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**Transparency and Disclosure by  
Ukrainian Banks 2010:  
*Decline in Transparency amid Financial  
Difficulties and Flawed Disclosure Infrastructure***

**Joint Research of the Financial Initiatives Agency  
and Standard & Poor's**

*with support from USAID Capital Markets Project*

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*The USAID Capital Markets Project (CMP), launched by Financial Markets International, Inc. (FMI) in 2005, is designed to assist Ukraine in developing a vibrant and effective financial sector. The project's activities address various aspects of Ukraine's capital markets, including the strengthening of competencies of regulators, implementation of pension reform, development of stock market infrastructure and creation of new financial instruments for portfolio investors.*

## *Executive Summary*

The transparency index, calculated as an average score for the 30 largest Ukrainian banks, fell 6.1 percentage points (p.p.) in 2010 to 42.7% as access to reports filed with regulators became more restricted, primarily due to the flawed disclosure infrastructure in the stock market, together with a significant decline in the volume of financial and operating information. The overall regulatory filings disclosure score declined 22.5 p.p. to 31.2%, and the overall ranking for the Financial and Operational Information category fell to 37.5%, 10.5 p.p. below the previous year's score, and the lowest in the history of this research.

The cumulative change in the transparency index from 2006 through 2010 adds up to an increase of just 0.8 p.p.<sup>1</sup>. But, over these five years, the index has moved in different directions this masks significant volatility over that time.

Across the 28 banks included in this research this year and last, the transparency index was down by 5.7 p.p. to 43%, with just eight banks from the sample demonstrating greater transparency, with an average improvement of some 4.8 p.p., and the other 20 showing a weaker performance, falling 9.9 p.p. The effect of structural changes in the sample this year, with the replacement of two banks, proved to be negative as the average transparency score for the two banks removed from the list was higher than that of the two added.

Some banks in the sample that, for reasons of financial problems, were in temporary administration introduced by the National Bank of Ukraine (NBU) during 2009-10, also had an adverse effect on the overall transparency index. As a result of their financial difficulties, these banks did not have a full corporate governance system and did not provide the full disclosures essential for investors.

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<sup>1</sup> Unadjusted for the effects of the research methodology change in 2007.

The difference in transparency between leaders and laggards is still significant and even widened compared with last year, from 43.9 p.p. in 2009 (the highest score: 71.4%, the lowest score: 27.5%) to 45.8 p.p. in 2010 (highest: 65.1%, lowest: 19.3%). The median index for the sample dropped from 51.2% in 2009 to 40.4% in 2010.

The average score of the top 10 banks also fell, to 54.9%, 6.5 p.p. below last year. There have been significant changes in the top three banks since 2009. VAB Bank proved to be the most transparent for the second consecutive year, with a score of 65.1%, albeit down 6.4 p.p. compared with 2009. The First Ukrainian International Bank (PUMB) was second, with a score of 60.9%, adding 5 p.p. to its result from last year. In third place, with a score of 60.3%, was the largest Ukrainian bank, PrivatBank, despite the fact its score fell 1 p.p. versus 2009. The two banks that ranked second and third last year – Forum Bank and Ukrgazbank – failed to even make the top 10 this year.

The study showed disclosure was greatest in “Ownership Structure and Shareholder Rights”: 56.3%, although this is weaker than last year, by a marginal 0.3 p.p. There was an improvement in the transparency of “Supervisory Board and Management Structure and Processes” information. An average increase of 1.2 p.p. for this category in the current financial and economic situation, giving a cumulative figure of 18.7 p.p. over the five years, can, in our view, be described as a significant achievement. The most noticeable change was the deterioration in transparency for the “Financial and Operational Information” category, down to 37.5% in 2010 from 48%. Bank web sites were recognised as the most comprehensive source of information about Ukrainian banks, providing 44.7% of meaningful information for investors. Last year’s transparency leader among sources of information, “Regulatory Filings”, took second place this year, with a score of 31.2%. This transparency score has proved highly volatile in the past, ranging from 21 p.p. to 26 p.p. through 2008, but then achieving a score of 53.7% last year.

Since 2007 we have observed a weakening in the transparency of bank annual reports. This year, out of our sample only one bank in three prepared an annual report and made it publicly available. As a result, the informative value of this source declined by 3.5 p.p. compared with last year, and over five years by 9.6 p.p. On average, out of the sample, annual reports provide investors with just 13.9% of essential information. The overall informative value of annual reports, calculated as an average score for banks that prepared such reports, was 41.7%.

### ***Sample of Banks Studied and Their Role in the Ukrainian Banking System***

This research covers the 30 largest Ukrainian banks by net asset value (NAV) as of July 1, 2010 (see Table 1). There have been minor changes in the sample — Ukrprombank and Kredobank have been replaced with Kreshchatyk Bank, formerly in the sample in 2007 and 2008, and Sberbank of Russia’s Subsidiary Bank, which makes its debut in the sample.

