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The Banking Sector in Ukraine: Past Developments and Future Challenges

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The Banking Sector in Ukraine: Past Developments and Future Challenges

Executive Summary

Ukraine's banking sector has followed a "boom-and-bust" cycle over the last couple of years. Rapidly growing loans -often denominated in foreign currency (FX) and funded by cheap short-term external borrowings- led to a build-up of macroeconomic and sector-specific vulnerabilities. With the arrival of the global financial crisis in late 2008, the bubble burst and the sector was confronted with severe liquidity and solvency problems. This resulted in a credit crunch, which put additional stress on the real sector, which entered into a severe recession. Quick and determined policy action by the authorities, supported by international financial institutions, prevented a complete meltdown, and calmed the situation.

The currently observable period of stabilisation in the banking sector allows us to conduct a thorough analysis and assessment of the overall situation. By doing so, we can derive some important lessons learnt to make the system more stable, without impeding the system's important financial intermediation function for the real sector. The following policy recommendations summarise our position:

1. Macroeconomic policy: Ukraine needs to improve its macroeconomic framework further, in order to achieve macroeconomic stability. A flexible exchange rate system and the gradual introduction of inflation targeting are key elements in this respect.
2. Credit growth: In a situation where credit is still scarce, the authorities should refrain from using instruments that limit credit further. Thus, the current de-facto prohibition as well as the planned legislative ban on FX loans to unhedged borrowers should be reconsidered. We prefer the application of macro-prudential rules to control FX risks rather than outright bans.
3. Consolidation: Market-driven consolidation may help to improve the efficiency of financial intermediation, but the current legislative framework for M&A is a serious impediment. The respective steps to create a positive legal environment need to be taken.
4. Asset side: Tackling the high level of bad debt must become a major policy priority, as otherwise banks will be reluctant to provide new credit. It is encouraging that the NBU seems willing to push for changes in the legal framework for bad debt resolution.
5. Liability side: We support current plans to cancel the right of depositors to withdraw time deposits any time, as this will mitigate liquidity risks and facilitate long-term lending.
6. Relationship between asset and liability side: Given the current restricted amount of long-term funding in local currency, one way to facilitate the increase in long-term lending in local currency would be the introduction of FX hedging mechanisms. In the medium term, the development model must follow the principle "domestic deposits fund domestic loans".
7. Capital: An adequate capitalisation of the sector is a key element in the rehabilitation process. The fulfillment of recapitalisation plans by all actors is thus needed. For the state-recapitalised banks, a strategic decision on what to do is needed.
8. Rights of lenders and borrowers: The protection of lenders' rights is crucial for fostering sustainable lending. The authorities need to improve the legal and judicial environment.

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Contents

1. Introduction

Ukraine's banking sector has followed a "boom-and-bust" cycle during the last couple of years. Before the arrival of the financial crisis to Ukraine in September 2008, the sector was expanding at a tremendous speed, and further growth expectations were high. This all changed rapidly, starting in late 2008, when the country entered a deep recession and experienced a severe banking crisis.

It is an undisputed fact among economists that the financial sector is crucially important for supporting the economy and the real sector, as Ukraine has learnt the hard way during the crisis. The current situation offers two main implications which need to be addressed by policy makers in a consistent and appropriate manner. The first implication is the objective of achieving financial stability in the banking sector, in order to regain trust and confidence in the country's banks. The second and equally important objective is to support banks to restart lending, in order to broaden the still fragile economic recovery.

As some time has passed since the outbreak of the crisis, and the sector shows tentative signs of stabilisation, time is right to provide a more systematic assessment of the sector's development. The present paper tries to contribute to this discussion by analysing the main developments of the banking sector in the past, identifying existing vulnerabilities and putting forward concrete recommendations how the deal with the weaknesses identified.

The structure of the paper is as follows: Chapter 2 presents a short description of the macroeconomic framework that was in place during 2005-2010, including a short overview of the main policies conducted by the authorities to combat the impact of the financial crisis. Chapter 3 describes the major developments in the banking sector during these years and the respective anti-crisis policy response by the authorities. Here, we try to identify the main weaknesses of the banking sector, which need to be addressed by policy makers. Chapter 4 summarises the lessons learned from the crisis and provides our policy recommendations.

2. Description of macroeconomic framework (2005-2010)

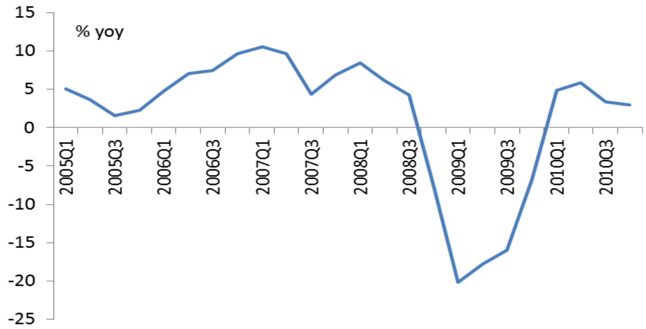
As shown by recent experience, the health of the banking sector depends to a large extent on the general macroeconomic situation. Thus, before looking at the banking sector, an analysis of the macroeconomic and monetary situation of the country is necessary. In the following sections we will describe the development of selected macroeconomic variables with strong implications on the banking sector.

2.1 Economic growth

From 2005 until September 2008, real economic growth was very strong in Ukraine, as Figure 1 shows:

Figure 1

Real GDP growth



Source: State Statistics Committee
Note: Quarterly data

However, this growth was mainly driven by strong domestic demand, and less supported by supply-side centered structural reforms. Thus, by the middle of 2008 the economy showed clear symptoms of overheating like rapid asset, wage and price inflation.

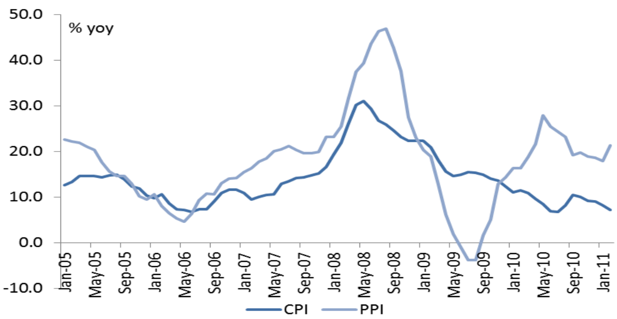
In this vulnerable context, Ukraine was massively hit by the arrival of the global financial crisis in September 2008, which caused real growth to fall steeply. In 2009, Ukraine recorded a drop in real GDP of 14.8%, which was one of the highest drops recorded in Europe and the CIS region. The economy started on a slow recovery path in 2010, when it grew by 4.2%, mainly driven by external demand. While growth is expected to stay at around this level in the foreseeable future, this is still considerably below the level recorded before the crisis. To put it differently, without the implementation of major structural reforms, there seems no basis for high and sustainable long-term economic growth in place.

2.2 Inflation

Ukraine has a long history of very high and volatile inflation, as Figure 2 shows:

Figure 2

Inflation



Source: State Statistics Commitee

The peak in consumer price inflation was in May 2008, when it grew above 30% yoy, making it one of the highest rates of inflation in the world at that time. Producer prices grew even higher during that time, reaching levels of around 50%. This setting was naturally a pretty bad starting point to enter the upcoming financial crisis, as it severely limited the policy options to combat the crisis (e.g. through the implementation of a loose monetary policy).

Especially during the crisis a process of gradual disinflation developed, despite the strong depreciation of the national currency. The main reasons were the steep decline in GDP and the existence of a huge output gap, as well as the restrictive macroeconomic policy stance required by the IMF in the framework of the negotiated Stand-By program.

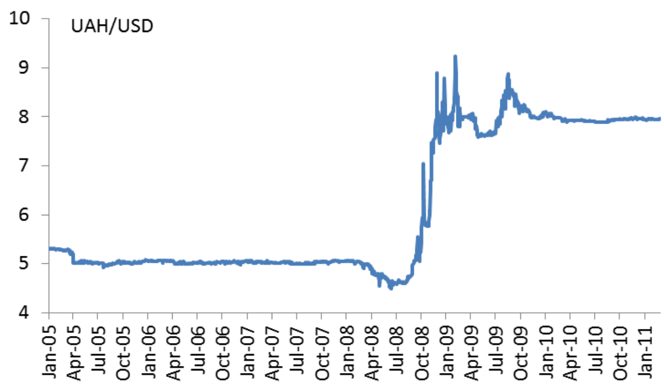
In line with regional and global trends, consumer price inflation picked up in the second half of 2010 (mainly due to supply shocks, i.e. food price increases). However, this proved to be short-lived, as the authorities used a wide range of measures to bring inflation firmly back into single-digit territory.

2.3 Exchange rate

Traditionally, a strong tendency towards fixing the exchange rate of the Hryvnia versus the US dollar by the National Bank of Ukraine (NBU) could be observed, as Figure 3 suggests:

Figure 3

Exchange rate



Source: Reuters

From 2005 until around April 2008, the exchange rate was tightly controlled in a band of 5.00-5.06 versus the US dollar. Interventions in the foreign exchange market were the main tool to control the exchange rate at the desired level. This changed gradually from April 2008 onwards, as some flexibilisation took place due to appreciation pressures. Consequently, the NBU decreased their activity on the market and let the currency appreciate to some extent.

However, the situation changed dramatically with the arrival of the crisis in the third quarter of 2008. A sudden loss in confidence in the banking system and the currency forced the authorities to devalue the Hryvnia in November 2008 by a considerable amount. The IMF program agreed in late 2008 foresaw the adoption of a flexible exchange rate, which would better insulate the economy from external shocks.

While volatility during the first three quarters of 2009 remained rather high, the authorities embarked since then on a path of de-facto fixing the level of the exchange rate again versus the

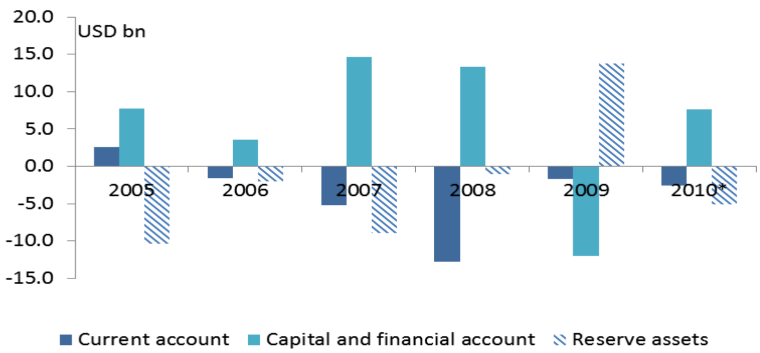
US dollar. Consequently, during 2010 until now, the exchange rate can be considered de-facto fixed again. The main instrument is foreign exchange market intervention, which is conducted actively.

