refuse the licence if

> 4. contrary to section 32 (1) sentence 2, the application does not contain adequate information or documents.

Netherlands: Act on the Supervision of the Credit System

Article 8 (1)

An enterprise or institution established in the Netherlands and wishing to take up the business of a credit institution shall apply to the Bank for authorization.

Article 8 (2)

To permit the decision as to whether authorization as referred to in section 9 will be granted or not, the application shall contain information about:

> a) the number, the names and the past history of the persons who determine the day-to-day policy of the enterprise or institution;
>
> b) the number, the names and the past history of the members of the supervisory board of the enterprise or institution or of the body of the enterprise or institution having a task comparable with that of a supervisory board;

c) the names and the past history of the persons who determine the day-to-day policy of the group of which the enterprise or institution forms part and who in that capacity also co-determine the day-to-day policy of the enterprise or institution;

d) the names and the past history of the persons who determine or co-determine the policy of the group of which the enterprise or institution forms part and who in that capacity also co-determine the policy of the enterprise or institution;

e) the names of those who have a qualifying holding in the enterprise or institution, as well as the size of any such qualifying holding;

f) annual accounts or an opening balance sheet, which shall be provided with an auditorвЂ™s report, signed by an accountant as referred to in section 393(1) of Volume 2 of the Civil Code;

g) a programme of operations which the enterprise or institution intends to carry on;

h) the envisaged administrative organization вЂ" including the financial accounting system and internal control;

i) the formal and actual control structure of the group of which the enterprise or institution forms part, and

j) if the enterprise or institution is a subsidiary or a branch of a credit institution not established in the Netherlands: a declaration from the supervisory authority of the State of establishment of that credit institution showing that this authority has approved the establishment of a subsidiary or a branch in the Netherlands.

Article 8 (3)

The Bank shall decide on the application within thirteen weeks of the date of receipt of the application.

Article 9 :

Article 9 (1)

The Bank shall grant the authorization, unless:

a) the enterprise or institution does not fulfil the requirements provided for in or under sections 10 and 11;

b) the Bank is of the opinion that the expertise of one or more persons who determine the day-to-day policy of the enterprise or institution is insufficient in connection with the pursuit of the business of a credit institution;

c) on the grounds of the intentions or the past history, the Bank is of the opinion that, in view of the interests of the creditors or future creditors of the enterprise or institution, the trustworthiness of one or more persons who determine or co-determine the policy of the enterprise or institution, is not beyond doubt;

d) the Bank is of the opinion that the expertise of one or more persons who determine the day-to-day policy of the group of which the enterprise or institution forms part, to the extent that in that capacity they also co-determine the day-to-day policy of the enterprise or institution, is insufficient in connection with the pursuit of the business of a credit institution;

e) on the grounds of the intentions or the past history, the Bank is of the opinion that, in view of the interests of the creditors or future creditors of the enterprise or institution, the trustworthiness of one or more persons who determine or co-determine the policy of the group of which the enterprise or institution forms part and who in that capacity also co-determine the policy of the enterprise or institution, is not beyond doubt;

f) without prejudice to the provisions of section 24, the Bank is of the opinion that, as a result of a qualifying holding in the enterprise or institution, the enterprise or institution is or could be subject to an influence contrary to sound banking policy;

g) the report referred to in section 8(2), under f, is a report to the effect other than that the annual accounts or opening balance sheet give a true and fair view of the financial position of the enterprise or institution, or

h) on the grounds of information as referred to in section 8(2), under f, g or h, the Bank is of the opinion that the enterprise or institution will not be capable of implementing its intentions or of meeting the requirements to be imposed on it on account of the supervision.

Article 9 (2)

The Bank may refuse authorization if it has reason to assume that the enterprise or institution has applied for authorization in order to evade the statutory rules or regulations pertaining to the supervision of the credit system in another Member State.

Article 9 (3)

The Bank may refuse authorization if it is of the opinion that the formal or actual control structure of the group of which the enterprise or institution forms part is so lacking in transparency as to constitute an impediment to the adequate exercise of supervision on the enterprise or institution.

Article 9 (4)

The Bank may also refuse authorization if the enterprise or institution forms part of a group and, in the opinion of the Bank, the adequate exercise of supervision on that enterprise or institution is impeded by the legislation of a State not being a Member State that is applicable to a group company or natural person forming part of the group.

Article 9 (5)

If the enterprise or institution is a subsidiary or a branch of a credit institution not established in the Netherlands, the Bank may refuse authorization if it is of the opinion that the supervisory authority of the State of establishment of the foreign credit institution does not, or not adequately, exercise supervision on a consolidated basis.

Article 10 :

Article 10 (1)

The day-to-day policy of a credit institution shall be determined by at least two persons.

Article 10 (2)

The persons who determine the day-to-day policy of a credit institution shall carry on their activities in this respect from within the Netherlands.

Article 10 (3)

A credit institution which is a 'naamloze vennootschap' or a 'besloten vennootschap met beperkte aansprakelijkheid' shall have a supervisory board as referred to in section 140 or section 250, respectively, of Volume 2 of the Civil Code, consisting of at least three members.

Article 10 (4)

A credit institution which is not a 'naamloze vennootschap' or a 'besloten vennootschap met beperkte aansprakelijkheid' shall have a body, consisting of at least three persons, having a task comparable with that of a supervisory board.

Article 10 (5)

The Bank may grant to a credit institution which is not a 'naamloze vennootschap' or a 'besloten vennootschap met beperkte aansprakelijkheid' and to which section 158 or section 268 of Volume 2 of the Civil Code is applicable, full or partial dispensation from the provisions contained in subsection (3) or (4) and attach stipulations to such dispensation.

Licensing and Supervision Requirements and Standards for Credit Institutions (Bank of Ireland) - http://www.centralbank.ie/documents/bsd/LICSUP.pdf

The Bank must be satisfied that:

(a) directors and senior management exercise adequate control over the credit institution;

(b) comprehensive risk management systems commensurate with the scope, size and complexity of all the credit institutions activities, including derivatives and associated risks, are in place, incorporating continuous measuring, monitoring and controlling of risk, accurate and reliable management information systems, timely management reporting and thorough audit and control procedures; and

(c) where the size or nature of the operations of the credit institution warrant it, a properly staffed internal audit function exists which has direct access to the board of directors or an appropriate sub-committee of the board.

3.2 A credit institution must satisfy the Bank, in regard to possible conflicts of interest arising in the conduct of different types of activity under its control, that adequate arrangements have been made to protect the interests of its clients. All credit institutions will be required to comply with any prudential rules or codes of practice drawn up by the Bank in relation to their investment business in accordance with the EU Investment Services Directive (93/22/EEC).

3.3 A credit institution should be aware of and monitor, on an ongoing basis, the risk to its business arising from its participation in payments and settlements systems and to take reasonable steps to minimise that risk.

3.4 Where a credit institution is involved in a fiduciary capacity in the management of clients' funds, it should ensure that the possible risks to the credit institution arising from such activities are adequately assessed and provided for.

3.5 A credit institution should maintain adequate fidelity guarantee insurance for all staff or make alternative arrangements acceptable to the Bank.

Legal Amendments for Risk-Based Supervision

Memorandum "Amendments to law of Ukraine required for implementation of Risk-Based supervision" dated February 28, 2003

SUMMARY

The memorandum has been prepared by senior legal advisor Mr. Gary Gegenheimer and legal and economic specialist Mr. Yevhen Telychko and distributed to members of a small Task Force as well as to other relevant parties (including Mr. Novikov from the Legal Department and Ms. Romanenko from the Methodology Unit).

The purpose of the memorandum is to provide comprehensive view on what changes are necessary in law of Ukraine for implementation of risk-based supervision and to serve as a basis for further discussion and for development of the specific strategy for making those amendments.

It brings together major points and conclusions made in previous memoranda on necessary legal amendments prepared during previous quarter, and raises some new issues.