**Table 1**  
*Banks Analysed and Their Parameters*

	Bank	Net assets as of July 01, 2010 (in US\$ mln.)*	Publicly traded Eurobonds	Other publicly traded bonds	Inclusion in stock indices
1	PrivatBank	12.330	Yes	Yes	
2	Ukreximbank	8.356	Yes	No	
3	Oshchadbank	7.431	No	Yes	
4	Raiffeisen Bank Aval	6.829	No	Yes	PFTS, UB
5	UkrSibbank	5.661	Yes	Yes	
6	Ukrsotsbank	5.398	No	Yes	PFTS, UB
7	VTB Bank	3.775	No	Yes	
8	Prominvestbank	3.624	No	No	
9	Alfa-Bank	3.436	Yes	Yes	
10	OTP Bank	3.389	No	No	
11	Nadra	2.891	Yes	No	
12	Financy i Kredit	2.808	Yes	No	
13	Forum	2.164	No	Yes	UB
14	First Ukrainian International Bank (PUMB)	2.156	Yes	Yes	
15	Brokbusinessbank	1.968	No	Yes	
16	Kreditprombank	1.749	No	Yes	
17	Svedbank	1.562	No	Yes	
18	Rodovid Bank	1.413	No	Yes	
19	Ukrgazbank	1.770	No	Yes	
20	Pivdennyi	1.324	Yes	Suspended	
21	Erste Bank	1.265	No	Yes	
22	Universal Bank	1.176	No	No	
23	ING Bank Ukraine	1.147	No	No	
24	Dongorbank	1.113	No	Yes	
25	UniCredit Bank	1.107	No	No	
26	Delta	1.032	No	No	
27	VAB Bank	900	No	Yes	
28	Sberbank of Russia Subsidiary Bank	898	No	No	
29	Pravex-Bank	849	No	No	
30	Kreshchatyk	816	No	Yes	

\* "Net assets" are a bank's gross assets less certain contra-asset items (reserves, discounts, etc.).

This sample of 30 banks plays a critical role in the national banking system; it represents just over 80% of sector NAV, over 81% of corporate loans and almost 87% of retail loans as well as 73% of funds raised from legal entities and 83% from individuals. This group of banks also controls two-thirds of Ukraine's banking capital.

The sample includes banks with private Ukrainian capital, state-owned banks, some recapitalised with state participation<sup>2</sup>, and subsidiaries of foreign bank groups. This, in our view, makes the sample representative in terms of covering different corporate governance practices and banking cultures.

This year's sample is characterised by another important factor: 20 of the constituents made net losses in 2009<sup>3</sup>, compared with only one in 2008. Although this had fallen to 10 at end-June 2010 (of which 8 were in the red at both reporting dates), a possible decline in transparency due to financial difficulties was already widely expected investors and other interested parties.

Since all banks in the sample complied with Ukrainian law regarding transformation into public joint stock companies, unlike previously we have not analysed free float. From now on, we will note the inclusion of the sample banks' shares in the indices of the two major exchanges in Ukraine: First Stock Trading System (PFTS) and Ukrainian Exchange (UB). Just three banks were included this year, versus two in 2009. It should be noted that, other than these banks, no other financial and banking sector issuers are on the index lists of the above exchanges. Seven banks issued publicly traded eurobonds. Eighteen out of the 30 also issued bonds in the domestic market. Several have ADRs; however, these instruments trade over-the-counter and are not subject to the stringent requirements of foreign exchanges, and their transparency levels are determined by different factors.

## *Research Methodology*

This research was based on the methodology developed by Standard & Poor's Corporate Governance Services. The methodology is based on the principle of full and timely disclosure of all information essential for investors and other stakeholders (analysts, clients, etc.).

Our questionnaire comprises 116 items divided into three categories:

- Block 1: "Ownership Structure and Shareholder Rights"; 28 criteria
- Block 2: "Financial and Operational Information"; 64 criteria
- Block 3: "Supervisory Board and Management Structure and Processes"; 24 criteria

The full list of criteria is given in Appendix I.

The methodology involves the examination and analysis of generally available information contained in three main sources:

- Annual reports
- Official web sites of the banks
- Public regulatory filings consisting of open-access information provided to the NBU, the Securities and Stock Market State Commission (SSMSC), stock exchanges, or published by the banks in accordance with the requirements of these bodies. This source also encompasses information included in prospectuses for securities (bonds, ADRs and GDRs) issued after January 1, 2010.

<sup>2</sup> Under Ukrainian law, the state-owned bank is a bank whose 100% of equity is owned by the state. However, none of the recapitalized banks are compliant with this requirement; that is why, they are grouped separately.

<sup>3</sup> Here and throughout the text, the fact of loss-making is established based on the official summary information from financial statements of banks published by NBU.

In our weighting system, public disclosure, regardless of the source through which it has been made, yields 80% of the maximum score on each point of the questionnaire. The remaining 20% is awarded if this information is also available from two other sources (10% each). This scoring system reflects the theory that replication of information across multiple sources is valuable to investors as it makes the information more easily accessible. The value of replication is, however, incremental compared with the fact of disclosure.

This survey analyses disclosure from the perspective of the international investor, an approach factored into the survey's criteria. It also recognises disclosure provided in English. The total score for a bank's transparency is defined as a percentage of the maximum possible degree of disclosure, as established by the list of criteria.

We have analysed information that was publicly available as of August 1, 2010. Information published after this date was considered irrelevant for the assessment of transparency related to 2010 results. The cut-off period was reduced by one month compared with last year to move closer in line with similar research practices in other countries and therefore make the results more comparable. Indeed, last year we extended the cut-off period up to September 1 in order to allow for uncertainties relating to the banks in temporary administration.

As in 2009, the transparency index value is calculated for all 30 banks, as are statistics on the breakdown of disclosure by component and by information channel. Our study discloses individual scores of only the 10 highest-scoring banks.

## Key Research Findings

### Substantial Drop in Transparency Index

For the first time in the five years of our research, we found a worsening transparency situation in practically all information blocks and for all sources. Additionally, for the first time the performance of the highest-scoring banks had deteriorated year-on-year.