2.4 External sector

The balance of payments development in the years before the crisis was characterised by a gradual worsening of the current account deficit (after reaching a current account surplus in 2005), which was financed by very strong net capital inflows, especially in 2007/08. These inflows covered the current account deficit and contributed to reserve accumulation under the fixed exchange rate system, as Figure 4 shows:

Figure 4

Balance of payments



Source: National Bank of Ukraine
Note: An increase in official reserve assets is denoted by a negative sign

A main recipient of these capital inflows (in different forms) was the banking sector, which used this comparably cheap form of (short-term) refinancing to provide loans at a rapid pace e.g. to households for purchasing consumer goods and housing. This contributed to the afore-mentioned surge in domestic demand, and led to an increase in imports, and thus negatively affected the current account deficit, but was also spurring domestic inflation dynamics.

The crisis, which exposed the external weaknesses in both the current and capital account, led to a drastic change in balance of payments dynamics. The current account adjusted rapidly, supported by the devaluation. At the same time, private capital inflows stopped and reversed partly ("sudden stop"), which put a drain on reserves. Official capital flows like the IMF loan were thus needed to finance the gap in the balance of payments and prevent the country from entering an uncontrollable situation.

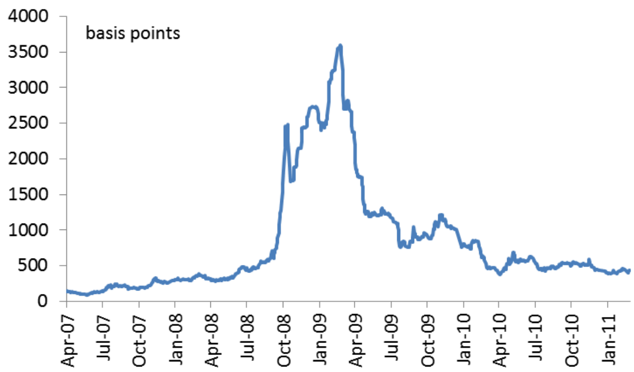
2.5 Macroeconomic policy response during the crisis (2008-2010)

Before the arrival of the crisis, Ukraine's economy grew rapidly, but was clearly developing along an unsustainable path, with increasing economic and financial vulnerabilities to external shocks. This created the picture of an increasingly imbalanced "bubble economy", which burst accordingly when severe external shocks hit the country. This is a major explanation for the fact that the crisis had such a big impact on Ukraine.

The development of the country risk, which is given by the risk premium on sovereign external debt, clearly mirrors this fact, as Figure 5 shows:

Figure 5

Country risk premium (EMBI+)



Source: Astrum investment

The sudden and massive shift in investor's perceptions on Ukraine's country risk forced the authorities to act swiftly. The right reaction was the conclusion of a Stand-By arrangement with the IMF in October 2008, which supported the necessary adjustment with a loan of USD 16.5 bn. This program can be considered a main anchor of confidence and a cornerstone of economic policy making during the crisis. Its primary objectives were to regain macroeconomic and financial stability in the short term, and establishing the conditions for sustainable economic growth in the medium term. For reaching these objectives, an extensive set of concrete policy changes (i.e. conditionality) was agreed upon.

While the program remained on track during most of 2009, the IMF decided to put the program on hold at the end of 2009, as certain policy actions by the authorities did not find the support of the Fund. However, the new administration renewed its commitment to the IMF in July 2010 with the conclusion of a new Stand-By arrangement, which has been agreed for 29 month and amounts to USD 14.9 bn. The main goals of the program are the implementation of fiscal, energy, and financial sector reforms in order to achieve a more balanced and robust level of economic growth.

3. Description of banking sector development and policy response (2005-2010)

3.1. Growth dynamics

The Ukrainian banking sector exhibited significant growth, especially since 2004.[1] The total balance sheet of the banking sector increased by 487% from early 2004 to early 2008, resulting in a volume of UAH 619 bn (USD 125 bn). Given that Ukraine experienced accumulated inflation of 76% during that period, while the Hryvnia remained constant against the US dollar, the real increase of the balance sheet amounted to around 400% in only four years.

[1] The years before, Ukraine had to handle the after pains of the Russian crisis of 1998. In 2003 24 banks were still under liquidation (2001: 38). Furthermore, after the 9/11 terror attacks Ukraine was taken on the FATF blacklist of money laundering. In 2004 Ukraine was removed from this list.

Figure 6

Balance sheet volume and yoy change[2]

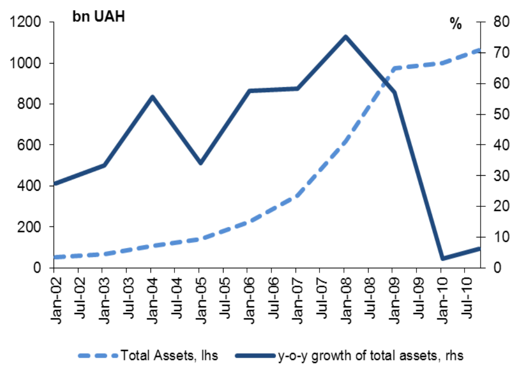
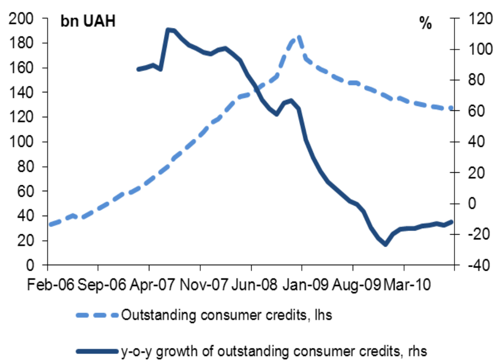


Figure 7

Outstanding consumer loans and yoy change

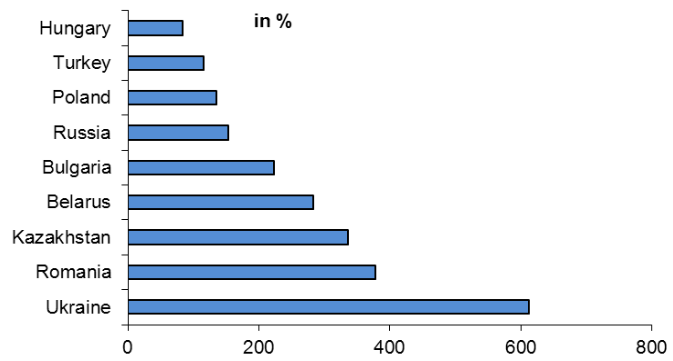


Source: National Bank of Ukraine

The pre-crisis growth of the balance sheet of Ukrainian banks was very much powered by the increase of loans, while capital market instruments did not play a significant role in the process (as opposed to what could be reckoned at most Western banks[3]). The most eye-catching increase happened in the sector of credits to natural persons (consumer and mortgage loans). In the period of 2004 to 2008 (referring in each case to the start of the year) the increase amounted to 1,630%. This corresponds to an average yearly increase of 104%, which is among the highest growth rates in comparison to other countries.

Figure 8

Credit growth from 2004 to 2008



Source: EBRD

An international comparison with banking sectors of the CIS economies and Middle and East European economies shows that Ukraine's growth of the loan volume was the second highest.[4] In the period of 2004 to 2008 the loan volume expanded by 612%. In Russia outstanding loans increased „only" by 154% and in Kazakhstan by 283% in the same period.

[2] Ukraine devalued the Hryvnia in November 2008. This means that the amount of foreign currency loans, expressed in UAH, increased all else being equal. To put it differently, the decrease of the balance sheet volume and of consumer credits is even more pronounced than shown above.

[3] In Western banks' balance sheets all kinds of capital market instruments were the main „culprits" of balance sheet growth. Toxic assets like RMBS, ABS, CDOs and so on played an important role in this respect.

[4] Among the 29 strong peer group the only country with a stronger growth in loan volume (700%) was Montenegro.

To sum up, almost all countries of Middle and East European countries as well as central Asian countries experienced a credit boom. In no other country the boom was as pronounced as in Ukraine, though. The figures show that there was a serious bubble building in the run-up to the crisis.

The lending boom stopped abruptly at the end of 2008, shortly after the bankruptcy of the US investment bank Lehman Brothers. Foreign exchange loans outstanding shrank by 27% from its August 2008 peak to September 2010 and a recovery is not in sight, as de-leveraging continues.

Figure 9

FX-denominated loans outstanding

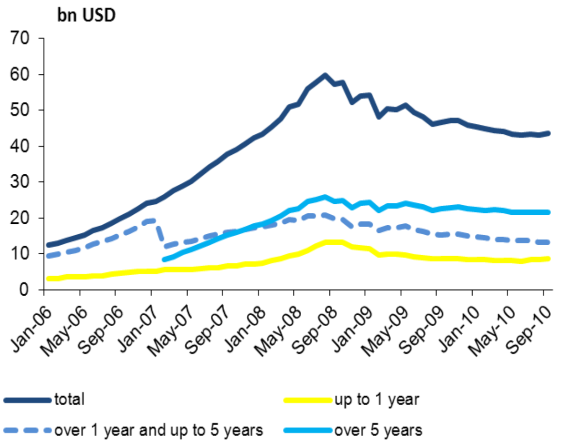
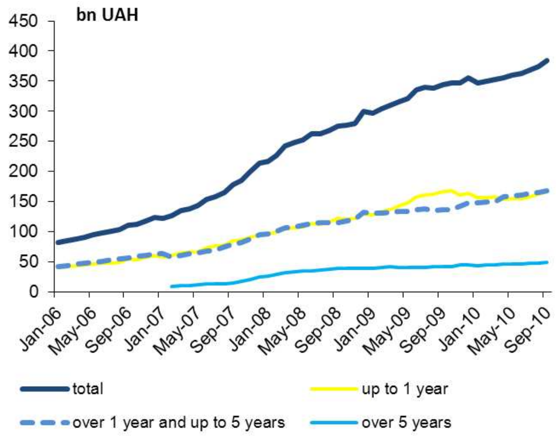


Figure 10

UAH-denominated loans outstanding



Source: National Bank of Ukraine, own calculations
Note: Graph for 1-5 years includes loans over 5 years before Feb-07

However, with respect to UAH loans the eruption of the crisis is not visible in the chart. We note merely that the growth of outstanding loans slowed down during the next months. While in September 2008 the loan volume was 63% higher than in the same month of 2007, the growth rate decreased to 40% in December of 2008. In June 2010 loan growth stood at 8% above the level of the year before, which meant a small decrease in real terms (i.e. adjusted by inflation). We suppose that many companies which asked for foreign exchange loans got – if at all – an UAH credit instead as many banks were not able, willing, or allowed to extend USD- and EUR-loans.

Topics for policy discussion:

1. The exponential growth of loans and balance sheets should have rang the alarm bells at the banking regulator as generally neither the personal nor the technical resources at the banks suffice to cope with such a high growth. This is a failure of the banking supervision given that the bad loans of today were extended mostly during the boom time of the past years.

2. How to identify a boom in the banking sector? Which tools should be used to identify a boom?

3. Are higher and countercyclical capital requirements the right tool to put a break on a lending boom? Wouldn't this impede the target to restart lending?

4. How could lending be restarted in the short term?

- The rule to require foreign exchange cash flows as a precondition for foreign exchange loans has obviously worsened the credit crunch.