The preliminary list of necessary legal efforts included in the conclusion of the memorandum is as follows:

1) To ensure that amendments are made to Art. 17-19, 39, 40, 45, 69, 73 of Law "On banks and banking activity" (BBL) in line with recommendations made by General Department of Bank Supervision (GDBS) in November – December 2002.
2) To promote changes in laws of Ukraine which make judgement by the National Bank of Ukraine as to adequacy of risk-management and internal control systems in a commercial bank decisive for judges. In particular, it is important to make relevant amendments to Part 1 of BBL Art. 73 "Enforcement Measures" as recommended in the memorandum.
3) To make amendments to BBL Art. 39 authorising supervisory body (NBU) to require changes in composition of Supervisory Council.
4) To make amendments to Art. 166-5 of Administrative Code of Ukraine increasing responsibility of bank's managers, including members of Supervisory Council.
5) To develop and implement effective policy on risk-management systems (and systems of internal control) in banks (guidelines), taking into consideration recommendations given in the memorandum.
6) To make some amendments to NBU Regulations #114 and #358 according to amendments to BBL.
7) To make necessary steps to give a proper status to NBU Regulation #358 that will make it enforceable.
8) To promote other changes in law that will ensure adequate quality of internal and external audit (as described in memorandum by Mr. Alex Kutsenko dated Feb 28, 2003).
9) To review NBU Regulations #275 and #375 on registration and licensing of banks and make amendments as per recommendations on amendments to BBL.

МЕМО

КОМУ:	Іваненко Н.В., Начальнику Управління стратегії, планування та координації Новікову В.В., Заступнику Начальника Управління вдосконалення банківського законодавства та профілактики банківських правопорушень Пожарській І.С., Головному економісту управління інспектування банків Присяженко О., Заступнику Начальника Управління моніторингу великих банків Романенко І.Ф. Начальнику Управління методології Уварову К., Раднику Голови НБУ Фабер С.В. Заступнику Директора Департаменту інспектування та моніторингу банків
ВІД:	Гері Гегенхаймера, Старшого радника з юридичних питань Євгена Теличка, Спеціаліста з юридичних та економічних питань
ДАТА:	28 лютого 2003 року
СТОСОВНО:	Зміни, необхідні в законодавстві України для запровадження нагляду на основі оцінки ризиків

ЗМІНИ, НЕОБХІДНІ В ЗАКОНОДАВСТВІ УКРАЇНИ ДЛЯ ЗАПРОВАДЖЕННЯ НАГЛЯДУ НА ОСНОВІ ОЦІНКИ РИЗИКІВ

Для запровадження нагляду на основі оцінки ризиків дуже важливо забезпечити наявність необхідного правового поля. Чинне законодавство України має деякі недоліки, що можуть бути перешкодою для досягнення цієї мети. У цьому меморандумі ми розглянемо ці недоліки та запропонуємо шляхи їхнього виправлення. Ми зосередимо свою увагу на наступних галузях:

1) Вимоги щодо наявності ефективних систем управління ризиками в комерційних банках;
2) Правове забезпечення можливості застосування заходів впливу на банки та їх керівників (включаючи членів Спостережної ради) у випадку неадекватності систем управління ризиками;
3) Зовнішній та внутрішній аудит як інструмент забезпечення адекватності систем управління ризиками та деякі питання вдосконалення корпоративного управління;
4) Вимоги щодо наявності достатніх систем управління ризиками при ліцензуванні.

1. Вимоги щодо наявності ефективних систем управління ризиками у комерційних банках.

Ст. 44 Закону України "Про банки та банківську діяльність" (ЗУББД) вимагає від банків створювати "постійно діючий підрозділ з питань аналізу та управління ризиками, що має відповідати за встановлення лімітів щодо окремих операцій, лімітів ризиків контрпартнерів, країн контрпартнерів, структури балансу відповідно до рішень правління (ради директорів) з питань політики щодо ризикованості та прибутковості діяльності банку". Дана Стаття також передбачає, що "для забезпечення додаткових заходів з метою управління ризиками банки створюють постійно діючі комітети, зокрема:
1) кредитний комітет, який щомісячно оцінює якість активів банку та готує пропозиції щодо формування резервів на покриття можливих збитків від їх знецінення;
2) комітет з питань управління активами та пасивами, який щомісячно розглядає собівартість пасивів та прибутковість активів і приймає рішення щодо політики відсоткової маржі, розглядає питання відповідності строковості активів та пасивів та надає відповідним підрозділам банку рекомендації щодо усунення розбіжностей у часі, що виникають;
3) тарифний комітет, який щомісячно аналізує співвідношення собівартості послуг та ринкової конкурентоспроможності діючих тарифів, відповідає за політику банку з питань операційних доходів.
Банки самостійно вирішують і створюють органи управління фінансовими ризиками з метою забезпечення сприятливих фінансових умов захисту інтересів вкладників та інших кредиторів."

Хоча навіть сама наявність окремої статті, присвяченої цьому питанню, свідчить про те, що в Україні розпочалося формування систем управління ризиками в комерційних банках, <u>недоліками статті є:</u>

1) відсутність вимог до банків щодо наявності відповідних внутрішніх положень по управлінню ризиками, які б детально описували процес управління кожним із ризиків

у відповідності із розміром банку та ступенем ризикованості його операцій, включаючи певні кількісні обмеження;

2) відсутність чіткої вказівки на те, що внутрішні положення щодо управління ризиками мають бути погоджені Спостережною радою банку, а також що саме члени Спостережної ради особисто відповідають за систему управління ризиками в банку і разом із керівництвом контролюють ефективність її роботи.

Для виправлення цих недоліків робоча група Генерального департаменту банківського нагляду щодо внесення змін до Закону "Про банки та банківську діяльність" запропонувала наступну редакцію частини першої Статті 44:

„Банк створює всебічну та адекватну систему управління ризиками для встановлення, вимірювання, моніторингу та контролю всіх ризиків. З цією метою в банку створюється постійно діючий підрозділ з питань управління ризиками, що має відповідати за встановлення лімітів щодо окремих операцій, лімітів ризиків контрпартнерів, країн-контрпартнерів, лімітів інших ризиків, за розробку процедур оцінки, відслідковування та контролю ризиків структури балансу відповідно до рішень спостережної ради та правління (ради директорів) з питань політики щодо ризиковості та прибутковості діяльності банку."

Крім того, запропоновані зміни до Статті 39 "Спостережна рада". Зокрема, однією з функцій Спостережної ради запропоновано зробити "затвердження внутрішніх положень банку та комплексну систему управління ризиками, ліміти ризиків, тарифікацію банківських продуктів".

У більшості західних країн органи нагляду розробляють положення (стандарти), що встановлюють конкретні мінімальні вимоги щодо систем управління ризиками, обов'язкові для виконання банками.

Прикладами таких положень є:

1) Положення Канадської корпорації страхування вкладів "Про стандарти ефективної ділової та фінансової практики" (Canada Deposit Insurance Corporation Standards of Sound Business and Financial Practices By-law (SOR/2001-299).
http://lois.justice.gc.ca/en/C-3/SOR-2001-299/text.html

2) Положення Центрального банку Голландії "Про організацію та контроль" (Regulation on Organization and Control (Netherlands)
http://www.dnb.nl/english/e_toezicht/wet_regelgeving/hbwtk/pdf/4201e.pdf

3) Положення № 4 Центрального банку Чехії "Про управління ринковим ризиком у банках" http://www.cnb.cz/en/_legislativa/opatreni/pdf/a_opa_4_2002.pdf

4) Положення Центрального банку Туреччини "Про систему внутрішнього контролю та управління ризиками у банках" (Regulation on Banks' Internal Control and Risk Management Systems) http://www.fe.boun.edu.tr/internalcontrol_and_riskmanagement.doc

Ці документи містять як обов'язкові вимоги до систем управління ризиками та систем внутрішнього контролю банків, так і просто рекомендації. При цьому невиконання рекомендацій також вважається ознакою недостатньою уваги банку до власних систем управління ризиками, що може бути підставою для застосування певних заходів до банку.

<u>Національний банк України також має розробити відповідне положення (стандарти) про системи управління ризиками (та системи внутрішнього контролю) в комерційних банках, що встановлюватиме мінімальні вимоги в цій галузі для комерційних банків, та забезпечити їхнє виконання банками.</u>

2. Правове забезпечення можливості застосування заходів впливу до банків та їх керівників (включаючи членів Спостережної ради) у випадку неадекватності систем управління ризиками.

Це питання є ключовим для побудови ефективного правового поля для нагляду на основі оцінки ризиків. Дуже важливо законодавчо закріпити механізм, за допомогою якого Національний банк зможе вимагати від банків наявності *адекватних* систем управління ризиками та застосовувати відповідні заходи впливу у випадку неадекватності таких систем.

Чинна редакція частини 1 Статті 73 Закону "Про банки та банківську діяльність" твердить:

"У разі порушення банками або іншими особами, які можуть бути об'єктом перевірки Національного банку України відповідно до цього Закону, банківського законодавства, нормативно-правових актів Національного банку України *або здійснення ризикових операцій, які загрожують інтересам вкладників чи інших кредиторів банку*, Національний банк України адекватно вчиненому порушенню має право застосувати заходи впливу".