**Table 2**  
*Transparency Score of Ukrainian Banks, 2010*

2010 ranking	2009 ranking *	Bank	Score, %	Ownership Structure and Shareholder Rights, %	Financial and Operational Disclosure, %	Supervisory Board and Management Structure and Processes, %	Score in 2009, % and change (↑ or ↓) *
1	1	VAB Bank	65.1	83.7	58.8	60.3	71.4 (↓)
2	10	PUMB	60.9	66.1	61.2	52.3	55.9 (↑)
3	5	PrivatBank	60.3	67.0	60.0	51.5	61.2 (↓)
4	—	OTP Bank	58.8	68.2	58.5	47.6	—
5	7	Raiffeisen Bank Aval	58.8	75.4	54.2	52.4	57.1 (↑)
6	—	UniCredit Bank	51.4	60.5	50.4	41.0	—
7	4	Ukreximbank	50.8	63.0	51.0	33.9	62.1 (↓)
8	6	Ukrsotsbank	49.7	72.0	42.4	42.1	57.4 (↓)
9	—	Financy i Kredit	46.9	64.7	41.5	41.0	—
10	—	UkrSibbank	46.1	55.7	44.4	38.7	—
Top ten average			54.9	67.6	52.2	46.1	61.3 (↓)
Whole sample average			42.7	56.3	37.5	42.2	48.8 (↓)

\* «—» indicates that in 2009 the bank was not scored in the top 10 for transparency

An analysis of the research findings by block reveals that the “Ownership Structure and Shareholder Rights” block again led in terms of transparency in 2010: 56.3% (in 2009 this block scored 56.6%. The Financial and Operational Information transparency block score fell to 37.5% (from 48% in 2009). The score of this block went down across absolutely all disclosure sources. Only “Supervisory Board and Management Structure and Processes” within the category bucking the declining trend. In 2010, the transparency index for this block rose to 42.2%, up 1.2 p.p. on last year.

**Table 3**  
*Degree of Informative Value of Various Sources*

Disclosure source	2010 score, %	Ownership Structure and Shareholder Rights, %	Financial and Operational Information, %	Supervisory Board and Management Structure and Processes, %	Score, %	
					2009	2008
Annual reports	13.9	20.0	13.0	8.7	17.4	24.8
Websites	44.7	59.0	42.3	32.7	44.6	43.1
Regulatory filings	31.2	41.2	12.3	40.2	53.7	26.0

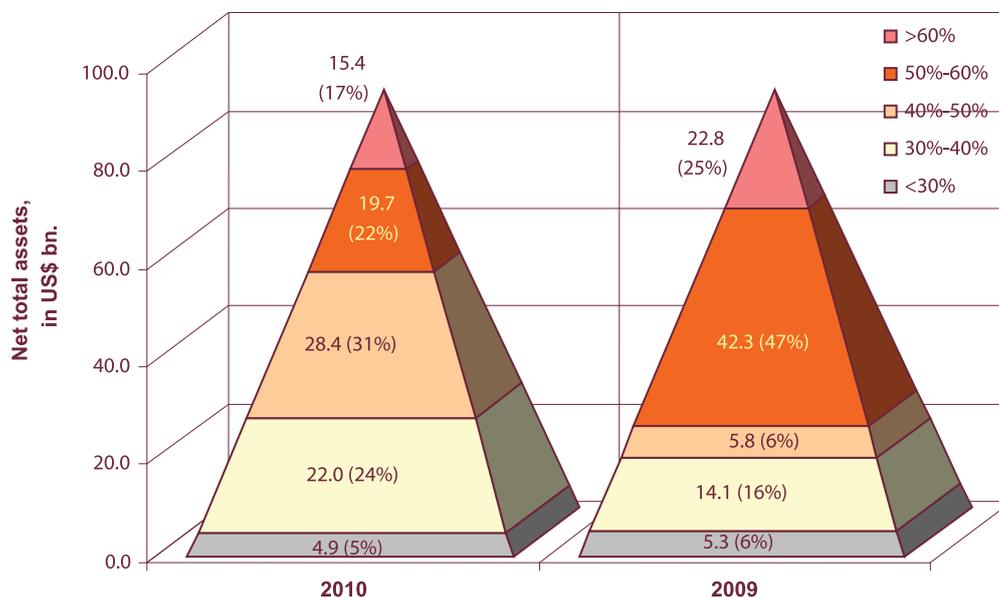
We found bank web sites were the most complete source of information about Ukrainian banks in the research. We observed slow but steady progress of this information source: this year, web sites provided 44.7% of meaningful information for investors, which is 0.1 p.p. more than last year. Over five years of research, the cumulative increase for this source is 3.78 p.p., with investors now able to find 59% of the necessary information on ownership structure and shareholder rights from this source, which is the best score among informational blocks.

Regulatory filings, recognised as the best information source last year, ranked second this year, with a score of 31.2%, a sizeable 22.5 p.p. below last year's result. Given the transparency of this information source at 26% in 2008, it may be concluded that a surge in transparency of this source in 2009 did not transform into a clear trend. Information on the Ownership Structure and Shareholder Rights and the Supervisory Board and Management Structure and Processes blocks scores fairly evenly – 41.2% and 40.2%, respectively. We observed a record-low level of financial and operational disclosure, scoring just 12.3%, versus 51.3% in 2009.

Annual reports, traditionally an image-making product rather than meaningful component of transparency, were given an average disclosure score in the sample of just 13.9% this year. Although this source has never contained more than 25% of the information essential for investors, we have observed a steady decline in transparency since 2008. Annual reports scored highest for disclosure in Ownership Structure and Shareholder Rights (20%) and lowest in Supervisory Board and Management Structure and Processes (just 8.7%).