5. How should lending be restarted in the long term?

- Would it be wise for the government to take over a bigger share of the banking sector to restart lending? Or does the take-over of banks and their corresponding liabilities bear a non-calculable risk? The latter is suggested by the experience of Ireland: Ireland did guarantee the whole banking sector's liabilities and took over big banks. As a consequence sovereign risk has increased massively as well as speculation about public debt's restructuring.
- What about implementing one or various bad banks to clean up the balance sheets?

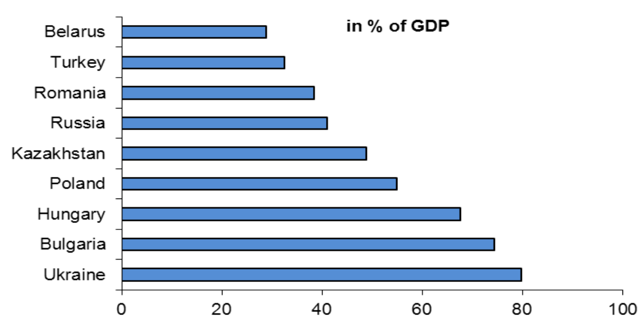
3.2. Size, concentration and ownership structure

3.2.1 Size

As a result of the boom the banking's sector balance sheet amounted to some UAH 900 bn (around 90% of GDP) prior to the outbreak of the crisis while loans outstanding stood at 80% of GDP, thereby being higher than in most other peer countries. This ratio, which is very much used as an indicator for the grade of banking sector's maturity, was at 41% for Russia and at 49% for Kazakhstan. Even Poland's corresponding ratio was only at 55%.

Figure 11

Domestic credit to private sector, end 2008



Source: EBRD

As the balance sheet volume of the banking sector still has increased in nominal terms while the GDP of Ukraine shrank somewhat in 2009 the size has even got bigger in relation to GDP and amounted to some 97% of GDP in 2009. For the end of 2010, this indicator stood at 87% of GDP.

3.2.2 Concentration

The degree of concentration of the Ukrainian banking sector is low. The top 17 banks (i.e. Group 1 according to the classification by the NBU) accounted for 62% of total assets shortly before the crisis erupted. Privatbank was the biggest bank having a balance sheet volume of UAH 68 bn, closely followed by Raiffeisenbank Aval and Ukrsibbank.

Table 1

Concentration in the Ukrainian banking sector in July 2008 and July 2010

July 2008	**Number of banks**	**Total Assets (UAH bn)**	**Share of total assets (%)**	**Highest (UAH bn)**	**Lowest (UAH bn)**	**Average (UAH bn)**
Group 1	17	451.2	65%	68.0	13.1	26.5
Group 2	17	117.6	17%	12.2	3.7	6.9
Group 3	34	75.1	11%	5.5	1.1	2.2
Group 4	110	54.9	8%	1.8	0.0	0.5
Total	**178**	**698.7**				**3.9**

July 2010	**Number of banks**	**Total Assets (UAH bn)**	**Share of total assets (%)**	**Highest (UAH bn)**	**Lowest (UAH bn)**	**Average (UAH bn)**
Group 1	18	608.2	69%	97.5	11.2	33.8
Group 2	17	141.2	16%	14.0	4.0	8.3
Group 3	34	60.2	7%	4.8	1.5	1.8
Group 4	110	75.7	9%	2.6	0.1	0.7
Total	**179**	**885.3**				**4.9**

Source: National Bank of Ukraine

Based on the balance sheet volumes, the Herfindahl index[5], which is a way to measure concentration in the banking sector, stood at 365 in 2009.[6] This compares with an average Herfindahl index of the EU-banking sector of 1102, which means that the concentration in the Ukrainian banking sector is relatively low.[7]

Two years after the crisis hit Ukraine concentration has increased only moderately. The banks of Group 1 accounted for 69% of total assets as of July 2010, from 65% in July 2008. [8] However, concentration remains still low compared to international standards. In addition, the biggest bank's (Privatbank) market share of 11%, which was extended during the crisis by one percentage point, cannot be called dominating. The Herfindahl indexed has increased accordingly to 394 in July 2010, which is still low compared to other countries.

[5] The Herfindahl-Index moves between near 0 (granularity at its maximum) and 10.000 (monopoly).
[6] In 2008 the index was probably somewhat lower given that some mergers occurred during the crises.
[7] Only Germany (183) and Luxemburg (276) have lower degrees of concentration. The Estonian banking market exhibits the highest degree of concentration in the EU (3410).
[8] Adjusting for the effect that in the 2010 data in the first group one more bank was considered, there is an increase of this group's market share to 67%.

3.2.3 Ownership structure

Traditionally, domestically-owned Ukrainian banks are part of big corporate groups, for whom they fulfill above all treasury functions. Observers note that the structure of some companies is deliberately complex to hide the banking activities and avoid regulatory oversight. A study of S&P et al. notices that the transparency with respect to ownership reached 49% of the figure that is theoretically possible, meaning that the transparency level has been way behind international standards.

Up to the crisis only two Ukrainian banks were owned by the public sector, the savings bank "Oschadbank" and the bank "Ukreximbank". Both financial institutions together accounted for 13% of banking system's assets. All other banks were private.

Thus, in Ukraine the state's influence by way of publicly-owned banks was not as high as in many of the Central Asian economies and Middle and Eastern European countries. Measured as a share of the balance sheet, public banks had a market share of 11.5% prior to the crisis, while Russia's respective market share was at 37.5% and the one of Belarus stood at 77.9%. In Poland the share was at 18.3% while the state played only a negligible role as an owner in Kazakhstan and Bulgaria. However, during the crisis, the state influence increased significantly, as the two state banks continued lending in an environment of de-leveraging, placing them among the Top-3 banks currently. Furthermore, the state had to recapitalise a number of ailing systemic institutions, and thus increased its share in the sector further.

In contrast to that foreign investors play a very significant role in Ukraine. Prior to the crisis some 35% of the total banking sector's capital was foreign capital. While there are other countries with much higher participation rates of up to 90%, the influence of foreign banks remains significant. During the crisis years their presence in the Ukrainian financial sector has continued to increase (slightly) and the corresponding figure is now 40.4%. However, these figures hide a significant structural shift in terms of geographical origin which occurred during the crisis. During the crisis, the presence of Russian (mainly state) banks in Ukraine's banking sector increased significantly, while Western investors play a smaller role than before the crisis. In this respect the purchase of Prominvest (number 8 as of July 2010) by Russia's VEB is noteworthy. Currently, there are three Russian-owned banks among the Top-10 banks in Ukraine according to assets. All of these banks pursue rather expansionary lending strategies, especially in the corporate segment.

During the crisis, the activities of International Financial Institutions (IFIs) as well as of bilateral institutions of financial cooperation increased. This counter-cyclical behavior was an important element of financial stabilisation, providing technical and financial assistance and thus increasing market confidence and trust in selected institutions and the banking sector in general. This support was granted by different institutions (EBRD, World Bank Group, EIB, KfW, etc.), targeting viable and solvent local banks through different instruments (equity, subordinated debt, syndicated loans, credit lines). To put this support into numbers, the EBRD, the biggest investor in the country, invested around USD 500 m in the banking sector during 2008 and increased this amount to USD 700 m in 2009.

Topics for policy discussion:

1. The ownership structure in the Ukrainian banking sector is not transparent measured against international standards. This complicates the supervision of financial institutions.

2. The banking sector exhibits a very low degree of concentration, compared to other countries. While this is not a destabilizing factor by itself, the high number of banks complicates closely supervision and limits the profitability of banks (see section: Profitability and capital basis), which implicates a small capital basis.

3. It seems that neither too high nor too low a concentration is desirable. The degree of concentration could be easily increased in requiring a higher minimal capital requirement (the "H1" normative standard) in UAH terms by all banks, as was introduced recently. The respective law foresees a gradual implementation, giving banks some time to adopt. However, this process would work only smoothly if the legal problems which are connected to the process of merging bank entities are reduced significantly. In this respect it is noteworthy that the merger of the Ukrainian units of Unicredit and HypoVereinsbank took a full year, which seems to be intolerable long time given that these were small units which were willing to organize a friendly merger. Other banks in the same situation seem to face similar obstacles.

4. At the same time a leverage ratio (which is planned to be introduced by Basel III and is the reciprocal of the capital ratio, only that the assets are not weighted by their risk) could be introduced to prevent banks from becoming too large. This leverage ratio should be smaller than the 33.33 proposed by Basel III.

5. A high degree of foreign banks can have but does not need to have a stabilising effect. While this time around foreign banks were prepared to inject capital and liquidity into their subsidiaries, it is conceivable that foreign banks start to reduce their foreign holdings in case of a new crisis in the future (as it happened and happens at many global banking conglomerates like RBS).

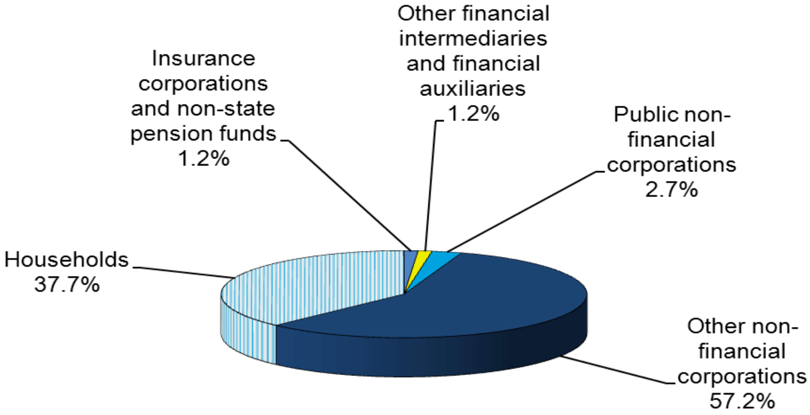
3.3 Asset side

Looking at the development of the quality of the asset side during the crisis we concentrate on loans, given that in July 2008 75% of total assets of the Ukrainian banking sector consisted of loans. The rest were above all interbank loans (13%), securities (3%), liquid assets (5%) and fixed/intangible assets (4%).

With respect to the loan structure non-financial corporate loans (58%) as well as loans to private households (38%) account for the biggest share of total loans outstanding. Only 3% of loans were extended to public companies. Half of the credits were denominated in UAH while the other half was denominated in FX, mainly in USD.

Figure 12

Structure of the banking sector's loan portfolio (Data as of July 2008)



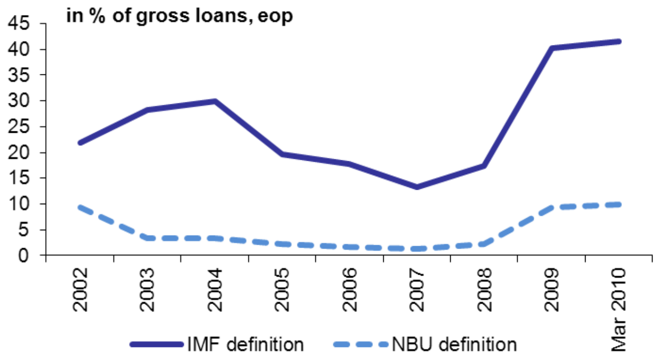
Source: National Bank of Ukraine

The quality of the assets started to deteriorate as the economic activity took a serious hit in the fourth quarter 2008. Given the bubble-like expansion of balance sheet volumes in the pre-crisis years the deterioration of the assets quality during the crises is not really surprising. The old saying "bad loans are made in good times" was strongly confirmed.