Навіть така редакція надає повноваження Національному банку застосовувати заходи впливу до банку, якщо цей банк здійснює "*ризиковані операції, що загрожують інтересам вкладників чи інших кредиторів банку*".

У проекті змін до Закону "Про банки та банківську діяльність" Генеральний Департамент запропонував таку редакцію частини 1:

"У разі порушення банками або іншими особами, які можуть бути об'єктом перевірки Національного банку України відповідно до цього Закону, банківського законодавства, нормативно-правових актів Національного банку України, *відсутності чи неадекватності системи управління ризиками або здійснення ризикових операцій, які загрожують інтересам вкладників чи інших кредиторів банку*, Національний банк України адекватно вчиненому порушенню *має право застосувати упереджувальні та примусові заходи впливу*".

Обидві редакції мають проблему, яка спостерігається в законодавстві всіх країн, що будують нагляд на основі оцінки ризиків, а саме - невизначеність. Нормальним явищем є те, що в законах відносно систем управління ризиками в банках застосовуються такі слова як "достатні", "адекватні" і таке інше, які не можуть бути вичерпно визначені (та і не повинні бути вичерпано визначені) в законодавстві. Хоча зазвичай положення наглядових органів є більш деталізованими (ступінь деталізації може бути різною), <u>кінцева оцінка "достатності" чи "адекватності" систем робиться банківським наглядом, що абсолютно вірно.</u> Однак це призводить до того, що банки часом звертаються до суду, звинувачуючи наглядовий орган у необ'єктивності та незаконності його вимог або заходів, що вживаються до банків. У західних країнах ця проблема потроху втрачає свою актуальність, оскільки суди повністю покладаються на оцінку та висновки органів нагляду. Тому випадки звернення банків до суду з цього приводу трапляються все рідше. В Україні, навпаки, це може бути перешкодою для побудови ефективного нагляду на основі оцінки ризиків.

Для вирішення цієї проблеми рекомендується:

1) При розробленні Положення НБУ про систему управління ризиками зробити його якомога більш конкретним щодо визначення адекватності системи управління ризиками, яка має бути в банку. При цьому чітко визначити, що кінцевий висновок (оцінка) щодо адекватності систем управління ризиками робиться банківським наглядом НБУ на основі не лише тих критеріїв, що наводяться в Положенні, але також за іншими чинниками, які НБУ може брати до уваги, спираючись на свій досвід.
2) Просувати такі зміни в Законах України, що зроблять рішення та оцінки Національного банку України щодо адекватності систем управління ризиками та систем внутрішнього контролю банків вирішальними для суддів. Важливим кроком в цьому напрямку було б внесення змін до Частини 1 Ст. 73 "Заходи впливу" Закону "Про банки та банківську діяльність" з викладенням її в такій редакції:

"У разі порушення банками або іншими особами, які можуть бути об'єктом перевірки Національного банку України відповідно до цього Закону, банківського законодавства, нормативно-правових актів Національного банку України, *відсутності чи, з точку зору Національного банку України, неадекватності системи управління ризиками або здійснення ризикових операцій, які загрожують інтересам вкладників чи інших кредиторів банку, Національний банк України адекватно вчиненому порушенню має право застосувати упереджувальні та примусові заходи впливу, що він вважатиме достатніми для виправлення порушень або недоліків*"

Відповідно до п.14 Ключових принципів ефективного банківського нагляду Базельського комітету, орган нагляду повинен мати законодавчо закріплені повноваження вимагати змін у складі Ради банку та Правління (якщо вони не мають необхідної кваліфікації відповідно до масштабів та характеру діяльності банку або не можуть реагувати на зміни параметрів ризику банку і на зовнішні ринкові зміни). Для виконання цього принципу робоча група ГДБН з питань внесення змін до Закону "Про банки та банківську діяльність" запропонувала додаткову частину 5 до Статті 40 "Виконавчий орган банку", виклавши її в такій редакції:

„Національний банк України має право вимагати змін у складі правління (ради директорів) банку, якщо вважатиме, що деякі з його членів перестали відповідати вимогам у зв'язку із змінами розміру банку, особливостей його діяльності, збільшенням ризику його діяльності, або значних змін умов на ринку."

Під час засідань робочої групи таке саме положення передбачалося і у Статті 39 "Спостережна рада". Однак, в остаточній версії проекту змін ця інформація чомусь була втрачена.

У зв'язку із цим до Статтю 39 треба додати частину 6, виклавши її в такій редакції:

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„Національний банк України має право вимагати змін у складі <u>Спостережної ради</u> банку, якщо вважатиме, що деякі з її членів перестали відповідати вимогам у зв'язку зі змінами розміру банку, особливостей його діяльності, збільшенням ризику його діяльності або значними змінами умов на ринку."

Крім того, члени Спостережної ради банку повинні нести особисту відповідальність за якість системи управління ризиками та систему внутрішнього контролю в банку. Для цього бажано внести деякі зміни до Адміністративного Кодексу України. Чинна редакція Статті 166-5 АКУ передбачає накладання штрафу на керівників банку (згідно із Законом "Про банки та банківську діяльність" керівниками банку є також члени Спостережної ради) "за порушення банківського законодавства, нормативно-правових актів Національного банку України або здійснення ризикових операцій, які загрожують інтересам вкладників чи інших кредиторів банку". Розмір штрафу встановлений на рівні від 50 до 100 неоподаткованих мінімумів доходів громадян, тобто від 850 до 1700 гривень. Сумнівно, щоб такий розмір штрафу був серйозним стримуючим фактором для порушень з боку керівників банку. У Сполучених Штатах, для порівняння, розмір штрафу <u>на особисте майно</u> члена спостережної ради банку може сягати мільйонів доларів.

3. Внутрішній та зовнішній аудит як інструмент забезпечення адекватності систем управління ризиками та деякі питання корпоративного управління.

Відповідно до вимог документів Базельського комітету[1], внутрішній аудит банку повинен пильно слідкувати за системою управління ризиками в банку та оцінювати її адекватність. Він має повідомляти Спостережній раді та Правлінню банку про всі виявлені проблеми (включаючи потенційні), недоліки та занепокоєння. Спостережна рада повинна через керівників банку здійснювати коригування системи управління ризиками відповідно до рекомендацій внутрішнього аудиту. З іншого боку, зовнішній аудит, відповідно до вимог Міжнародних стандартів аудиту та документів Базельського комітету, має перевіряти якість роботи внутрішнього аудиту щодо системи управління ризиками та доповідати про все Спостережній раді. Спостережна рада має робити відповідні кроки, щоб поліпшити систему внутрішнього контролю та систему управління ризиками.

У чинній редакції Закону "Про банки та банківську діяльність" (Ст.45) внутрішній аудит поки що є "органом оперативного контролю *правління* банку", а не його Спостережної ради. Крім того, серед функцій внутрішнього аудиту оцінка систем управління ризиками банку не згадується.

Для виправлення цих та інших недоліків робоча група ГДБН з питань внесення змін до Закону "Про банки та банківську діяльність" запропонувала таку редакцію Статті 45:

„Банки створюють службу внутрішнього аудиту, яка є органом оперативного контролю спостережної ради банку. Працівники служби внутрішнього аудиту не можуть бути членами виконавчого органу банку. <u>Служба внутрішнього аудиту підпорядковується спостережній раді банку та звітує перед нею, діє на підставі положення, затвердженого спостережною радою</u>.

Служба внутрішнього аудиту виконує такі функції:
1) забезпечує незалежну оцінку адекватності запровадженої політики та методики діяльності банку;

[1] Зокрема, "Внутрішній аудит у банках та відносини наглядового органу з аудиторами", серпень 2001 року.

2) здійснює нагляд за поточною діяльністю банку;
3) контролює дотримання законів, нормативно-правових актів Національного банку України та рішень органів управління банку;
4) наглядає та перевіряє результати поточної фінансової діяльності банку;
5) здійснює оцінку системи управління ризиками;
6) аналізує інформацію та відомості про діяльність банку, професійну діяльність її працівників, випадки перевищення повноважень посадовими особами банку;
7) надає спостережній раді та правлінню (раді директорів) висновки та пропозиції за результатами перевірок – для здійснення оперативного контролю;
8) перевіряє адекватність системи внутрішнього контролю банку протидії відмиванню коштів, отриманих злочинним шляхом, та банківському шахрайству;
9) інші функції, пов'язані з наглядом та контролем за діяльністю банку.