Banks scoring above the 50% threshold overall account for 39% of total net assets in the sample, barely half of last year's 72% in 2009 and down on the 43% in 2008. As in the two previous years, just three banks scored higher than 60%; however, not one single bank scored more than 70% this year (compared with one last year and none in 2008). This would imply last year's results revealed a transparency “surge” rather than a sustainable change. Banks scoring less than 30% account for 5% of total assets in the sample (6% in 2009 and 5% in 2008), while the actual number of banks in this group has remained unchanged for three years at two banks.

**Chart 1**  
*Disclosure Pyramids for Ukrainian Banks*



We note that divergent changes in the transparency index gave way to a period of clear regression this year. In addition to a decline in transparency indices observed across sources and disclosure blocks, the imbalance in informative value degrees remains. This year, a gap between the most informative and the least informative sources exceeded 30 p.p., and by information block 50 p.p. This compared with 35 p.p. and 53 p.p., respectively, last year. In fact, the relative balance of source transparency achieved last year proved unsustainable.

### *Drivers of Transparency Index Drop*

In the course of 2009's research, we saw that apparent pessimistic investor expectations with respect to transparency failed to materialise. The annual transparency index rose almost 4 p.p. in 2009. Nonetheless, that year we also noted fewer banks published annual reports and financial statements prepared under International Financial Reporting Standards (IFRS). This has an adverse impact on individual transparency scores, and hurts the summary statistics.

Continuing the recent trend, in 2010, the number of banks in the sample that prepared and presented annual reports in any form declined to 10 (2009: 14; 2008: 18), while, separately, the number of banks that published IFRS financial statements<sup>4</sup> also fell to 10 (Chart 2). In other words, as of the cut-off date, two out of three banks in the sample did not use an annual report as a communication channel with existing and potential investors or did not present financial statements in the internationally accepted format.

<sup>4</sup> Besides, two more banks mentioned the preparation of financial statements under IFRS in the structure of their annual reports on [www.stockmarket.gov.ua](http://www.stockmarket.gov.ua); however, we could not find such financial statements either on the banks' web sites or in their annual reports. We have already observed a similar situation in 2007 when 17 out of 30 banks announced that they would prepare financial statements under IFRS, but just 12 banks were actually able to make them publicly available as of the cut-off date.

**Chart 2**

*Changes in the Transparency Index and the Number of Banks That Prepared Annual Reports and IFRS Financial Statements*



In the course of our research, we put forward and tested a hypothesis on the existence of a correlation between a bank's loss-making position and its transparency level. However, the average transparency level of the eight loss making banks was actually broadly equal to that of those banks that reported a profit in 2009: 42.5% and 42.8%, respectively. That said, the average score of those eight banks that had also made losses in 2009 was 4.7 p.p. below the average for the other banks in the sample, falling to 43.7% vs. 48.3%, according to the first two quarters' results in 2010. Given these facts and that, in 2010, six out of 10 top banks for transparency made losses as of the beginning of the year, we cannot assert that the existence of losses had a substantial impact on transparency, although there is a slight correlation.

We are inclined to explain a general deterioration in Ukrainian banks' transparency in 2010 by:

- A decline in the number of banks issuing eurobonds: Out of the 30 banks analysed, 11 had eurobonds outstanding in 2007-09, which had fallen to eight in 2010. It should be remembered that in order to have debt securities publicly traded in foreign markets, the issuer must comply with various standards and disclosure requirements. In our previous research we noted that banks entering foreign borrowing markets scored higher for transparency than those that did not. With fewer eurobond issues, it has followed that the level of bank disclosure has deteriorated (because such disclosures are not required for other purposes).
- Changes in the stock market transparency infrastructure. Although requirements for the content of disclosures are standard, technological features of the operation of information agencies and their projects often vary greatly from agency to agency. For example, the Stock Market Infrastructure Development Agency of Ukraine (SMIDA) used to post its information primarily on [www.smida.gov.ua](http://www.smida.gov.ua), the web site that allowed the disclosure to be posted in several languages, with hyperlinks to other sources, mostly bank web sites. In the past, banks often used the option of establishing direct links from the SMIDA web site to specific documents on their own intranet pages, which we welcomed from the

perspective of our methodology<sup>5</sup>. In 2010, the SMIDA began to post issuers' information on another portal - [www.stockmarket.gov.ua](http://www.stockmarket.gov.ua), which, unfortunately, in our view still lacks the appropriate level of technological support for transparency: the web site has only one language version (Ukrainian), does not support the hyperlink mode, and any search for an issuer is based on its state registration code rather than its name. We believe these changes were the main reason for a decline in transparency of the regulatory filings source.

The web sites of the two largest Ukrainian exchanges, PFTS and the Ukrainian Exchange, contain hyperlinks only to the abovementioned information portals (directly to bank pages), but do not provide any additional information on issuers. Another stock market information resource, the ESCRIN System, created with support from the USAID Capital Markets Project and transferred to the SSMSC in August 2010, is still accumulating information (only two out of the 30 banks are currently incorporated).