However, the official NPL-figures deviate significantly from figures of international financial institutions and rating agencies. According to the NBU, non-performing loans comprising prolonged, problem and doubtful loans[9] amounted to 1.58% as of July 2008 and increased to around 10% by April 2010. Currently (February 2011), it stands at 11.2%.

Figure 13

NPL development



Source: National Bank of Ukraine (narrow definition), IMF (wide definition)

[9] Definitions of non-performing loans vary in time and between official publications. In contrast to the above mentioned statistics, in the "Financial Soundness Indicators"-Publication non-performing loans comprise the categories "doubtful" and "loss". However, this definition is only valid since 2008. Prior to 2008 non-performing loans are defined as those which were in the categories „under control", „substandard", "doubtful", and "loss". Accordingly non-performing loans were much higher at the end of 2007, namely at 48.12%.

By contrast, according to the IMF the ratio of non-performing loans stood above 13.2% by the end of 2007 and increased to 41.6% by March 2010. The IMF-definition includes also "substandard" loans in addition to the classes "doubtful" and "loss".

Apart from the fact that official statistics of non-performing loans lack international comparability it is very hard to get an idea of the quality of assets amidst a boom phase with loans outstanding growing at a double digit pace. For instance as of July 2008, 38% of all loans were extended during the last 12 months. It's quite typical that problem loans emerge only after a while. In this phase of the credit cycle it was relatively easy for companies to roll over their loans with the bank. By this way solvency problems of the companies to which loans had been extended were hidden.

Topics for policy discussion:

1. Currently, banks have usually no incentive to report the true state of quality of their loan portfolio. As non performing loans result in higher losses which bite into the capital base, especially those banks with a weak capital base try to avoid the recognition of bad loans.

2. The usefulness of the official Ukrainian data with respect to non-performing loans is limited, partly because it is not possible to compare those figures internationally. Thus the NBU lacks an important instrument to track the quality of the banking sectors' loan portfolio.

3. It is necessary to monitor much more closely the quality of the asset portfolios of the banks. Therefore, risk management systems have to be installed in the banks according to modern standards. This means amongst other things that systems should be capable to give a picture about the structure of the portfolio with respect to

- Size of loans, currency, maturity, interest rate (fixed, variable, other)
- Clients (including close links between clients)
- Industry sector (with a high level of detail)
- Internal and (if existent) external rating

upon the requirement of the regulator without delay.

Those corporations which rely heavily on foreign exchange loans have suffered particularly hard. The USD loan market has recently stabilized at a much lower level than the level it had reached in September 2008. There are no signs of a strong recovery in this area. In the UAH area the credit crunch is not that obvious. Though there was some decrease of loans outstanding at the end of 2008/beginning of 2009 measured in inflation adjusted terms, the general trend has been slowly upwards since spring 2009.

Figure 14

USD loans to non-financial corporations

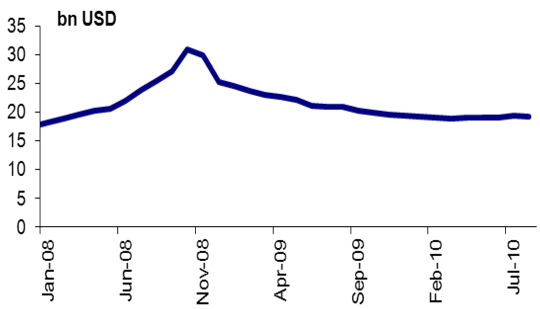
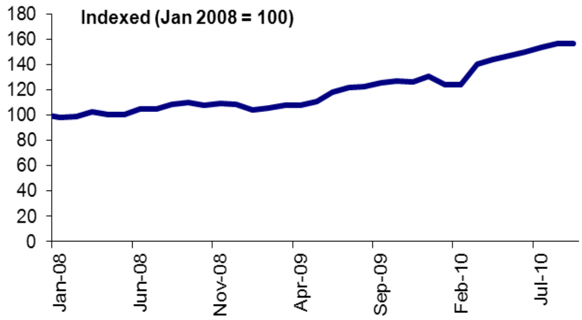


Figure 15

UAH loans to non-financial corporations, adjusted for CPI inflation



Source: National Bank of Ukraine, own calculations

Box 1: Data on lending to SMEs

In order to assess the situation with lending to small and medium-sized enterprises, relevant data from the NBU are needed. However, the NBU does not publish specific data on SME lending. It publishes data on loans by form of incorporation, and this only since 2009. Loans to private enterprises, farmers and cooperatives stood at UAH 32 bn in Jan 2009 or 7.3% of loans to non-financial corporations. They dropped to UAH 28.5 bn or 6.3% of loans in Jan 2010. In Jan 2011 loans outstanding grew somewhat (by 5.3% yoy) to UAH 30.1 bn but their share in loans to nonfinancial corporations dropped further to 6.0%. These data may reflect trends and dynamics in lending to SMEs but are certainly not representative of the total volume of bank funding to SMEs. SMEs usually conduct business in the form of private entrepreneurs, private enterprises and LLCs. Also individuals may use household loans for business purposes. Thus loans to SMEs are likely significantly larger.

Non-financial corporations also reported data on their balance sheets to Derzhkomstat in 2009. Only incorporated small enterprises (as opposed to private entrepreneurs and farmers) were required to report this data. Short-term bank loans to small enterprises increased from UAH 51.7 bn to 54.2 bn while its share in the total reported remained at 24%.[10] This share is consistent with the share of small enterprises in economic activity (16.3% of turnover and 24% of official employees). However, this share may drop when longer-term financing is considered.

3.4 Liability side

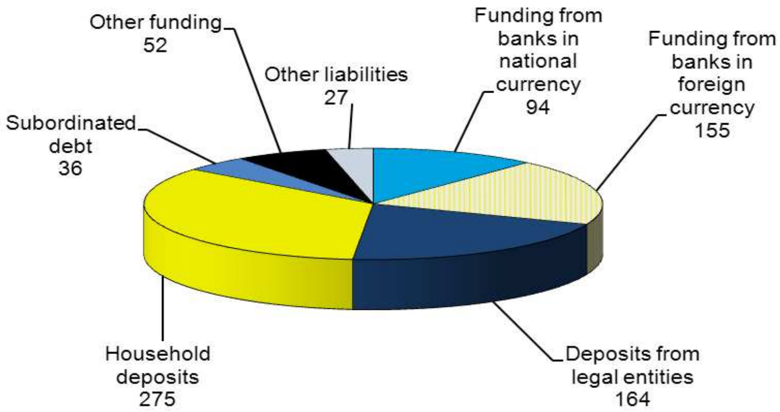
The refinancing of banks is based on deposits of corporates, private households as well as interbank loans, each of them accounting for around a fourth to a third of the total volume. Fixed income securities did never play an important role for most banks even though these funding tools were important for a few individual banks. An example is Kreditprombank, which ranked at place 16 and refinanced around 10% of its liabilities via the issuance of corporate bonds. The item

[10] Reported total is relatively close to figures reported by NBU, but the difference is quite volatile.

"other obtained funds" refers to central bank funding, a funding source that was actually negligible prior to the crisis, as liquidity was usually generated via FX-interventions.

Figure 16

Funding structure (in UAH bn, per January 2011)



Source: National Bank of Ukraine

3.4.1 Maturity structure of deposits

The structure of maturities of deposits provides only limited information due to the fact that so-called time deposits are callable at any moment by the depositor. This is foreseen in the Civil Code. Having said that, the data give an indication about the willingness of investors to place money for longer periods with a bank. On average most deposits had a maturity of one to two years before the crisis, as of August 2008 (36%). Maturities of above 2 years accounted only for 11% of total deposits. Correspondingly some 54% of the deposits (including sight deposits) had a maturity of less than one year. This changed a lot during the crisis. Depositors withdrew term deposits or swapped them into sight and short term deposits.

3.4.2 Currency structure of deposits

Deposits of private households

Prior to the crisis private households placed around 63% of their money in UAH deposits. 25.3% of the deposits were denominated in USD and EUR deposits accounted for 11.4%. The share of RUB deposits was negligible.

Figure 17

Deposits of private households (August 2008)

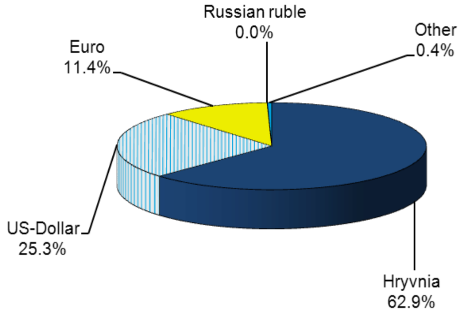
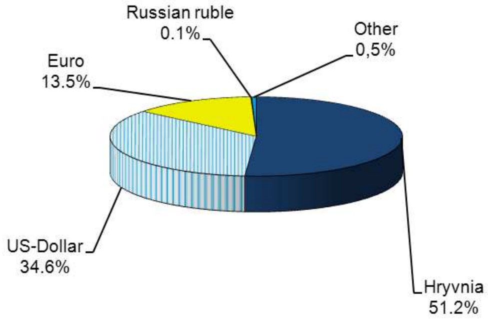


Figure 18

Deposits of private households (September 2010)



Source: National Bank of Ukraine

During the crisis the share of Hryvnia deposits decreased as a share of total household deposits. In the next section, this development will be explained in greater detail.

Deposits of non-financial corporates

With respect to non-financial corporates' deposits we note that UAH deposits play a more important role (currently: 68%). This may be due to the fact that most of the payment transactions (wages, services) are carried out in local currency. Deposits in foreign currency are dominated by USD. The RUB plays a somewhat more visible role (1.4%) than in the case of private household deposits.

Figure 19

Deposits of non-financial corporations (August 2008)

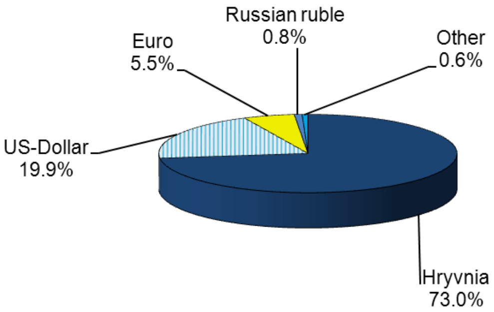
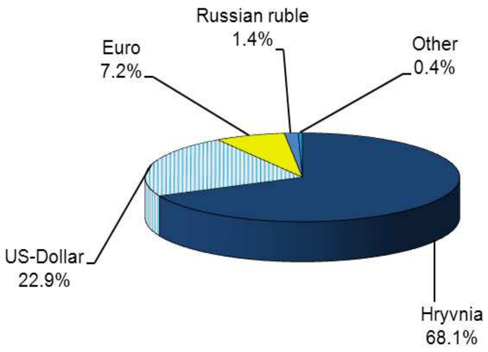


Figure 20

Deposits of non-financial corporations (September 2010)



Source: National Bank of Ukraine

Due to the crisis and the depreciation the share of UAH-deposits has decreased (see following section).