Служба внутрішнього аудиту має право на ознайомлення з усією документацією банку та нагляд за діяльністю будь-якого підрозділу банку. Служба внутрішнього аудиту уповноважена вимагати письмові пояснення від окремих посадових осіб банку щодо виявлених недоліків у роботі.
Кандидатура керівника служби внутрішнього аудиту погоджується з Національним банком України.

Служба внутрішнього аудиту не несе відповідальності і не має владних повноважень щодо операцій, за якими вона здійснює аудит.

Служба внутрішнього аудиту несе відповідальність за обсяги та достовірність звітів, які подаються спостережній раді щодо питань, віднесених до її компетенції, визначених цим Законом

Працівники служби внутрішнього аудиту при призначенні на посаду дають письмове зобов'язання про нерозголошення інформації щодо діяльності банку та збереження банківської таємниці відповідно до вимог глави 10 цього Закону."

Відповідні зміни також будуть потрібні в Постанові НБУ №114 " Про затвердження Положення про організацію внутрішнього аудиту в комерційних банках України".

Іншим важливим моментом є правовий механізм, що дозволяє вимагати від спостережної ради та правління банку виконання рекомендацій аудиту.

У цьому відношенні Постанова НБУ №358 "Про затвердження Методичних вказівок щодо застосування стандартів внутрішнього аудиту в комерційних банках України" визначає, що:

"8.25. Після проведення перевірки внутрішні аудитори повинні контролювати становище в банку щодо виправлення виявлених і зазначених в аудиторському висновку порушень, а також визначити можливе прийняття на себе Правлінням або Радою банку ризику незастосування відповідних заходів.
8.26. Подальший контроль, який проводиться внутрішніми аудиторами, це - встановлення адекватності, ефективності та своєчасності заходів, що вживаються керівництвом банку у зв'язку з викладеними в аудиторському висновку зауваженнями внутрішніх та зовнішніх аудиторів.
8.27. Відповідальність за подальший контроль повинна визначатися в Положенні про службу внутрішнього аудиту банку.
8.28. Керівники банку несуть відповідальність за вжиття заходів щодо усунення порушень, зазначених в аудиторському висновку. Керівник служби внутрішнього аудиту банку здійснює відповідний контроль.
8.29. Керівництво банку має право взяти на себе ризик і відмовитися вживати відповідних заходів щодо викладених в аудиторському висновку фактів у зв'язку з великими витратами на їх проведення або іншими міркуваннями. В такому разі керівник служби внутрішнього аудиту повідомляє про це рішення Раду банку.
8.30. Деякі викладені в аудиторському висновку недоліки можуть бути настільки важливими, що вимагатимуть від керівників банку негайних дій. Внутрішні аудитори зобов'язані тримати такі ситуації під особливим контролем.
8.31. Якщо керівник служби внутрішнього аудиту переконаний, що Правління і Рада банку вживають

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достатніх заходів для усунення фактів порушень, то подальший контроль здійснюється в рамках наступної аудиторської перевірки.
8.32. Розробка графіка подальшого контролю повинна базуватися на передбачених ризиках, а також на ступені складності та важливості фактів виявлених порушень.
8.33. Керівник служби внутрішнього аудиту для проведення подальшого контролю повинен: - встановити час, який потрібен на отримання відповіді від керівників підрозділів банку щодо усунення виявлених недоліків; - розглянути відповіді керівників підрозділів, що перевіряються; - провести у разі потреби повторну контрольну аудиторську перевірку."

Хоча тут чітко визначається, що "керівники банку несуть відповідальність за вжиття заходів щодо усунення порушень, зазначених в аудиторському висновку", проблема з цим документом полягає в тому, що він має тільки реєстрацію Національного банку і ніколи не був зареєстрований Міністерством юстиції. Відповідно, тут можуть виникнути деякі проблеми із примушуванням банків виконувати вимоги, викладені в документі.

Відповідно до частини 4 Ст.14 Закону "Про аудиторську діяльність в Україні", "затвердження норм і стандартів аудиту є виключним правом Аудиторської палати України". Саме цим пояснюється небажання Міністерства юстиції реєструвати цей документ, який по суті є "стандартами аудиту для банків". З іншого боку, Аудиторська палата України також не дуже зацікавлена у реєстрації цього положення оскільки воно відноситься до "внутрішнього аудиту", а Закон "Про аудиторську діяльність в Україні" взагалі внутрішній аудит не згадує. Він по суті є Законом про зовнішній аудит.

<u>У будь якому випадку, треба знайти вирішення цієї проблеми та надати Постанові №358 належний статус.</u>

Для виправлення деяких недоліків, пов'язаних із **зовнішнім аудитом**, робоча група ГДБН з питань внесення змін до Закону "Про банки та банківську діяльність" запропонувала наступну редакцію частин 8-10 Статті 69:

„Аудиторська перевірка банку здійснюється <u>відповідно до міжнародних стандартів аудиту</u> аудиторською фірмою, яка має сертифікат Національного банку України на аудиторську перевірку банківських установ.
За результатами аудиторської перевірки складається аудиторський звіт, який має містити:
1) баланс (з урахуванням позабалансових зобов'язань);
2) звіт про фінансові результати;
3) звіт про рух грошових коштів;
4) звіт про власний капітал;
5) примітки до звітів;
6)таблицю строків активів та пасивів;
7) інформацію стосовно формування резервів, статутного та регулятивного капіталу, їх достатності;
8). інформацію стосовно адекватності бухгалтерського обліку, <u>системи внутрішнього контролю, стану роботи служби внутрішнього аудиту та стану системи управління ризиками</u>;
9) висновок про те, чи відображує наданий банком фінансовий звіт дійсний фінансовий стан банку.

Банки, аудиторські висновки та звіти яких не відображають дійсний фінансовий стан, зобов'язані проводити повторну аудиторську перевірку іншою аудиторською фірмою за вимогою Національного банку України. Національний банк має право позбавити аудитора сертифіката на аудиторську перевірку банків."

Ці зміни, зокрема, дозволять вимагати від зовнішніх аудиторів приділяти більшу увагу системам управління ризиками в банку та стану роботи служби внутрішнього аудиту.

Таким чином, після внесення вказаних вище змін у Ст. 45 та 69 Закону "Про банки та банківську діяльність" та надані належного статусу Постанови №358, Національний банк України матиме можливість вимагати від банків 1) підзвітності служби внутрішнього аудиту банку Спостережній раді; 2) обов'язкової перевірки систем управління ризиками банку внутрішніми та зовнішніми аудиторами (із включенням відповідних розділів до аудиторських звітів); 3) перевірки служби внутрішнього аудиту банку зовнішніми аудиторами; 4) виконання членами Спостережної ради банку та Правління рекомендацій внутрішніх та зовнішніх аудиторів.

Це тільки частина питань, що стосується внутрішнього та зовнішнього аудиту. Більш детальний аналіз проблем пов'язаних з аудитом (зокрема питання, сертифікації банківського аудиту) надається у меморандумі Олексія Куценко "Проблеми та перспективи розвитку аудиту" від 28 лютого 2003 року та у меморандумах пана Чарльза Кенфілда, який у грудні 2002 та січні 2003 в рамках Голландського гранту займався питаннями вдосконалення аудиту.

Подальші рекомендації щодо аудиту та корпоративного управління будуть надані в наших наступних меморандумах.

4. Вимоги щодо наявності адекватних систем управління ризиками при ліцензуванні

Необхідно забезпечити адекватний рівень систем управління ризиками банку вже на етапі ліцензування.

Для виправлення деяких недоліків, пов'язаних із ліцензуванням, робоча група ГДБН з питань внесення змін до Закону "Про банки та банківську діяльність" запропонувала внести до Ст. 19 абзаци 5-7, що для отримання банківської ліцензії вимагають від банків подавати також документи, які підтверджують:

«наявність підрозділів, в тому числі служби внутрішнього аудиту **та управління ризиками**, які виконуватимуть відповідні операції та функції;

наявність внутрішніх положень, що регламентують здійснення діяльності згідно наданої банківської ліцензії, **в тому числі положення про внутрішній аудит банку та про систему управління ризиками**, які відповідають чинному законодавству України, вимогам Національного банку України та статуту банку».

Деякі зміни також будуть потрібні в Постанові НБУ №375 "Про затвердження Положення про порядок створення і державної реєстрації банків, відкриття їх філій, представництв, відділень" та Постанові НБУ №275 "Про затвердження Положення про порядок видачі банкам банківських ліцензій, письмових дозволів та ліцензій на виконання окремих операцій".

Ми тільки почали аналізувати законодавство у цій сфері і надамо більше рекомендацій щодо ліцензування в наших наступних меморандумах.