- Weakening administrative incentives that would encourage greater transparency. Based on the results of our previous research, we acknowledged a positive role of banking and stock market regulators in providing transparency, specifically the preparation and communication to banks of requirements for the content and publishing deadlines of regular and ad hoc information. The NBU's efforts last year, in particular in introducing the amended Financial Reporting Regulations, did not yield effective results in improving transparency of banking institutions, although they did bring reporting closer to IFRS. Unfortunately, the NBU has not initiated the establishment of a centralised repository of annual and quarterly data, and the amount of information on specific banks on the regulator's web site is unchanged. Finally, a decline in foreign borrowings "exempted" some of the reviewed banks from the need to provide disclosures under the standards of foreign exchanges and trading platforms, which can be described as a "technical" diminution of the administrative incentive.
- Earlier cut-off date – August 1. In the course of our previous research, we highlighted that some Ukrainian banks only complete the preparation of annual reports at the end of August. Such practices are not acceptable to investors, because, according to international best practice, an annual report and, all the more so, audited financial statements, must be prepared before the shareholders' meeting. A delay of eight months after the balance sheet date, especially in an unstable economic environment, makes information in such dated documents irrelevant.
- The decision of some banks not to publish annual reports. In our opinion, this is a factor of financial problems. If we concluded earlier that there is only a slight difference between general levels of transparency at loss-making and profitable banks, we found a real correlation between of the business being loss-making and the absence of an annual report: just 6 out of 20 banks in our sample that made losses in 2009 produced annual reports. From the investor's perspective, such practices are not acceptable: this selective representation distorts the true view of these banks, and results in the absence of a database with guaranteed access for decision-making purposes.

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<sup>5</sup> See the Research Methodology section for more details.

A distinctive feature in 2010 disclosure practices was that the sample included banks recapitalised by the state (Ukrzazbank and Rodovid Bank), and one in temporary administration (Nadra). A unique situation in the corporate governance system, a temporary administrator assumes the functions of the bank's governing bodies, complicating the assessment of information pertaining to the supervisory board and management procedures and effectiveness.

This year, we saw no pronounced trend in economic transparency incentives. Public trading of stocks and corporate bonds of analysed banks, which requires issuer disclosures, did not have a substantial impact on transparency, because this information was available only in Ukrainian and only under Ukrainian national accounting standards. We believe the steady increase in retail deposits in 2010 reflects the absence of alternative saving instruments for the general public, among other things, rather than a marketing drive by the banks, supported by returning confidence as transparency has improved. Also, bank actions to expand the retail banking segment proved to be asymmetric: amid an individual deposits increase of 23% during 2009, loans to individuals dropped 13%. Due to poor financial literacy and the lack of confidence in financial statements, banks used pricing, rather than transparency, as a competitive advantage.

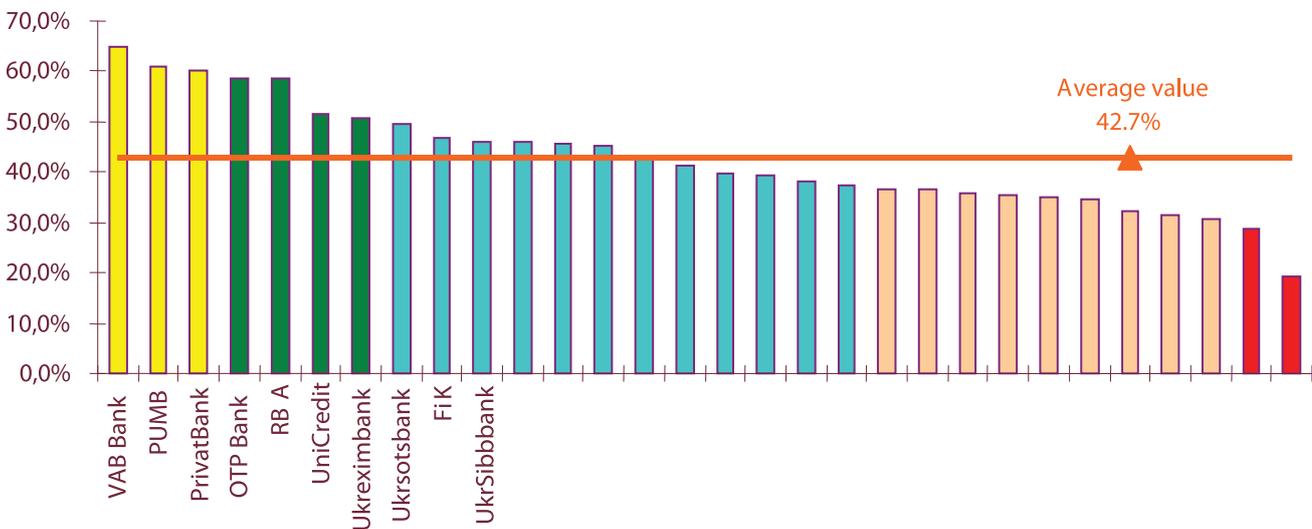
In this environment, we believe the authorities have missed an opportunity to strengthen regulatory actions launched in previous years, for example, publication on the NBU's web site of not only quarterly information about also the assets, liabilities, equity and financial performance of each bank, but also official quarterly and annual financial statements, complete with notes and the auditor's opinion.

### *Changes Vs. Previous Research*

In the overall rankings, we can see significant changes in the top the three banks compared with last year (see Chart 2); only one of the triumvirate retained its place, whereas the other two other failed to even make it into the top 10.

#### **Chart 3**

*Bank Distribution by Information Transparency, 2010*



## Leaders

Like last year, VAB Bank came out on top with 65.1%, despite its score falling 6.4 p.p. from 2009.

VAB Bank's highest score was in "Ownership Structure and Shareholder Rights", reflecting the bank's affiliation with an international financial group (over 80%). Nevertheless, there is still significant room for improvement in disclosure practices, given it scored only 60% in "Financial and Operational Information", and marginally higher for "Supervisory Board and Management Structure and Processes".

PUMB ranked second, with an overall score of 60.9%, up 5 p.p. on 2009, having just made the top 10 last year. The bank improved its scores in "Ownership Structure and Shareholder Rights" and "Supervisory Board and Management Structure and Processes" after making full disclosure of the group structure and operating procedures of its corporate governance bodies. The bank's "Financial and Operational Information" score was unchanged from last year's, despite the reduction in time to prepare reports and provide timely interim reports to users.