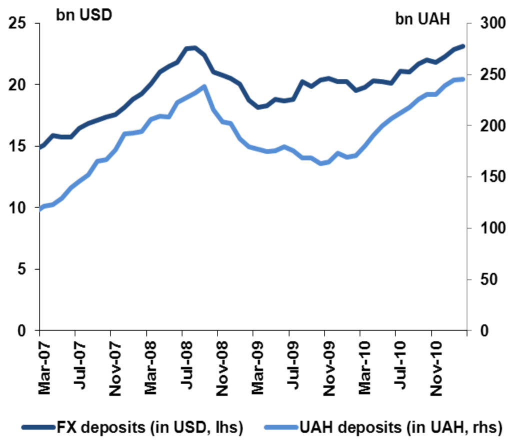
3.4.3 The development of deposits

When the crisis struck Ukraine in September 2008, a massive withdrawal of both, UAH and foreign currency denominated deposits could be witnessed which gained momentum when Ukraine's sixth biggest bank, Prominvestbank, was put under administration of the central bank on October 7. Other banks followed. With respect to withdrawals, time deposits with an agreed maturity of one to two years were hit exceptionally hard. This shows that these deposits which usually experience only little volatility proved to be even more volatile than sight deposits, as clients had a right to call the deposits. It is quite remarkable that the decrease of foreign exchange deposits has been far lower than the decrease of UAH deposits. This has to do with the fact, that many clients simply reallocated their deposits from Hryvnia to USD. In addition, it could be observed that USD deposits started to recover already by February 2009 while UAH-deposits reached the bottom only one year later.

With respect to sight deposits and demand deposits with maturity of up to one year the level of both, UAH and foreign currency deposits are at a higher level than prior to the crisis. This has to do with the already described reallocation between short-term and long-term deposits Furthermore, the development shows also that trust is returning to the banking sector gradually.

Figure 21

UAH and FX deposits



Source: National Bank of Ukraine, own calculations

Figure 22

UAH denominated deposits

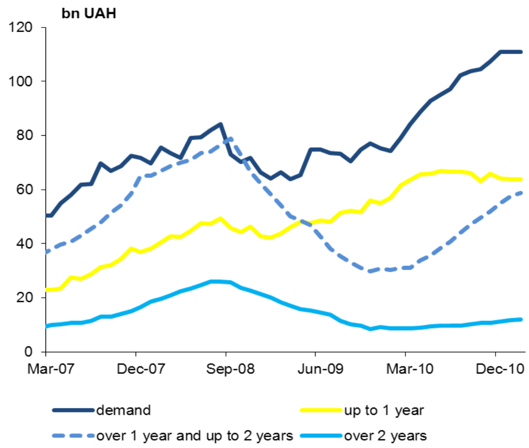
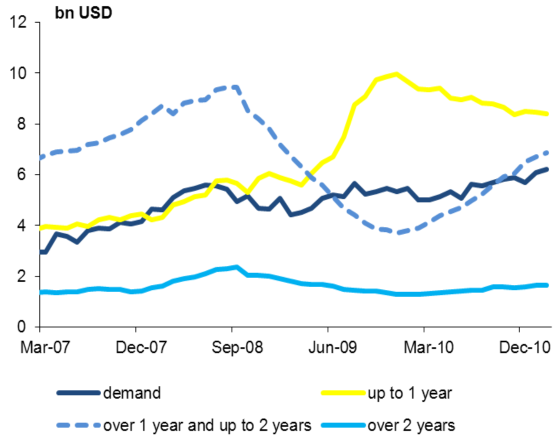


Figure 23

FX denominated deposits



Source: National Bank of Ukraine, own calculations[11]

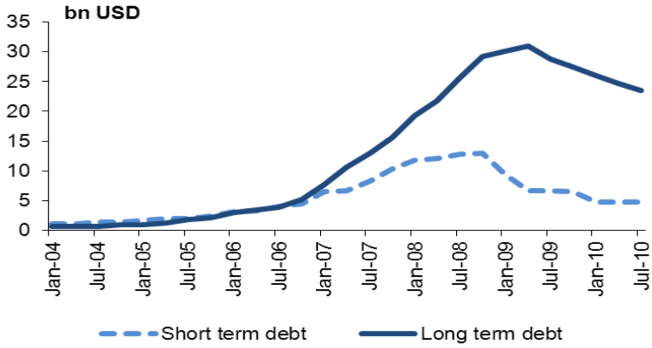
3.4.4 Role of foreign borrowings

Prior to the crisis the external debt of the banking sector increased at a very fast pace and reached USD 42.1 bn in October 2008, representing around one third of the bank sector's balance sheet. The relatively high volume of the banking sector's external debt is in part due to the fact that many parent companies were willing to extend loans to their subsidiaries in Ukraine.

When the crisis hit Ukraine, the lack of funding from abroad translated in a significant decrease of external debt, which came down to USD 28.2 bn in July 2009, a fall of 23% against October 2008.

Figure 24

External debt of the banking sector: short term and long term debt



Source: National Bank of Ukraine, own calculations[12]

A major shift happened with respect to foreign short-term debt (above all trade credits) and long-term debt (dominated by loans as well as bonds and notes). The share of short-term debt

[11] The foreign exchange deposits are documented in the statistics in UAH, which means that they have to be translated in USD. As 80% of foreign exchange deposits are denominated in USD we have chosen for simplicity reasons the UAH/USD for the calculation.
[12] See Footnote 11.

decreased significantly during the crisis from 31% in October 2008 to only 16% in July 2010, which has obviously been the direct impact from the financial crisis which started as a global liquidity crisis (thus, shortage of short-term funding). While the fall of short-term funding came to a stop during the last few months, there are few signs that the issue of long-term funding is improving. It seems to be especially hard to get access to both short-term and long-term loans in foreign currencies. Apart from the two big state banks, which issued Eurobonds[13] recently, most banks continue to have difficulties to issue bonds and notes.

Figure 25

Short term debt of the banking sector

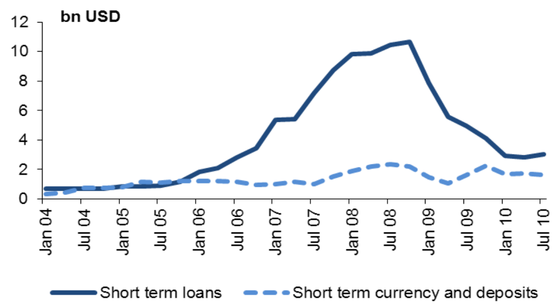
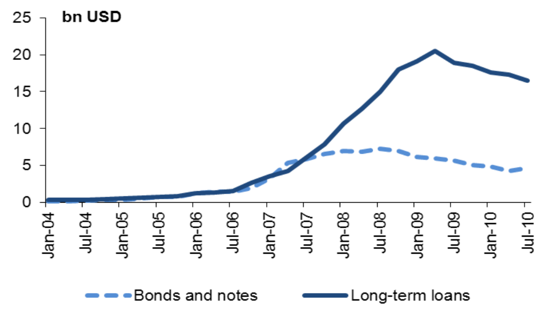


Figure 26

Long term debt of the banking sector



Source: National Bank of Ukraine

While there has been great fear among bondholders of losing significant amounts of money due to forced restructurings of bank debt, in general this did not happen. While there have been numerous banks which restructured their debt, most of these transactions happened in a market friendly way which means that an offer was issued and accepted by a wide range of bond holders. Mostly, these restructurings involved maturity extensions, coupon increases, initial cash payments, and amortizing features, but avoided haircuts. Nadra was an exception in this respect. In other countries like e.g. Kazakhstan, four defaults among the leading banks happened in the financial sector, involving restructurings with haircuts between 50 and 80%. The fact that most banks in Ukraine did not default on their foreign currency denominated bonds and notes may be one explanation why outstanding bonds and notes have recovered during the last months.

3.4.5 Policy reaction to the funding shortfall

The central bank took various measures to stop or at least curb the bank runs:

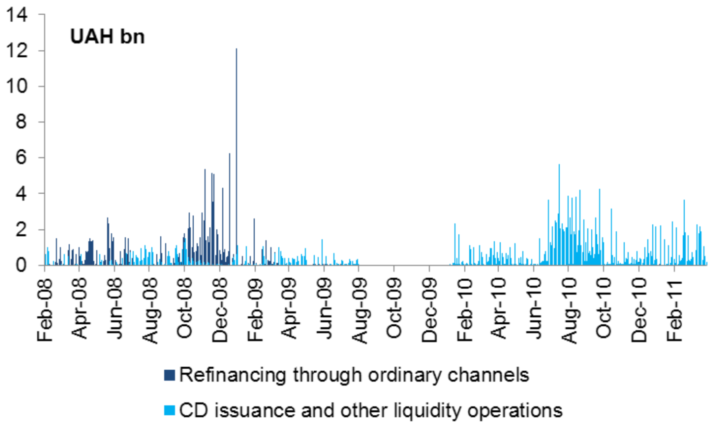
<u>Ad-hoc liquidity injections to individual banks / intervention:</u> In an immediate reaction to the bank runs which occurred in the third quarter of 2008 the NBU made available substantial amounts of liquidity for some banks. For example the NBU provided Prominvestbank with liquidity of UAH 5 bn in September/October 2008. On October 7 Prominvestbank was intervened by the central bank and was put under administration. Only one day later Nadra Bank, then the ninth biggest institute, received a UAH 1.5 bn liquidity injection with 12 months maturity. The action was induced by external debt coming due.

[13] Apart from standard US dollar issues, Ukreximbank placed in early 2011 a UAH-denominated Eurobond in the equivalent of USD 300 m, which was the first placement of such an instrument. The notes will be settled in Euroclear in US dollars.

In a somewhat more systematic approach, the NBU provided short term liquidity through so called standing refinancing line and standing tender line. After relying heavily on short term liquidity by the end of 2008, the use of central bank liquidity seemed to have come down somewhat in spring 2009 while at the beginning of 2010 (when the fear about sovereign risk led to increased global tensions) the reliance on support from the monetary authority increased once again. Currently, the liquidity problems of the sector seem to have ended, as deposit inflows continue, coupled with a still subdue recovery in lending. This implies that banks have a rather comfortable short-term liquidity situation.

Figure 27

Daily volumes of central bank refinancing



Source: National Bank of Ukraine

While the ad-hoc measures token show that the regulator was very ill-prepared to such a crisis, the NBU was obviously not alone, given that ad hoc liquidity measures for individual banks took also place in the USA, Eurozone and a great number of other countries. The measures, in principle, seemed to have been the only possibility to prevent a complete meltdown of the financial sector, given that the banks rescued were very probably of systematic importance.