ВИСНОВОК

Таким чином, для побудови ефективного правового поля для розвитку нагляду на основі оцінки ризиків необхідно:

1) Забезпечити внесення змін до Ст. 19. 39, 40, 45, 69, 73 Закону "Про банки та банківську діяльність" відповідно до пропозицій, зроблених ГДБН в листопаді-грудні 2002 року.
2) Просувати такі зміни до Законівх України, які зроблять рішення та оцінки Національного банку України щодо адекватності систем управління ризиками та систем внутрішнього контролю банків вирішальними для суддів. Зокрема, внести зміни до частини 1 Ст. 73 "Заходи впливу" Закону "Про банки та банківську діяльність", виклавши її в запропонованій редакції.
3) Внести зміни до Ст. 39, законодавчо закріпивши повноваження органу нагляду вимагати змін у складі Ради банку.
4) Внести зміни до Ст. 166-5 Адміністративного Кодексу України, посиливши відповідальність керівників банку, включаючи членів Спостережної ради.
5) Розробити та запровадити ефективне положення про системи управління ризиками (та системи внутрішнього контролю) в банках, взявши до уваги рекомендації, зроблені вище.
6) Внести деякі зміни до Постанов НБУ №114 та №358 відповідно до змін у Законі "Про банки та банківську діяльність".
7) Зробити відповідні кроки для надання належного статусу Постанові НБУ №358, що дозволить забезпечити її виконання банками.
8) Сприяти іншим змінам у законодавстві, що дозволять забезпечити достатню якість внутрішнього та зовнішнього аудиту (див. меморандум Олексія Куценка від 28 лютого 2003 року)
9) Переглянути Положення НБУ №275 та №375 про ліцензування та внести зміни відповідно до рекомендацій щодо змін у Законі "Про банки та банківську діяльність".

Цей список не є вичерпним, та подальші рекомендації (зокрема, стосовно аудиту, корпоративного управління та ліцензування) будуть надані у наших наступних меморандумах.

Summary of Pilot Bank Program

SUMMARY

This is a memo addressed to Mr. Pushkariov requesting his help in the organization and implementation of the Pilot Bank program.

The memo explains that the Pilot Bank Program is one of the two main objectives of the Risk Based Supervision Task Force together with the development and implementation of appropriate methodologies and practices. The aim of the Pilot Bank Program is to test in the pilot banks the Risk Assessment System developed by the Task Force.

The Pilot Bank Program consists of two main stages:

- Presentations delivered by the selected banks on their risk management systems to the Task Force members
- Testing of the Risk Management System in one or more pilot banks

The purpose of the presentations is two-fold:

First, based on these presentations the Task Force will have an opinion on the level of understanding of the risk management concept by commercial banks in order to develop recommendations on how to improve their risk management systems as well as to take this into consideration during the development of the Policy Guidelines.

Second, this is the way of having banks involved in the development of progressive banking supervision tools, thus promoting cooperation between banking supervision and the banking industry.

The list of banks selected for the presentations is given. A tentative plan of the presentations is described.

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МЕМО

Кому:	пану В.В.Пушкарьову, директору Генерального департаменту банківського нагляду Національного банку України
Копія:	пані Н.В.Іваненко, заступникові директора Генерального департаменту банківського нагляду пані С.В.Фабер, заступникові директора Департаменту моніторингу та інспектування
Від:	пана Френка Е. Блімлінга, старшого радника
Дата:	20 березня 2002 року
Тема:	Програма пілотних банків

Від імені Постійно діючої робочої групи із запровадження банківського нагляду на основі ризиків, до складу якої входять представники всіх управлінь Генерального департаменту банківського нагляду Національного банку України, та групи радників BearingpPoint, звертаємося до Вас із проханням сприяти організації та здійсненню Програми пілотних банків.

Здійснення Програми пілотних банків є одним із двох основних завдань Постійно діючої робочої групи разом із розробленням та запровадженням методології та практики банківського нагляду на основі оцінки ризиків. Програма пілотних банків має на меті оцінку систем управління ризиками спеціально відібраних для цього банків та тестування системи оцінки ризиків (СОР), яка на даному етапі знаходиться в процесі розроблення та має стати одним із основних інструментів банківського нагляду.

Програма пілотних банків має складатися з двох основних етапів:

- Проведення презентацій представниками пілотних банків щодо їхніх систем управління ризиками перед членами Постійно діючої робочої групи
- Тестування системи оцінки ризиків на одному або кількох із цих банків в рамках планових виїзних інспектувань

Проведення презентацій має на меті виконання двох основних завдань:

По-перше, на основі цих презентацій Постійно діюча робоча група зможе зробити висновок щодо рівня розуміння банками концепцій управління ризиками та ступеню розвитку систем управління ризиками. Спираючись на цей висновок, на результати майбутнього тестування системи оцінки ризиків (СОР), а також враховуючи думки та зауваження самих банків щодо системи оцінки ризиків (СОР), служба нагляду зможе виробити рекомендації для банків щодо удосконалення їхніх системи управління ризиками.

По-друге, залучення банків до презентацій по суті означає їхню участь в розробленні нових прогресивних механізмів банківського нагляду, що сприятиме взаєморозумінню між службою банківського нагляду та банківською спільнотою.

Тестування системи оцінки ризику планується здійснити за участю іноземних радників. Воно дозволить як надати рекомендації банкам щодо удосконалення їхніх систем управління ризиками, так і буде слушною нагодою для запровадження нового прогресивного наглядового інструменту серед працівників служби банківського нагляду. Пропонуємо здійснювати таке тестування в рамках виїзних інспектувань одного або кількох банків, які ми відберемо з пілотної групи, спираючись на результати їхніх презентацій та на наші знання та розуміння їхніх систем управління ризиками, отримані з інших джерел.

Для проведення презентацій було відібрано наступні банки:

1) Аваль
2) Приватбанк
3) Вабанк
4) Кредитпромбанк
5) Хрещатик
6) Укрсоцбанк
7) Ексімбанк
8) Мікрофінансовий

Кожна презентація триватиме приблизно дві години (з урахуванням можливих запитань). Пропонуємо здійснювати по одній презентації на день, починаючи з 1 квітня. Для цього буде розроблено графік, який залежатиме від результатів наших усних бесід з банками, на яких буде пояснено нашу мету. Крім того, згідно з нашими планами, до1 квітня буде завершено розроблення проекту системи оцінки ризиків (СОР), яка буде надіслана до банків для ознайомлення та коментарів. Гадаємо, це допоможе пілотним банкам зорієнтуватися та належним чином підготуватись до презентацій.

Будемо дуже вдячні за підтримку в нашій роботі та сприяння організації Програми пілотних банків.

Pilot Bank Program

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MEMO

ON THE PILOT BANK PROGRAM (OUTSLINE)

The launching and implementation of the Pilot Bank Program may include the following steps:

I. **Testing tools and processes for Risk Management Systems in banks based on the Risk Based Supervision approach.**

1. Identifying which risk assessment tools and procedures are to be used in the process of Risk Management in banks. As a result, a list of appropriate tools and processes is to be made.
2. Based on this list, reviewing risk assessment tools and procedures identified based on the Risk Based Supervision approach in order to:
   - identify what is available and used in the system;
   - identify what needs to be additionally developed and/or improved.
3. The selection of participating banks. These should include both large and medium sized Kiev and regional banks, as well as foreign owned. The following banks have been preliminary selected based on the advise of the Department of Inspection and Monitoring:
   1) Aval
   2) Privatbank
   3) Va-Bank
   4) Creditprombank
   5) Kreshchatik
   6) Tas-Kommerz
   7) Ukrsotsbank
   8) Finances and Credit
   9) ING
   10) Credit Lyonnaise
   11) First Ukrainian International (backup)
   12) Premier-Bank (backup)
   13) Energobank (backup)
   14) Micro-finance Bank (backup)
4. All banks are to make an 1-2 hour presentation on their risk management systems (ING and Credit Lyonnaise have already done it). Based on these, as well as on additional analysis of their operations and products, it will be identified which banks are most appropriate to test risk assessment tools for different risks (e.g., Bank A – credit risk, Bank C – market risk, etc., with one or more banks to be tested comprehensively – the complete Risk Assessment System)
5. Risks should be prioritized in order to determine the schedule of our work in banks.
6. Letters will be developed and sent to the banks in order to:

1) explain to them what our purpose and plans are, as well as the benefits of risk management systems in their banks. Benefits of risk management systems and risk based supervision should be explained, emphasizing:
   - better Council and management oversight
   - consistent approach to methodologies, common terminology
   - better organization through the integration of processes
   - clear roles and responsibilities
   - excellent training and communication
   - improved information systems
   - less bureaucracy;

2) request meetings with management and supervisory council members.