The largest Ukrainian bank, PrivatBank, placed third, with 60.3%, which is almost 1 p.p. below last year's result. Nonetheless, this performance was enough to see the bank leap from fifth to third place. Privatbank has increased the level of disclosures in terms of "Ownership Structure" (the annual increase was 8 p.p.) primarily due to the preparation of its first full annual report in English. However, there has been an overall decline in transparency, mainly because the Regulatory Filings source provided less information than 2009.

## Upper-Middle Category

If, last year, the upper-middle category included banks with transparency scores of over 55% (of which there were seven), in 2010 we had to lower the bar to 50% (as a result of a 6.1 p.p. drop in overall transparency). Nevertheless, even with a lower "pass score", just four banks can now be included in this category: OTP Bank, Raiffeisen Bank Aval, UniCredit Bank and Ukreximbank.

We discussed these banks in our previous research, and some of them were included in the top 10. Nonetheless, we believe these banks, like others in the sample, have significant room for improving transparency. This is especially true of banks that are part of international entities, because their transparency level is, year after year, weaker than that of their parent or holding companies.

## Research Findings by Disclosure Category

### "Ownership Structure and Shareholder Rights" Category Findings

This category scored highest in the transparency rankings for the second year in a row, despite a 0.3 p.p. decline y-o-y, to 56.3%. The breakdown of the component scores by information source was more balanced in 2010, with web sites awarded 59% and regulatory filings moving back into second place, with 41.2%, shedding over 20 p.p. compared with last year. Annual reports, which contain just one-fifth of expected information, are the least informative source. The range of scores for this category is also the greatest – over 53 p.p. (from 30.6% to 83.7%).

Overall, we believe the banks' web sites contain sufficient disclosure of the amounts, classes and par values of outstanding common shares, descriptions of classes of shares; holders of significant stakes (more than 10%); and the latest corporate events in the form of press releases. Information on stakes held by individual managers and supervisory board members is more limited. Disclosure of the most recent shareholders' meeting is incomplete, with banks often limiting the detail to a brief news item or just confirmation that a meeting was held. The list of external assets owned by holders of blocking stakes is disclosed mostly by large international groups. There is virtually no disclosure of cross-shareholdings and declared dividends. Although disclosure of Codes of Corporate Governance and Ethics has improved compared with last year, it is still lacking. In some cases it is still difficult to determine the group to which a particular bank belongs.

We conducted an additional ad hoc analysis of the banks' ownership structure transparency, specifically disclosure of ultimate owners.

By virtue of regulatory requirements, all banks provided disclosures of all shareholders that own a stake of more than 10%. Out of the 30 in this sample, 13% are owned by the state, 10% by other governments, and the remaining 77% are privately owned. Our analysis suggests that ownership concentration in Ukraine's banking sector is extremely high: we found a single shareholder's stake of over 75% of equity in 70% of the banks in the sample. However, this did not have a substantial impact on disclosure of ultimate ownership, since 33% of these banks are partially state-owned and 48% are subsidiary banks of large international entities. Generally, it is these entities that provide largest disclosures.

This year, 25 out of the 30 banks gave information on their ultimate owners, which is one bank less than last year. All 25 disclosed the information through their web sites, and seven replicated this information in all three information sources. Information on ultimate owners is traditionally provided by banks that have government capital, subsidiary banks of international groups that are actively using hyperlinks to parent company web sites, and banks directly owned by individuals. Other banks limit their disclosures to information on direct nominal owners that are little-known companies.

### *“Financial and Operational Information” Category Findings*

The disclosure score for this category was just 37.5%, the weakest performance across all categories and down 10.5 p.p. on 2009 (when it was up 1.5 p.p.). The reasons for such a negative change were a decline in the number of banks preparing financial statements under IFRS and a decline in the amount of information published under the Regulatory Filings source.

As was the case last year, the range of scores proved to be very wide: from 8.1% to 61.2%. While a smaller range than under Ownership Structure and Shareholder Rights, it still highlights the disparities in disclosures.

On a more general note, the following categories of information scored highest (aggregate score above 60%):

- Statements filed with the NBU (under Ukrainian accounting standards) that disclose an audit firm and contain the independent auditor's opinion;
- Bank accounting policies, including asset valuation methods;

- Capital adequacy, reserves and liquidity status information, compliance with bank regulations, concentration indicators;
- Asset quality information;
- Analysis of various banking risks, describing risk management policies.

Disclosure is also fairly comprehensive in terms of bank products and services, physical volumes, industry regulatory environment reviews, segment analysis and detailed itemisation of bank income and expenses, and rates for loans and deposits.

We note fairly comprehensive disclosure here is as important to investors as the interim statement category. Many banks replicate on their web sites information published in accordance with the Law of Ukraine on Banks and Banking in the official media: *Holos Ukrayiny* and *Uriadovyi Courier*.

Nonetheless, disclosure on matters pertaining to forecasts is lacking. Also the level of disclosure of bank products and services, as well as the disclosure of market share, has declined since our previous report. None of the banks in the sample disclosed auditor compensation or any related services provided by auditors.