Having said that, many measures remain controversial. Many people suspect for example that liquidity injections were (if not paid in USD) changed immediately into dollar to deposit them abroad. Apart from that it remains unclear to what extent collateral had to be deposited with the central bank when getting liquidity injections.

With respect to the provision of liquidity facilities most central banks still provide liquidity of unusual amounts. In the Eurozone for example banks have the possibility to get as much liquidity they want for up to three months as long as they are able to provide collateral eligible for these transactions.

Freezing of deposits: In October 2008 the NBU froze all time deposits for half a year as to arrest the run on banks. Usually time deposits are callable at any time in Ukraine. On May 12, 2009 the NBU lifted the ban, seven months after implementation.[14] The effectiveness seems to have been

[14] Apart from the fact that the freezing was announced to be valid for only six months for most of the time deposits the agreed maturity was already over.

limited. The chart on page 22 shows that the freeze of time deposits had only a small impact if at all. Time deposits depleted at a higher rate than sight deposits. The instability of time deposits is an indication that there is need for action.

Deposit guarantee: On November 5, 2008 the authorities tripled the deposit guarantee from UAH 50,000 to UAH 150,000 after having discussed such a measure as early as beginning of October 2008. The increase of the deposit guarantee is a measure which was taken by almost all states in reaction to the banking crisis. The main idea behind the increase is to avoid a spreading of bank runs. In Ukraine this measure was announced only after the first wave of bank runs. Further runs followed. However, the fact that USD deposits started to recover in February 2009 and UAH deposits in February 2010 shows that the measure cannot be considered to have been without an impact.

Other measures of the central bank aimed not directly to stop the run on deposits but indirectly as the target of these steps was to put the banking sector on a sounder footing and therefore to restore confidence in the banking sector in the long run. These measures are described in section 3.7 (Profitability and capital basis).

Conclusion: The damage done to confidence of depositors and other providers of funding to the Ukrainian banking sector has been huge due to the crisis and due to the fact that many clients experienced the shock of not having access any more to their savings. This means, firstly, that banks remained dependent on central bank funding for a while.[15] Secondly, it implies that investors will demand a risk premium for putting their money into the Ukrainian banking system which should mean that interest rates will remain relatively high in comparison to other emerging economies who managed to come through the crisis in a smoother way, like for example Turkey.

3.5 Relationship between asset and liability side ("mismatches")

3.5.1 Currency and maturity mismatch of deposits and loans

Whether a high degree of foreign currency loans poses a risk for the banking sector depends first, on the structure of the liability side and second, on the income stream of the borrowers.

As to the first point: We note that banks were willing to increase loan extensions in foreign currency at a much faster rate than the inflow of deposits denominated in USD and EUR. Thus the currency mismatch increased. The ratio of loans to deposits (both in foreign currencies) was at 250% prior to the crisis in August 2008.[16] Some two and a half years earlier this ratio was located at a much lower level of 130%. At the beginning of the crisis (end of 2008, beginning of 2009) the ratio increased even further, due to the run on the deposits. In March 2009 the loan to deposit ratio peaked at around 290% and came down to 200% in September 2010, as the credit crunch meant that foreign currency loans outstanding decreased while foreign currency deposits started to recover.

[15] The dependence on central bank funding is nothing exceptional in these times. Banks from Greece e.g. are funding some 17% of their balance sheet through repo funding from the European Central Bank. In other countries like Portugal and Ireland this numbers hovers around 5 to 7%.

[16] A ratio of loans to deposits of 250% means that the volume of loans was 2.5 times as high as the volume of deposits.

Figure 28

Currency mismatch[17]

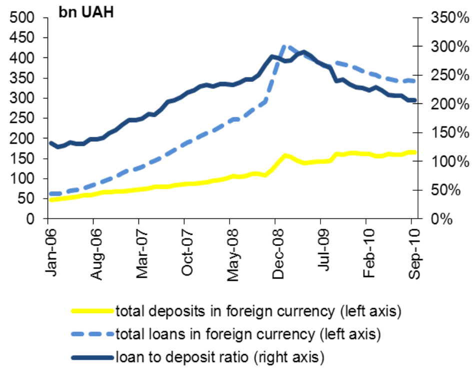
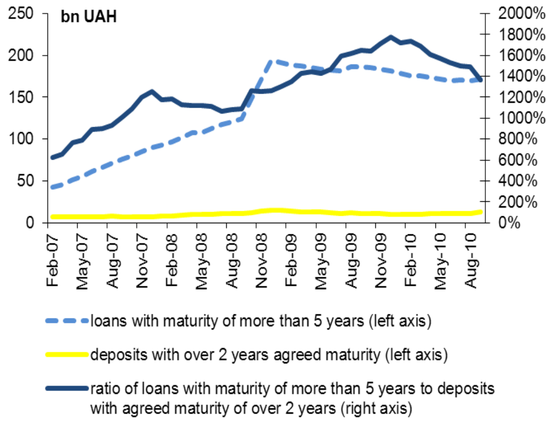


Figure 29

Maturity mismatch



Source: National Bank of Ukraine

<u>Interest rates differentials as one important reason for currency mismatches</u>

One reason for this currency mismatch at the balance sheet level of banks are the interest rates.

Figure 30

Deposit interest rates in UAH and FX

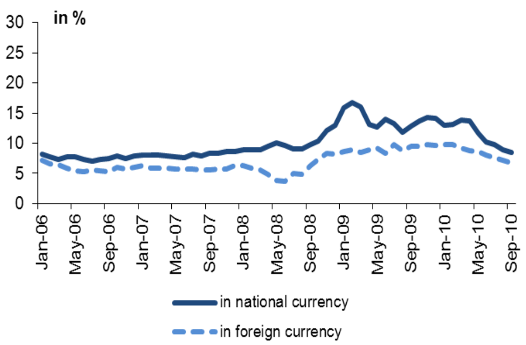
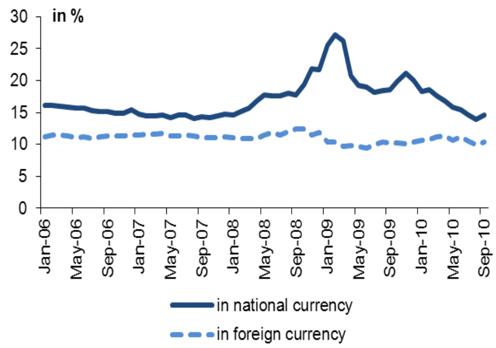


Figure 31

Loan interest rates in UAH and FX



Source: National Bank of Ukraine

The interest rates for deposits and for loans show that there has always been a significant differential between UAH and foreign currency interest rates. This kind of interest rate structure is on the one hand the results of the fact that foreign currency loans and deposits are considered to be less risky than the comparable instruments in UAH. On the other hand, this interest rate structure is obviously having a significant impact on the above described currency mismatch. The fact that:

[17] Note that both foreign exchange loans and deposits are expressed in UAH. While this leads to a jump in both loans and deposits at the end of 2008 due to the depreciation of the UAH, the loan to deposit ratio (which is here at the centre of the analysis) is not touched by the depreciation.

- Firstly, foreign exchange loans could / can be taken out at much lower interest rates than UAH loans
- Secondly, deposits in UAH provide much higher interest rate payments than the corresponding USD deposits
- Thirdly, the UAH was seemingly anchored firmly to the USD up to 2008 (suggesting there was no currency risk at all)

created a massive incentive for households and corporate to hold their deposits in UAH while taking advantage of the relatively good conditions in the market for USD loans. Due to the crisis, which led not only to a significant depreciation, but also to an increasingly volatile exchange rate afterwards, the people might be much more aware of the risk which is inherent to taking foreign exchange loans without having regular access to foreign exchange income. In any case, we would consider it inappropriate to influence the currency mismatch directly through interest rates.

Currency mismatch at the borrowers level

As to the second point, another aggravating factor is, that there is often a mismatch at the level of the borrowers. In particular private households were borrowing foreign exchange loans without having a cash flow income in USD or EUR. The reason for this behavior is obvious the interest rate differential between USD and UAH loans as well as USD and UAH deposits.

Maturity mismatch

In addition there has been an increasing maturity mismatch with respect to foreign exchange as well as UAH-business. E.g. the ratio of foreign exchange long-term credits (with an original maturity of more than five years)[18] to time deposits (agreed maturity of more than two years) deteriorated up to the end of 2007 and stabilized then at the level of around 1,100%. At the beginning of 2006 the corresponding figure was at 624%. The ratio only peaked by the end of 2009, as long term deposits were withdrawn at a faster rate than the loans outstanding. Once again this shows the ineffectiveness of the so called long-term deposits as a stabilizing funding tool.

All in all, the vulnerability of the banking sector was and remains very high due to currency mismatches in combination with maturity mismatches. While the loan to deposit ratios have improved over the last years the level is still too high and needs to come down further.

3.5.2 Policy reaction

The NBU worried in particular about the currency mismatch at the level of the borrowers.

The NBU enacted that all loans which were extended from February 2009 without evidence that the borrower has foreign exchange cash flows, had to be backed with 100% capital, and denominated in the corresponding foreign currency. By this measure the central bank hoped to bring down the demand for currencies other than UAH.

The measure might have contributed to a stabilisation of the UAH-USD exchange rate. At the same time this policy action might be partly responsible for banks constraining their USD-lending business to a higher degree than would have been necessary (without the new measure in place). While the measure makes sense with respect to private households (even more developed

[18] Both, two year deposits and five year loans are considered here as long term and thus are compared with each other. A category of two year loans or of five year time deposits does not exist.

countries like Hungary got into trouble due to the fact that private households mortgage debt was denominated in Swiss Franc), a simpler and less radical regulation should be applied to the corporate sector. For instance banks could be obliged to underlay foreign exchange loans with more capital than UAH loans, however not with 100%.

<u>Topics for policy discussion:</u>

1. In a highly dollarized banking system the interest rate differences between local and foreign currency provides an incentive for a currency structure which is not consistent with the structure of the real economy, resulting in an instable financial sector. How to change such an outcome?

2. While the central bank focuses on the mismatch on the borrower level, it seems also necessary to monitor the currency mismatch at the bank level. In times of stress, banking sectors like Ukraine's will always have difficulties to get access to foreign currency loans. Thus, the higher the gap between foreign exchange outstanding and reliable foreign exchange-funding (e.g. long term funding) the higher the stress banks as well as borrowers will have to suffer if the mood at international markets changes to the negative.

3.6 Interest rates

In August 2008 the central bank's key interest rate was at 12%, 4 percentage points higher than in December 2007. The tightening policy which was carried out in 2008 was the reaction to the increasing pressure on the UAH and high inflation. While loan rates started to increase only slowly at the beginning of 2008 according to central bank data, tensions in the interbank market were hitting the market at the point of time in a noticeable way. Overnight interest rates reached a first peak at around 30% in April 2008 while average loan rates were only at 16.4%. Tensions in the money market, which were at the heart of the global liquidity crisis, increased further given the default of Lehman Brothers, the depreciation of the UAH and the eruption of the Ukrainian banking crisis through bank runs. This became also obvious observing the halving of transaction volumes at the interbank market, which went hand in hand with an increase of the interbank market rate, peaking at some 70% in March 2009. At the same time the central bank was kept at 12%. Average loan rates reached a peak of approx. 24% in March, too. Since then, rates have come down. Especially in the interbank market rates fell abruptly.[19] This coincided with the general calming down of the banking crisis and lower tensions in the currency market. This was the trigger for the central bank to cut interest rates which was also motivated by a decrease of the inflation rate.