7. Meetings with management and supervisory councils of the banks will be held in order to discuss what was outlined in the letters sent to them (see above) and ask for permission to evaluate risk management systems in these banks using the tools reviewed – in order to evaluate them (this may be done, for example, as a part of targeted onsite inspections).
8. Based on the answers received, a schedule will be developed for the targeted onsite examinations or other visits (as is decided). Timeframes will be identified for visiting each bank (depending on the complexity of risk or risks to be dealt with, from a few days to a few weeks). Scopes of visits may be adjusted based on the results of these meetings.
9. Actual visits to banks and testing risk assessment systems.
10. Development of conclusions and recommendations on the development, improvement and/or updating their risk management systems.
11. Based on these conclusions and recommendations, the development of a draft Policy Statement (in the form of an Instruction/Resolution) will be initiated to incorporate these recommendations on minimal requirements to risk management systems in banks. This Policy Statement should be a Template (in accordance with our Work Plan) for risk management systems in banks. It should cover all key risks (as identified by the Risk Based Supervision Task Force) and describe the key elements for an effective risk management systems.

II. Obtaining input from pilot banks.

12. Send the draft Policy Statement to the pilot banks and to relevant BSD units (e.g., Inspections and Monitoring, Methodology, Kiev Regional office, etc.), having set deadlines.
13. Obtain the input and summarize it.

III. Template development.

14. The final version of the Policy Statement will be developed based on the summary (see above). Before the Template is finalized, additional meetings with the pilot banks may be needed.
15. Issuing the Policy Statement (Template).

Survey of International Practices in the Training Organizations Area for Banking Supervision

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SURVEY OF INTERNATIONAL PRACTICES IN THE TRAINING ORGANIZATION AREA FOR BANKING SUPERVISION

Introduction

With the purpose of evaluating the organization of the NBU personnel training function and the development of recommendations on its improvement, as well as in order to determine the areas of our efforts in future, information on the organization of the banking supervision personnel training function in a number of countries was surveyed.

Internet sites of central banks and regulatory agencies of the following countries were searched:

- USA (FFIEC, OCC, Federal Reserve);
- Great Britain (Bank of England and the FSA);
- Australia (Central Bank and Prudential Regulation Authority);
- Hong Kong (the Hong Kong Monetary Authority);
- India (Reserve Bank of India)
- Poland (National Bank of Poland);
- Singapore (The Monetary Authority of Singapore);
- South Africa (Reserve Bank of South Africa);
- Switzerland (Central Bank, Swiss Federal Banking Commission);
- Canada (Central Bank and the OSFI);
- Denmark (Central Bank and the Financial Services Authority);
- South Korea (Bank of Korea);
- Norway (Kredittildynet);
- Sweden (the Financial Services Authority);
- Japan (the Financial services Authority)

In these sites information also was obtained on personnel training and career development in some other countries.

The organization of the personnel training and career development functions was viewed and evaluated, taking into consideration the following factors:
- Declared objectives and aims in the area of personnel training and career development
- Principles of personnel training
- Organization of the personnel training function. Training centers.

Declared objectives and aims in the area of personnel training and career development.

Declared objectives and aims in the area of personnel training and career development in central banks and regulatory agencies studied may be summarized as follows:
- The need in meeting requirement of the continually changing environment
- The need in ensuring an appropriate level of knowledge and skills of personnel
- Additional motivation and retention of personnel.

All regulatory agencies and central banks declare the need in their personnel training and emphasize that they consider it a priority. This is explained primarily by the necessity to support the appropriate level of professionalism and knowledge in the changing environment.

Additionally, a priority is also ensuring the level of knowledge and skills of personnel, that would comply with the needs of banking supervision and allow to appropriately represent regulatory authorities in the banking community. This was stated in all sites of the organizations reviewed. Personnel training programs in a number of countries include both professional training, and management and leadership training, since from time to time many regulators perform management functions, for example, during onsite examinations. First of all, it concerns banking supervision units and agencies in western countries, like Great Britain, Australia, USA (OCC), Canada, where attention is traditionally paid to the principles of team work, which implies close cooperation between both employees, and employees and managers.

Finally, the third main objective in the personnel training area is the need to offer additional motivation to employees thus ensuring the retention of personnel. The possibility of professional growth and receiving knowledge is a very strong motivation for employees and is considered by management of many organizations as a way to retain personnel and the development of a strong corporate culture. Even though this is declared by almost all organizations reviewed, it should be stated that this objective is especially emphasized by regulatory agencies of the Asian region (South Korea, Japan, Hong Kong, Singapore) with their hierarchical corporate culture which treats investing in personnel as extremely important

Principles of Personnel Training.

Based on the information gathered, it may be stated that the main principles of personnel training listed in the Concept of the Comprehensive Training Program for Banking Supervision (Resolution # 153) comply with the international practice. These principles are: continuity, unification, variety, self-sufficiency.

Common for **all** agencies reviewed is that they all have some form of a **program** of their personnel training. That means, that personnel training in banking supervision areas:
- is performed in an organized manner;
- is mandatory for all professional personnel (not including support functions, e.g., secretaries, etc.);
- consists of a variety of courses, including programs of different levels, orientation and topics, which also may be both universal and specialized;
- is performed on an ongoing basis;
- combines different types of training (classroom, on the job, internships, etc.);
- combines different sources of training (both internal, and external).

In all agencies reviewed there exists a separate training function for banking supervision personnel. Depending on how the banking supervision function is organized in a given country, this may be within a human resources department of the central bank or an independent regulatory agency. Besides, some countries have personnel training units within their banking supervision areas (e.g., in the Reserve Bank of India).

Professional employees of all countries reviewed are subject to specialized training. In most regulatory agencies and banking supervision areas of central banks new employees go through one to four years of mandatory training. This complies with the needs of banking supervision, since it requires a lot of specific technical knowledge and skills, which are not available within university programs. Sites of regulatory agencies of many countries (USA, Great Britain, Australia, South Africa, Canada) contain rather detailed information on what training is required from new employees in order to start their careers and obtain the right to perform supervisory assignments of certain complexity levels.

Personnel training programs of all agencies and central banks reviewed are structured to meet the needs of the given organization. For example, they may depend on whether there is a specialization in the organization (e.g., experts specializing in credit, investments, etc.). Also, the organization of regulatory functions is taken into consideration, i.e. whether onsite and offsite supervision is performed by the same or different people, whether the institution has a separate methodology unit or methodology is written by practitioners, etc. Depending on these factors, training programs offered to different categories of employees may either differentiate, or be universal.

Therefore, in some countries personnel training policy is oriented to the training of general experts with some number of people specializing in certain areas (e.g., in Australia, Canada, Denmark, USA, Japan, Great Britain), other countries stress the specialization of their employees (Sweden, Singapore, Norway). Depending on this, different agencies may give more attention to the unified training, when all employees are to go through a certain amount of universal training and be capable of performing different supervisory functions and replace each other.

However, it should be stated that whatever the organization of training programs is, all of them have the following common features:

1) Training starts with a short orientation course, which gives new employees an idea on the activities of the agency, after which they go through extensive courses on specific topics, which actually make the training program
2) All training programs consist of courses of different complexity levels
3) In addition to technical courses, all training programs include courses on writing and oral presentations.

It should also be mentioned that personnel training is an ongoing function in all agencies reviewed. Most agencies declare the principle of continuity (Great Britain, USA, Australia, Canada, Japan, India, etc.), since knowledge and skills of banking supervision employees must comply with changes that continually go on in the banking sector and in the economy.

All training programs combine formal classroom training (primarily in the form of seminars) and on the job training. All agencies are also trying to offer some forms of internship to as many of their employees as possible (often abroad). Internship abroad is extremely promoted in the Asian region (India, South Korea, Singapore, Hong Kong) and Scandinavian countries (Denmark, Norway). At the same time regulatory agencies of most Western countries actively offer training to their overseas colleagues in the facilities available to them (USA, South Africa, Great Britain, Switzerland). Additionally, self-training is supported, for which end many organizations offer distance training programs (USA, Great Britain, Switzerland, Japan).

In their training efforts all agencies and central banks reviewed rely on both external and internal sources. The principle of self-sufficiency is applied very widely and in almost all agencies. This is natural, given a highly specialized nature of regulatory activities. Many agencies emphasize that their personnel training programs rely primarily on internal resources, when experienced technicians and managers train newcomers and less experienced people (Australia, USA, Great Britain, Sweden, Japan, etc.).