We analysed ad hoc the disclosure of asset quality, specifically, any given bank's loan portfolio. We established that the investor can also obtain this information from several independent sources:

- Audited annual financial statements of banks both under national and international standards. A note to the annual statements that contains the analysis of a bank's loan portfolio and information on non-performing and bad loans by type of counterparty, borrowing currency, classification category, etc. However, with all its meaningful information, this source has a major drawback: it is sporadic at best (once a year) and publication can be delayed (more than three months).
- In compliance with Ukrainian law, banks publish quarterly statements prepared under Ukrainian accounting standards (UAS) in the *Holos Ukrayiny* and *Uriadovyi Courier* newspapers and will often replicate the release on the web. Required notes to financial statements contain information on the composition of the bank's loan portfolio broken down into five classification categories as per banking supervision standards. This allows investors to assess the amount of loans outstanding in each category and, separately, reserves built against them. However, this information is not broken down by borrower type (individuals or legal entities).
- Banks' financial statements that include information on assets are published by the NBU on its web site, broken down by counterparty type. Balances outstanding and reserves built are also provided. However, this information will not allow investors to assess debt quality, i.e. the portfolio's breakdown by classification category.

Information from the two latter sources is updated on a quarterly basis, with a delay of up to one month after the reporting date. However, such timeliness of information does not, in our opinion, make up for the lack of structural integrity and completeness, which complicates the loan portfolio quality analysis, which is further exacerbated by a bias of this information toward the Ukrainian language. Few banks provide quarterly statements in English, and, in the English-language version of the NBU web site, summary statements are also given in Ukrainian.

We have also analysed disclosures by banks of discount window loans from the NBU for liquidity purposes (a loan of last resort), which in this instance is only provided in IFRS statements, specifically in the note detailing any remaining borrowings from the national bank. In IFRS statements, banks confirmed receipt of such support, amounts outstanding and applicable rates, as well as subsequent steps taken to repay such debt. In our analysis, this information, essential for investors, was not included in UAS statements.

### ***“Supervisory Board and Management Structure and Process” Category Findings***

Disclosure in this category had been the weakest since 2006. However, over the past three years, we noted positive changes in the transparency index value for this category: an increase of 6.7 p.p. in 2008 and of 8.1 p.p. in 2009. Given a 1.2 p.p. growth in 2010, the transparency level of this category reached 42.2%, which put it in second place. We believe that progress in this category is related to the improvement in corporate governance practices and continued efforts by regulators to encourage bank transparency.

Unlike other categories, but much like 2009, the public sources of regulators proved the most abundant source of information, in aggregate in this category, proving more informative than the banks' web sites, and almost five times the amount of useful information than annual reports.

Disclosure in terms of backgrounds of a bank's supervisory board chairman and executive management was greatest in this category. Information on the role of the supervisory board in the relevant bank's operations and information about supervisory board members and their remuneration were somewhat less transparent. We found the banks have made limited progress toward creating formal corporate governance mechanisms used in international best practice. Several banks disclosed information about the existence of supervisory board committees and independent members on the board. Disclosure of other information, such as terms and conditions of contracts with a bank's senior executives, management remuneration, internal audit regulations, details of individual attendance at supervisory board meetings and meeting formats (in-person or in-absentia meetings), has traditionally been very weak and superficial, and we found remains the case.

## *Related Research*

This study, conducted by the Financial Initiatives Agency and Standard & Poor's Corporate Governance Rating Service with support from the USAID Capital Markets Project, implemented by Financial Markets International, Inc., builds on similar research in Ukraine and other countries. The first T&D study of Ukrainian banks was released in 2005 and has been conducted annually ever since. It should be noted that Standard & Poor's Corporate Governance Rating Service has extensive experience in carrying out such research in different countries.

In 2002, Standard & Poor's published its first transparency and disclosure study of companies selected from the following Standard & Poor's indices:

- S&P/IFC Emerging Asia,
- S&P/IFC Latin America,
- S&P Asia-Pacific 100,
- S&P/TOPIX 150.

In April 2003, Standard & Poor's released the study of the S&P Europe/350 companies. In addition, in 2004 and early 2005, Standard & Poor's published a number of studies devoted to corporate governance disclosure by companies in various countries of the East-Asian region, including Hong Kong, Singapore, Indonesia, Malaysia, and Thailand. In June 2005, Standard & Poor's published the Turkish T&D Survey, which analyzed the disclosure practices of 52 largest Turkish companies with the most liquid stock. This research was updated in 2006.

In 2002, Standard & Poor's published its first survey of T&D by the largest Russian public corporations. As a result of the continued interest among investors and analysts, Standard & Poor's has been updating its Russian corporate survey and continuously developing the methodology. The latest annual update of the corporate T&D survey was published on Oct. 21, 2009. In 2005, Standard & Poor's Corporate Governance Rating Service released its first T&D survey on Russian banks. The study was updated in 2006 and in 2007 because of the interest among investors and analysts. The T&D study of 300 Chinese companies was first conducted in 2008 and the study of 30 largest Kazakhstani and 56 largest Brazilian companies – in 2009.

## *Appendix I*

### *List of Assessment Criteria*

#### *Block 1. Ownership Structure and Shareholder Rights*

##### **Component 1. Ownership Structure and Group Structure**

1. The number and par value of issued ordinary shares.
2. The number and par value of other types of issued shares (e.g., preferred, nonvoting).
3. The number and par value of authorized but unissued shares of all types.
4. The identity of the largest shareholder.
5. The identity of holders of all large stakes (blocking: > 25%; controlling: > 50%).
6. The identity of shareholders holding at least 25% of voting shares in total.
7. The identity of shareholders holding at least 50% of voting shares in total.
8. The identity of shareholders holding at least 75% of voting shares in total.
9. The number and identity of all shareholders holding more than 10%.
10. The indication that management is not aware of the existence of any stake exceeding 5% other than those that are reported.
11. A list of external assets held by the blockholders.
12. Shareholding in the bank by individual senior managers.
13. Shareholding in the bank by individual directors.
14. The description of share classes.
15. A review of shareholders by type.
16. The percentage of cross-ownership.
17. Information about indirect ownership (e.g., convertible instruments).
18. A list of affiliates in which the bank holds a minority stake.
19. A list of subsidiaries.
20. The ownership structure of subsidiaries and affiliates.