[19] The abrupt fall of interbank interest rates is a phenomenon that could be observed other countries, too. In the US and the Eurozone this fall did not mean, that the interbank market started to function once again, but was due to the fact, that the central banks provided short term liquidity at essentially no costs in almost unlimited amounts whenever a bank required liquidity and was able to provide some kind of collateral.

Figure 32

Central bank interest rate and UAH/USD exchange rate

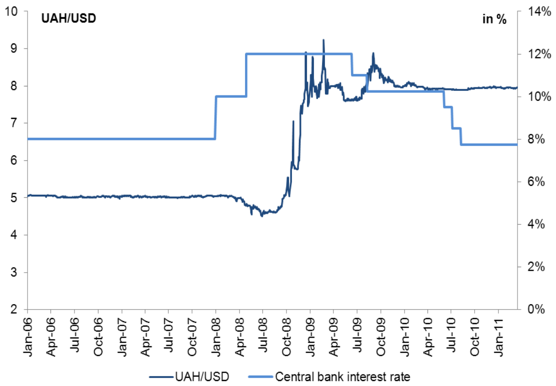


Figure 33

Loan interest rate in local currency and overnight interbank rate

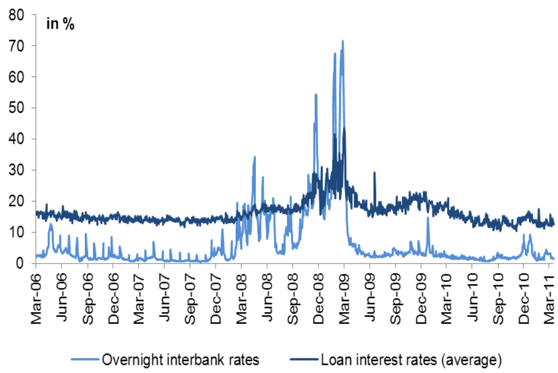


Figure 34

Loan interest rates in local currency and foreign currency (all maturities)

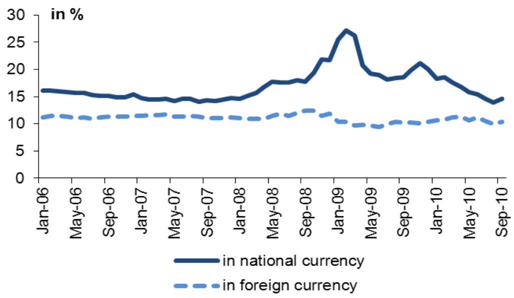
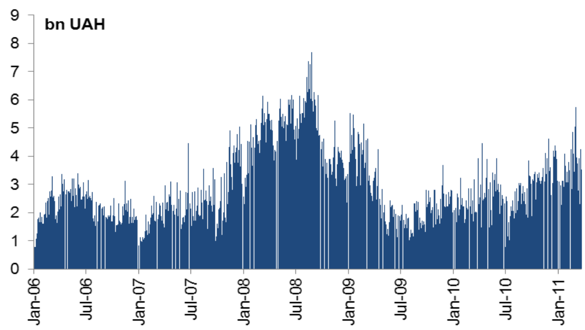


Figure 35

Daily Volume of transactions happening in the interbank market



Sources: National Bank of Ukraine and Reuters

It is quite remarkable that the interest rates for UAH loans have increased much more than the interest rates for foreign currency loans. With respect to foreign currency loans, it is even hard to notice the crisis, according to NBU data. While part of the increasing spread has to do with the increase of inflation we would have assumed a somewhat stronger reaction of foreign currency loans due to capital flight and the corresponding foreign exchange scarcity.

We wonder if the data of the central bank with respect to loan interest rates mirror the true picture. We think that –after the outbreak of the crisis – they are based on much less transactions than before. These few transactions may not represent the scarcity of capital like neoclassical economic models would predict. They may be the result of transactions which where done e.g. in the context of forced prolongations (forced in the sense that without prolongation the borrower would default putting the viability of the bank at risk) or in the context of close links (a company that is affiliated to the bank). Hence, the resulting rates may be somewhat distorted.[20] However,

[20] In addition credit rationing and negative selection may play an important role, too: An increase of the scarcity of capital, which happened during the crisis, would lead in neoclassical models to a new equilibrium with higher interest rates and lower quantities, squeezing out those who are not able to pay high interest rates. In reality this may not happen.

the bottom line to all this is that it became much more expensive (if possible at all) for companies and private clients to take out a loan.

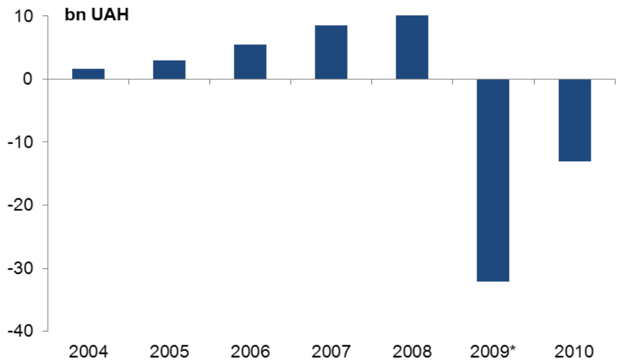
3.7 Profitability and capital basis

3.7.1 Profitability

While the aggregate profits of the Ukrainian banking sector increased by 478% in the period of 2004 to 2008 (considering inflation: 403%), the profitability of the banks remained modest or even low on average. The return on equity stood at 8.5% in 2008 and at 12.7% in 2007. Returns on total assets were over the period reviewed below 1%. Given that the interest rate margins were at 5 - 6% and thereby very attractive (in western banks the interest rate margin is usually between 1 - 2%) and given the relatively high yield offered by Ukrainian sovereign debt at that time (6 - 7%) we consider the profitability of Ukrainian banks prior to the crisis as rather weak.

Figure 36

Pre-tax profits of Ukrainian banks



Source: National Bank of Ukraine
*Note: *Excluding the banks that were liquidated and didn't send their financial reports in 2009*

The pre-tax profits, which increased prior to the crisis turned into a huge pre tax loss of more than UAH 30 bn in 2009, over-compensating the profits of the last years. During 2010, the banking sector as a whole still showed losses, although they shrank in comparison to 2009. The main reason for the losses is the impairments of loans. As shown above (quality of assets) it is difficult to guess how long the number of non-performing loans will continue to increase as it seems that the central bank's figures underestimate the actual amount of problem loans.

With respect to the operating profit there is also still downward pressure. While the operating profit is in positive territory the figures seem not to show the true situation as unpaid interest accruals are taken into account.

3.7.2 Capital adequacy

Considering that Basel requires a capital ratio of 8%, the corresponding figure of the Ukrainian banking sector of 13.92% at the beginning of 2008 seems to be high and comfortably above the regulators minimum CAR of 10% (N2). Even if you compare the ratio with the banking sectors of

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Banks assume that borrowers, who are the most eager ones to get a loan and thus are prepared to pay extraordinary high interest rates, are the most risky borrowers and simply refuse them access to credit to protect their balance sheet.

other CIS- and CEE-countries Ukraine's ratio looks relatively strong. However, in a broader context the capital base was not strong enough. During the years prior to the crisis the capital ratio decreased significantly. At the start of 2003 the capital ratio was at 20%. This means firstly that the growth of the loan portfolios was only partially accompanied with a corresponding build-up of capital. Or, to put it differently, profits were not high enough to put aside capital to finance growth adequately. Secondly, banks which operate in an economic and political risky environment should command a higher buffer against losses than banks operating in more stable environments. Finally, given the experience of the global financial crisis it seems to be questionable if the old directive of 8% minimum capital standard is enough. Indeed, the BIS announced only recently that higher minimum capital standards will be introduced soon.

Meanwhile, capital ratios have increased significantly. NBU reported a capital ratio of 20.15% for October 1, 2010. This was the result of various measures taken by the central bank, the government and the banks themselves.

3.7.3 Policy reaction to deterioration of capital ratios

<u>Stress tests / Capital measures:</u> At the end of 2008 Ukraine passed a bill which allows the government to nationalize banks with systemic importance if and when the owners are not able or willing to endow the corresponding financial institution with enough capital. To identify banks in need of capital stress tests were implemented. Stress tests are a much-used measure in many countries, which strives for various goals: Firstly, to identify those banks which need more capital or which have to be winded down. Secondly, to increase transparence and to regain credibility given those banks were in most cases kind of black boxes.

The criteria of the tests were worked out by the central bank and the IMF, based on data of October 2008. The tests resulted in a recapitalisation need of USD 3 bn of which USD 2 bn was required for foreign-owned banks. In the period of December 2008 to February 2009 stress tests for 38 banks in total were carried out. 25 banks were identified as undercapitalised of which 21 banks pledged themselves to prop up their capital base. However, only six banks managed to deliver. Of the 15 banks, which did not conduct the capital increase eight were sanctified while the other seven did not bear any consequences, as it seems. In May 2009 further 144 banks were subject to stress tests with the result that 31 banks were described of being undercapitalised. 25 of them have pledged to increase their capital base to 10% minimum by the end of 2009. However, there is some lack of information as to whether these banks have succeeded in doing so. In the Annex a list with those banks which are under administration/liquidation can be found.

Against this background, stress tests are a reasonable measure. Whether the measure is successful in regaining the credibility depends on how consequent the results of the stress tests are translated into action. In this respect it is conspicuous that banks which did not increase their capital, even though they received a corresponding order from the regulator, had not to suffer sanctions. Thus the regulator should not wonder when allegations arise that some credit institutions were treated in a privileged manner.

<u>Alleviation of propping up capital:</u> In September 2009 the NBU decided to alleviate the propping up of the capital base. The new measures stipulate that Tier 1 capital can be composed by 100% of Tier 2 capital (subordinated debt). Up to then the regulator provided that only 50% of Tier 2 capital was allowed to be considered in the calculation of Tier 1 because Tier 2 capital does not offer much of a loss buffer.

The advantage of allowing subordinated debt to count as Tier 1 capital is the fact that subordinated debt can be issued in foreign currency avoiding foreign exchange risk which is important for banks from abroad. By contrast in the case of a classical recapitalisation the investor has to buy the stocks in local currency, exposing himself to the risk of currency movements. Generally it seems to be useful to think about alternative ways to capitalise banks. In the context of Basel III rules one idea is to support the issuance of so called cocobonds (contingent convertible bonds). These bonds become core capital automatically once the capital ratio decreases below e.g. 8%.[21] However, the new Basel III rules also define a new core capital ratio where only equity capital and reserves are taken into account while subordinated debt is considered to be a too weak for absorption of losses.