However, it should be mentioned that very popular are training seminars and courses delivered by teachers from different academic institutions, like universities, colleges, training centers, etc. Bankers are also involved in banking supervisor straining in a number of countries (USA, Australia, South Africa, Canada, Japan, India).

Training Centers.

Another feature specific to the organization of personnel training in different countries is training centers. They may be used for the training of employees of different levels, from top managers to newcomers from different regions of the country.

Additionally, within some training centers specialized training programs for graduates from colleges and universities are organized in order to hire them to the central bank or regulatory agency afterwards. Such programs exist, for example, in Great Britain, South Africa, Australia, USA. They may be both rather long-term (2-3- years), and relatively short (from 5 to 12 months). Usually, the best students are offered appropriate positions based on successfully passed examinations. In fact, many of such centers have features of both university type higher educational establishments, and training institutions of a central bank or regulatory agency. Many training centers are called colleges and were established specifically to satisfy this purpose (for example, in India).

In the USA regulatory agencies established a joint training and methodology center called the Federal Financial Institutions Examination Council. The purpose of this institution is to develop approaches common for all regulatory agencies and training their personnel in a consistent manner taking into consideration these approaches. The Council also offers its training services outside the United States. For example, regulators from Canada are trained there.

Generally, many training centers of central banks and regulatory agencies are essentially international institutions, since they offer many training programs to banking supervisors from other countries, both management and technicians. Such are the Center of Central Banking Studies in Great Britain, the college of the Reserve Bank of South Africa, which offers its services to a number of African countries, the Swiss Central Bank Training Center, etc. A separate establishment is the Toronto training center, specifically focusing on management training for regulatory agencies of the world.

Several years ago, with the assistance of USAID, a training center was established at the National Bank of Poland (the so called Training Initiative for Banking Supervision). It was created primarily in order to efficiently use the experience in the banking supervision area in Poland and other countries in the Eastern Europe, as well as the former Soviet Union.

The Training Initiative for Banking Supervision is unique, since its primary focus is technician, rather then management training, i.e. its services are primarily oriented to experts who are in charge of the efficient implementation of supervisory standards and methodologies, conducting the everyday supervision of banking institutions, and working with problem banks in the Eastern European region.

The Training Initiative usually offers practical courses structured in such a way, that the attendants are offered more then just theory supported by general practical examples. Since these courses are aimed at training technicians, the case studies that are offered are of an advanced level of complexity, thus differing from routine everyday assignments. Therefore, the unique feature of the Polish Training initiative is the technical nature of the courses oriented primarily to experienced technicians, rather then either management, or young inexperienced employees.

BearingPoint
Formerly KPMG Consulting

МЕМОРАНДУМ

Огляд міжнародної практики організації тренінгу

Тренінг (в українській термінології частіше називається "підготовка персоналу" або "навчання персоналу") – надання працівникам установи/організації оптимальних можливостей набуття знань, навичок та вмінь для задоволення вимог до виконання конкретних виробничих функцій. Форми та методи тренінгу залежать від потреб у навчанні кожного окремого працівника.

Вступ

З метою оцінки організації функції підготовки персоналу Національного банку України та вироблення рекомендацій щодо її удосконалення, а також задля визначення напрямків нашої роботи в подальшому, ми розглянули інформацію щодо організації підготовки персоналу банківського нагляду в ряді розвинених країн світу.

Було здійснено пошук по сайтах центральних банків та агентств нагляду за банківськими та іншими фінансовими установами таких країн:

- Сполучених Штатів Америки (Федеральний офіс освіти інспекторів фінансових установ (FFIEC), Офіс контролера грошового обігу (OCC), Федеральної резервної системи;
- Великої Британії (Банку Англії та Управління фінансових послуг (FSA));
- Австралії (Центрального банку та Управління пруденційного регулювання Австралії);
- Гонконгу (Управління монетарної політики Гонконгу);
- Індії (Резервного банку Індії)
- Польщі (Центрального банку Польщі);
- Сінгапуру (Управління монетарної політики Сінгапуру);
- Південної Африки (Резервного банку Південної Африки);
- Швейцарії (Центрального банку Швейцарії, Федеральної комісії з питань банківської справи Швейцарії);
- Канади (Центральний банк Канада та Офісу суперінтенданта фінансових установ (OSFI));
- Данії (Центрального банку Данії та Управління нагляду за фінансовими установами Данії);
- Південної Кореї (Банк Кореї);

- Норвегії (Управління нагляду за кредитними установами);
- Швеції (Управління нагляду за фінансовими послугами Швеції);
- Японії (Управління нагляду за фінансовими послугами)

Було також отримано певну інформацію щодо організації навчання та розвитку кар'єри персоналу ряду інших країн – в основному через ретельне вивчення зазначених вище сайтів.

Організація функцій навчання та розвитку кар"єр персоналу розглядалася та оцінювалася з урахуванням таких факторів:
- декларовані завдання та цілі щодо навчання та розвитку кар'єр персоналу;
- принципи навчання персоналу;
- організація функції навчання персоналу, навчальні центри.

<u>Декларовані завдання та цілі щодо навчання та розвитку кар'єри персоналу.</u>

Основні декларовані завдання та цілі агентств та служб банківського нагляду різних країн світу можна викласти таким чином:
- необхідність відповідати вимогам середовища, що постійно змінюється;
- необхідність забезпечувати належний рівень знань та навичок персоналу;
- додаткова мотивація та збереження персоналу.

Всі агентства нагляду та центральні банки наголошуються на необхідності навчання персоналу і декларують організоване навчання персоналу як своє пріоритетне завдання. В першу чергу це пояснюється необхідністю підтримувати належний професійний рівень та рівень знань у середовищі, що постійно змінюється.

Крім того, пріоритетним завданням є забезпечення такого рівня знань та навичок персоналу, який відповідав би потребам банківського нагляду та дозволяв їм достойно представляти органи нагляду в банківській спільноті. Це зазначалося на сайтах всіх розглянутих організацій. Програми підготовки персоналу ряду країн передбачають як професійний тренинг, так і навчання методам керівництва та основам менеджменту,оскільки час від часу багатьом наглядовцям доводиться виконувати функції керівників, наприклад, на виїзних інспектуваннях. В першу чергу це стосується служб та агентств банківського нагляду західних країн - Великої Британії, Австралії, Сполучених Штатів (ОСС), Канади, де традиційно велика уваага приділяється принципам роботи "в команді", який передбачає тісну професійну взаємодію як працівників між собою, так і працівників та представників керівництва.

Нарешті, третім найважливішим завданням програм підготовки персоналу є необхідність забезпечення додаткової мотивації та збереження персоналу. Можливість професійного зростання та набуття знань є дуже сильним мотивом для працівників і розглядається керівництвом багатьох наглядових організацій як один із шляхів збереження персоналу та розвитку єдиної для всіх корпоративної культури. Хоча в тій чи іншій формі це декларується майже всіма розглянутими організаціями, слід зазначити, що особливо це завдання підкреслюється службами нагляду країн азіатського регіону (Південної Кореї, Японії, Гон-Конгу, Сингапуру) з їхньою ієрархічною корпоративною культурою, яка надає особливе значення інвестуванню в персонал.

Принципи навчання персоналу.

Спираючись на зібрану інформацію, можна стверджувати, що основні принципи підготовки персоналу, перелічені в "Концепції Комплексної програми з підвищення кваліфікаації працівників банківського нагляду" (Постанова Правління НБУ № 153 від 25.04.2002 року), відповідають світовій практиці. Нагадаємо ці основні принципи: безперервність, уніфікованість, самодостатність, різноманітність.

Загальним для **всіх** розглянутих установ є те, що в тій чи іншій формі вони мають **програми** навчання свого персоналу. Тобто підготовка працівників для роботи на посаді у службі банківського нагляду

- відбувається організовано;
- є обов'язковою для всього професійного персоналу (ми не говоримо про супровідні функції, наприклад, секретарів тощо);
- складається з різноманітних курсів, які включають програми різних рівнів, орієнтації та тематики, а також можуть бути як універсальними, так і спеціалізованими;
- здійснюється на постійній основі;
- поєднує різні типи навчання (у класі, на робочому місці, стажування тощо);
- поєднує різні джерела навчання (як внутрішні, так і зовнішні).