##### **Component 2. Shareholder Rights**

21. The contents of corporate governance charter/guidelines.
22. The contents of codes of business conduct and ethics.
23. The provisions of the bank's articles of association (including changes).
24. A formalized dividend policy.
25. Announcement of recommended dividends before the record date.
26. The existence of a review of the latest shareholders meeting (e.g., general presentation of voting results).
27. Detailed press releases covering latest corporate events.
28. Policy on information disclosure.

#### *Block 2. Financial and Operational Information*

##### **Component 3. Financial Information**

29. The bank's accounting policy.
30. Annual filings to the National Bank of Ukraine (NBU) for the last year.
31. Quarterly profit and loss statements.
32. Notes to annual financial statements according to national standards.

33. Notes to quarterly financial statements according to national standards.
34. An independent auditor's report regarding annual financial statements according to national standards.
35. Whether the audit firm that audits financials according to national standards is an internationally reputable auditor.
36. Whether quarterly financial statements according to national standards are reviewed by an auditor.
37. Annual financial statements according to an internationally recognized accounting standard (IFRS/U.S. GAAP) without notes.
38. Notes to annual financial statements according to IFRS/U.S. GAAP.
39. An independent auditor's report regarding annual financial statements according to IFRS/U.S. GAAP.
40. An unqualified (clean) audit opinion regarding annual financial statements according to IFRS/U.S. GAAP.
41. Formalized policy on related-party lending.
42. Audited IFRS/GAAP annual financial results published before the end of April.
43. Unaudited IFRS/GAAP annual financial results published before the end of April.
44. Audited IFRS/GAAP annual financials published before AGM.
45. Unaudited IFRS/GAAP financial results published before the end of June.
46. Disclosure of related-party transactions (RPTs): total sales to/purchases from, payables to/receivables from related parties.
47. Transactions with companies from the same group.
48. Indication that RPTs are made on market or nonmarket terms.
49. Exact terms of RPTs
50. Quarterly financial statements according to an internationally recognized accounting standard (IFRS/U.S. GAAP)
51. Notes to such financial statements.
52. Whether these financial statements are reviewed.
53. A basic earnings forecast of any kind.
54. A detailed earnings forecast.
55. A segment analysis (results broken down by business line).
56. Revenue structure (detailed breakdown).
57. Cost structure (high degree of detail).
58. The name of the bank's auditing firm.
59. Whether the audit firm is a top-tier auditor.
60. Auditor rotation policy (IFRS/U.S. GAAP)
61. How much the bank pays in audit fees to the auditor.
62. Whether or not the auditor renders any nonaudit services.
63. Nonaudit fees paid to the auditor.
64. Methods of asset valuation (including depreciation).
65. Information about reserves.
66. Information about average interest rates on loans, deposits, and promissory notes.
67. Capital adequacy ratios.
68. Information about observing norm ratios stated by the National Bank of Ukraine.
69. Liquidity indicators (immediate, current, general, and liquidity gaps).

70. Indicators of concentration (industry, client/shareholder, insider, and so on).

#### **Component 4. Operational Information**

71. Details of the products/services provided.
72. Output in physical terms (e.g., number of clients).
73. Efficiency indicators, such as ROA, ROE and so on.
74. A discussion of the bank's strategy.
75. Analysis of the currency risk (description, the way it may affect the bank).
76. Analysis of the interest rate risk (description, the way it may affect the bank).
77. Analysis of the liquidity risk (description, the way it may affect the bank).
78. Risk management policy.
79. Any plans for investment in the coming year(s).
80. Detailed information about investment plans in the coming year(s).
81. Asset/capital forecast.
82. An overview of the regulatory environment regarding the industry.
83. The market share for any and all of the bank's businesses.
84. Social reporting (e.g., Global Reporting Initiative (GRI)).
85. Principles of corporate citizenship.
86. The list of top-five providers of funds (creditors).
87. The list of top-five receivers of funds (borrowers).
88. Reservation policy.
89. Information about asset quality.
90. Information on restructured liabilities.
91. Information on off-balance sheet assets and liabilities.
92. Information about internal controls.

### ***Block 3. Supervisory Board and Management Structure and Processes***

#### **Component 5. Supervisory Board and Management Information**

93. The list of Supervisory Board members (names/titles).
94. Details about the current employment and position of directors.
95. Other details (previous employment, positions, and education).
96. When each director joined the Board.
97. A named chairman listed.
98. Details about the role of the Supervisory Board.
99. List of matters reserved for the Supervisory Board.
100. List of Supervisory Board committees.
101. Names of all members of each existing committee disclosed.
102. The bylaws on internal audit functions besides the audit committee.
103. Information about the ratio of in-person and in-absentia Supervisory Board meetings.
104. Attendance record for Supervisory Board meetings.
105. The list of senior managers not on the Supervisory Board.
106. The backgrounds of senior managers.
107. Details of the CEO's contract.
108. The number of shares held in affiliated companies by managers.

## Component 6. Supervisory Board and Management Remuneration

109. The decision-making process for directors' pay.
110. The specifics of directors' pay, including the salary levels.
111. The form of directors' salaries, such as whether they are in cash or shares.
112. The specifics of performance-related pay for directors.
113. The decision-making process for determining managerial pay.
114. The specifics of managers' (not directors') pay, such as salary levels and bonuses.
115. The form of managers' (not directors') pay.
116. The specifics of performance-related pay for managers.