В усіх розглянутих установах існує окрема функція підготовки персоналу служби банківського нагляду. У залежності від того, якими чином організована функція банківського нагляду даної країни, це може бути підрозділ управління персоналу центрального банку або відокремленого наглядового агентства. До того ж в ряді країн існують відділи навчання персоналу у складі підрозділів банківського нагляду центральних банків (наприклад, в Резервному банку Індії).

Професійній працівники служб нагляду всіх країн, які ми розглянули, підлягають спеціалізованій підготовці. У більшості наглядових організацій та служб нагляду центральних банків передбачена підготовка молодих фахівців протягом періоду від одного до чотирьох років. Це цілком відповідає потребам служб нагляду, оскільки банківський нагляд передбачає наявність значної кількості вузькотехнічних знань та навичок, які не вивчають у вищих учбових закладах. Сайти служб нагляду багатьох країн (США, Велика Британія, Австралія, Південна Африка, Канада) містять досить докладну інформацію щодо того, який тренінг необхідно пройти молодим працівникам, щоб розпочати просування по службі та отримати право виконувати завдання відповідного рівня складності.

Програми навчання персоналу всіх розглянутих нами агентств та центральних банків побудовані в залежності від особливостей даної установи. Наприклад, має значення те, чи існує в даній установі спеціалізація за різними напрямками (фахівці в галузі кредиту, інвестицій тощо). Враховуються також особливості організації наглядових функцій – тобто, чи здійснюється виїзний та безвиїзний нагляд різними чи одними і тими ж самими працівниками, чи існує в установі окремий підрозділ методології або всі методологічні наробки створюються практиками тощо. В залежності від цього навчальні програми, які пропонуються різним категоріям працівників, можуть відрізнятись одні від одних, або бути універсальними.

Таким чином, в деяких країнах політика щодо навчання персоналу орієнтована на підготовку фахівців універсального типу в поєднанні з певною кількістю працівників, які мають спеціальні знання в певній області (наприклад, в Австралії, Канаді, Данії, США, Японії, Великій Британії,), інші країни наголошують на орієнтації на спеціалізацію їхніх працівників (Швеція, Сінгапур, Норвегія). В залежності від цього різні організації можуть приділяти особливу увагу уніфікованій підготовці фахівців, коли всі працівники зобов'язані пройти через певну кількість універсальних курсів і бути у змозі виконувати різні наглядові завдання та заміняти одні одних.

Однак необхідно зазначити, що якими б не були особливості організації програм навчання, для всіх них характерні такі спільні риси:

1) навчання починається з короткого курсу орієнтаційного характеру, який дає новим працівникам загальне уявлення про діяльність установи, після чого всі працівники проходять через інтенсивні та розширені курси більш конкретного характеру, з яких власне і будуються програми підготовки персоналу;
2) програми підготовки персоналу всіх розглянутих установ передбачають наявність ряду рівнів різного ступеня складності;
3) крім курсів спеціального технічного характеру, програми навчання персоналу всіх розглянутих установ включають курс щодо підготовки письмової документації та курс щодо підготовки та проведення усних презентацій.

Слід також зазначити, що навчання персоналу є постійною функцією в усіх агентствах та центральних банках, про які йде мова. Більшість агентств декларує на своїх сайтах, що навчання персоналу є безперервним процесом (Велика Британія, США, Австралія, Канада, Японія, Індія тощо), оскільки професійні знання та навички наглядовців повинні відповідати змінам, які весь час відбуваються в банківському секторі та в економіці взагалі.

Всі професійні програми підготовки персоналу поєднують навчання в класі (в основному у формі семінарських занять) з підготовкою на робочому місці. Всі наглядові агентства також намагаються забезпечити стажування (часто за кордоном) для якомога більшої кількості своїх працівників. Стажування за кордоном особливо заохочується агентствами країн азіатськього регіону (Індії, Південної Кореї, Сингапуру, Гон-Конгу) та скандинавських країн (Норвегії, Данії). У той самий час агентства банківського нагляду більшості західних країн самі активно пропонують стажування своїм колегам із-зі кордону (США, Південна Африка, Велика Британія, Швейцарія). Крім того, заохочується самопідготовка персоналу, для чого в багатьох організаціях пропонуються дистанційні учбові програми (США, Велика Британія, Швейцарія, Японія).

Всі розглянуті агентства нагляду та центральні банки, організуючи функцію навчання своїх працівників, покаладаються як на зовнішні, так і на внутрішні джерела. Принцип самодостатності використовується дуже широко і майже в усіх органах нагляду. Це зрозуміло, зважаючи на високо спеціалізований характер діяльності банківських наглядовців. Багато наглядових організацій підкреслюють, що їхні програми підготовки персоналу спираються в першу чергу на внутрішні ресурси, коли досвідчені працівники навчають менш досвідчених (Австралія, США, Велика Британія, Швеція, Японія тощо).

Проте слід також зазначити, що широко практикуються і стажування, прослуховування місцевих та міжнародних семінарів за участю фахівців різних профелів – викладачів університетів, коледжів та тренингових центрів. До участі в підготовці персоналу також залучаються банкіри (США, Австралія, Південна Африка, Канада, Японія, Індія).

Навчальні центри.

Ще однією особливістю, яка спостерігається в організації навчання персоналу різних країн, є наявність центрів підготовки персоналу. Ці центри орієнтовані як правило на різноманітні форми навчання. В них можуть проходити підготовку працівники різного рівня, починаючи від вищих керівників і закінчуючи молодими працівниками з різних регіонів країни.

Крім того, на базі деяких центрів також організовані спеціалізовані програми підготовки випускників відповідних вузів з метою їхнього подальшого наймання на роботу в центральному банку або в органі нагляду. Такі схеми працюють, наприклад, у Великій Британії, Південній Африці, Австралії, США. Вони можуть бути розраховані як на два-три роки, так і на більш короткий період (від 5-6 місяців до одного року). Як правило, на подальшу роботу запрошуються найкращі слухачі подібних курсів після успішно зданих іспитів. По суті, багато таких центрів за своїм характером поєднують функції вищого учбового закладу, де готують фахівців у галузі банківської справи, та навчальної установи центрального банку та/або органу банківського нагляду. Багато навчальних центрів навіть називаються коледжами і були створені саме з такою метою (наприклад, в Індії).

У Сполучених Штатах органи нагляду створили спільний для всіх навчально-методологічний центр під назвою Рада питань інспектування федеральних фінансових установ (Federal Financial Institutions Examination Council). Мета цієї організації – вироблення спільних для всіх наглядових агентств підходів та навчання їхнього персоналу з урахуванням цих підходів. Рада пропонує свої послуги щодо підготовки персоналу служб нагляду не лише у Сполучених Штатах, але і деяким іншим країнам. Наприклад, там проходять навчання також працівники органів банківського нагляду Канади.

Взагалі навчальні центри центральних банків та агентств банківського нагляду багатьох розвинених країн є міжнародними за своєю суттю, оскільки пропонують багато навчальних програм для наглядовців зарубіжних країн, причому як для керівного складу, так і для фахівців. Такими є навчальні центри Центр досліджень з питань діяльності центральних банків (Center of Central Banking Studies) у Великій Британії, коледж Резервного банку Південної Африки, який обслуговує ряд африканських країн, навчальний центр Національного банку Швейцарії тощо. Окремо відстоїть навчальний центр у Торонто, основний фокус діяльності якого – навчання саме керівного складу служб банківського нагляду країн світу.

Лише кілька років тому за сприяння Агентства розвитку Сполучених Штатів Америки було створено навчальний центр при Національному банку Польщі. Центр було створено в першу чергу з метою найбільш ефективного використання досвіду, накопиченого службами нагляду Польщі та інших країн східноєвропейського регіону та колишнього СРСР.

Унікальною особливістю навчального центру Національного банку Польщі є те, що його програми призначені в першу чергу для навчання не керівного складу, а фахівців-наглядовців, як відповідають за ефективне запровадження наглядових стандартів та методологічних розробок, здійснення повсякденного нагляду за банківськими установами та роботу з проблемними банками в країнах східноєвропейського регіону.

Курси, які викладають в навчальному центрі Національного банку Польщі, зазвичай мають практичний характер і побудовані так, щоб запропонувати слухачам щось більше, ніж просто теорія та загальновідомі практичні приклади. Оскільки ці курси створені для досвідчених працівників-практиків, практичні завдання, які розв"язуються на них, мають підвищений рівень складності, що відрізняється від їхньої щоденної рутинох роботи. Таким чином, вузько технічний характер семінарів зумовлює унікальність польського навчального центру, призначення якого - навчання саме досвідчених фахівців, а не ані керівництва, ані молодих працівників.