Topics for policy discussion

1. In banking systems with foreign currency deposits the central bank is very much limited in its traditional role of a lender of last resort as it cannot print foreign currency. Being aware of this shortcoming the monitoring of currency mismatches should be one of its highest priorities.

2. How effective a high capital ratio can be to stabilize the banking sector depends very much on what banks can take into account as capital and which weightings have to be applied to different assets. During the financial crisis many global banks had to recognize that first, part of their so called capital had only limited loss absorption capacity. Secondly, big chunks of their assets were much more risky than the risk weightings applied to them would have suggested.

3. How to balance the need for recapitalisation of banks on the one hand and the risk that banks which are requested to prop up their capital stop to extend loans, thereby obstructing the economic recovery? Should the regulator have the power to prohibit the payment of dividends and bonuses as long as the capital ratio is below a certain threshold? Or would this, in turn, make it impossible to issue new equity / have negative effects on operating profits?

3.8 Rights of lenders and borrowers

Over the last few years prior to the crisis default rates in general and especially in the area of residential mortgages stayed at extremely low levels. Thus, during this time the existing legal instruments were not seriously put to a test. However, this changed obvious since the eruption of the crisis. Given the huge increase of defaults, there has been and still is a high number of borrowers who try to minimize their payment obligation while the lender’s intention is to maximize the value of their outstanding problem loans.

We concentrate on problems with the insolvency law as well as on the deficiencies of the law concerning mortgage contracts.

3.8.1 Insolvency law

While the Ukrainian insolvency law, which was reformed radically in 1999, has improved over the last years due to various amendments, there are still a lot of deficiencies with respect to the law itself as well as to the practical procedures.

[21] There are already banks like Rabobank from the Netherlands and Credit Suisse which have issued cocobonds.

In principle there is a general consensus that the Ukrainian insolvency law is dominated by the intention to protect the rights of the debtors. The following points support this view:

- It is easier for debtors than for creditors to initiate the bankruptcy filing. The creditor can only file for the debtor's bankruptcy after having obtained a court award against the debtor, the initiation of an enforcement proceeding against the debtor's assets, and finally after having waited three months after the start of the enforcement proceedings.
- The debtor is given the possibility to restructure the business. However, creditors are not really involved in the assessment of the restructuring and there is no supervision of the plan's implementation.
- A timely delivery of property of the debtor to the bankruptcy administrator is not in the law.
- There is a lack of effective avoidance of problematic transactions prior to the actual bankruptcy filing.
- Creditors are exposed to the risk that the debtor may file for bankruptcy without giving notice to the creditor. If the creditor fails to file the claim 30 days after the opening of the insolvency proceedings he loses the right on the claim.

Other problems are that the requirements for the qualification of a bankruptcy administrator seem too inadequate and that there are insufficient sanctions in the case of non-compliance with the law. Finally, the predictability of the outcome of bankruptcy cases is not given.

The above described problems mean that a bankruptcy proceeding takes a lot of time giving the debtor time to take out the company's assets so that the creditor cannot seize them. We suspect that, due to the crisis, the situation has worsened in this respect.

The EBRD assesses the Ukrainian insolvency law in the following maps:

Figure 37

Factors in creditor-initiated insolvencies

Source: EBRD (2004)

Figure 38

Factors in debtor-initiated insolvencies

Source: EBRD (2004)

As a consequence of the debtor friendly insolvency law creditors usually do not initiate proceedings of bankruptcy. Instead, they try to negotiate alternative solutions. Solutions are, amongst other things:

- Change of the collateral structure
- Debt currency conversion
- Debt to equity swaps
- Bilateral contracts for novation between a credit institution and its counterparty[22]
- Non-contractual replacement of management

One of the results of the debtor-friendly bankruptcy law seems to be that many still solvent borrowers take advantage of the crisis situation and file for bankruptcy knowing well that the creditor's chance to get the assets are quite small. This factor might have contributed to the increase of non-performing loans. While it looks sensible to protect debtors rights especially during a crises (as a very creditor friendly bankruptcy procedure could have even accelerated the loss of production capacity and thus jobs), the current legal frame has a negative impact on the cost of capital, i.e. interest rates. Banks require a surcharge on lending to compensate for the risk of not having access to the collateral pledged.

3.8.2 Procedure with respect to mortgages in default

The mortgage law stipulates enforcement against mortgage collateral in two ways. First, by judicial enforcement that can be based on court decision or on notary writ. Second, through extra-judicial settlement, without the involvement of courts. As a result of these procedures the lender should ideally be put in a position to foreclose the real estate collateral. However, the whole foreclosure procedure entails a set of difficulties:

[22] Novation means that mutual claims and obligations are automatically amalgamated in such a way that this novation fixes one single net amount each time novation applies and thus creates a legally binding, single new contract extinguishing former contracts.

- Title transfer can prove to be difficult as the registration authorities[23] show reluctance to accept the re-registration of the title.
- In addition, the transfer is expensive as 2% of the value of the collateral has to be paid (to the state and the state pension fund).
- The debtor's cooperation is needed with respect to the transfer. If the debtor does not cooperate it is coming down to a (time consuming and costly) court action.
- The sale of the asset means that there must be a notarized sale agreement, including an excerpt from the title register. This title is only available to the owner. Creditors usually try to avoid this problem at the time of the loan disbursement by insisting on a power of attorney from the debtor. This power of attorney, however, is always revocable.
- The eviction of the mortgagor has always been difficult. However, as a reaction to the crisis a new rule prohibits residential evictions in the case that the property is the borrower's only residence.

As the foreclosure usually is connected with huge problems many creditors seek negotiated solutions instead. The lack of a smoothly functioning enforcement law means that banks need to provide a lot of resources for negotiations on an individual basis, thus making loans more expensive. Apart from that, refinancing instruments for mortgages like covered bonds lose credibility if procedures to get access to the collateral are not in place.

4. Lessons learned and policy recommendations

4.1 Macroeconomic policy

The de-facto pegging of the hryvnia to the US dollar before the crisis created some major problems both for macroeconomic and banking sector stability, as became clear during the crisis. On the macroeconomic front, the NBU was not able to fight the surge in inflation 2007/08 successfully, as its main objective was to hold the exchange rate constant. This created major problems during the crisis, as it restricted Ukraine's effectiveness to respond to the crisis severely. A second problem of the peg was the implicit assurance of economic agents of the absence of exchange-rate risk. This contributed to the high level of dollarization in general, and the often un-hedged FX borrowing of banks' clients in particular.

We thus recommend a transition to a flexible exchange rate system, where the Hryvnia is allowed to move freely, but where the NBU prevents excessive fluctuations. Such a system would be able to absorb external shocks better, and create a two-way exchange rate risk, discouraging dollarization. However, this implies also that a new anchor for monetary policy is needed. We think that a gradual introduction of inflation targeting (IT) is needed, as this policy framework can achieve low and stable inflation in the medium term. For IT to be operational, a wide range of institutional elements need to be in place. Regarding the NBU, this implies more independency in monetary policy decisions, coupled with increased accountability for these decisions.

Recommendation 1: Ukraine needs to improve its macroeconomic framework further, in order to achieve macroeconomic stability. This would give a boost to a sustainable financial

[23] Ukraine has a reliable registry of mortgages which is effective in ensuring that the title to a property is not transferred without consent of secured creditors.

development, as it increases credibility and confidence in the Hryvnia. A flexible exchange rate system and the gradual introduction of inflation targeting are key elements in this respect.

4.2 Credit growth

While fast credit growth, coupled with lax underwriting standards and increasing leverage destabilized the sector and contributed to the strong impact of the crisis, the picture changed completely as new credit dried up completely. Within a very short period of time, the sector went from "boom to bust", and entered a credit crunch. This complete change in the situation also revealed weaknesses in the regulatory and supervisory process, which was never really able to catch up with the rapidly evolving sector dynamics.

In the current situation, the supply of credit is still relatively low and fragile, which creates huge economic problems for the real sector. This implies for the regulator that instruments which limit credit growth in the current situation are debatable. One such instrument relates to the prohibition/limitation of loans in FX[24]. Our skepticism does not mean that such strong instruments might not have their justification later on in time, especially if (FX) credit growth becomes too strong again. In such cases, a quick reaction may indeed become necessary, using appropriate instruments. However, these developments show how important it is that banking policy is always in tune with the correspondent situation. The timing and the set of measures is thus of paramount importance.

To tackle the problem of dollarization, which is without doubt a major economic policy problem as it increases vulnerabilities to shocks, a broader view is needed. This relates to the underlying causes of dollarization, and depending on them, the right policy response. In case the underlying cause is related to macroeconomic instability (e.g. high and volatile inflation, resulting in low confidence in the local currency) and weak institutions, authorities need to tackle the problem by the root. This is the problem described in section 4.1. A simple ban may be the wrong instrument in this case and do more harm than good, as the country lacks other resources. In general we have a preference for macro-prudential rules/market-based instruments, which follow a "limitation approach", instead of outright prohibitions.

Recommendation 2: The authorities should not combat yesterday's problems, i.e. getting the policy response right is the key. This implies in a situation where credit is scarce to refrain from using instruments that limit credit further. In this respect, the current de-facto prohibition as well as the planned legislative ban on FX loans to unhedged borrowers should be reconsidered. Rather, a "limitation approach" should be followed, which is based on macro-prudential rules, rather than outright bans.

4.3 Consolidation

There is a wide agreement between banking experts that consolidation in the still fragmented sector is needed, in order to improve the efficiency of financial intermediation. However, there are very different interpretations of what consolidation means and thus on what actions are needed.

One view stresses that there are too many small weak and potentially dangerous banks ("pocket banks", often involved in related-party lending), which bind precious supervisory resources.

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[24] After the anti-crisis law expired at the end of 2010, FX lending to borrowers without regular FX revenue was again legally permitted. However, the NBU has tight macro prudential rules in place which limit de-facto FX lending, even though some banks have started to issue FX car loans, e.g. in RUB. There are plans by the NBU to legally ban FX-lending to unhedged borrowers. A relevant draft law is under preparation.

According to this view, fewer banks are needed. One instrument to achieve this would be by raising minimum capital requirements. Indeed, Parliament adopted a law on February 15, 2011 that increases the minimum share capital for banks to UAH 120 m (from present UAH 75 m). It gives existing banks 5 years' time to comply with the new regulations. On the other hand, small banks hardly attract deposits from the population and carry little importance financial intermediation. In our view, small banks are not the right focus when talking about the urgent current problems of the whole system. Some issues, e.g. regarding increasing ownership transparency, which we fully support, can also be dealt with by other instruments than raising capital.

It is our impression that many market participants would indeed like to conduct mergers between existing banks, but also foreign investors (mainly Russian) would like to acquire several (medium-sized) banks and merge them. However, these plans, which are based on economic rationales, are currently not being implemented. A more appropriate question is then why such moves to consolidate the sector do not happen on a large scale?

The answer lies in the huge legislative and administrative barriers for mergers and acquisitions (M&A) of banks in Ukraine, which cost much time and money for the banks involved. Apparently even banks belonging to the same owner report that the merger involved substantial amounts of time and money. Thus, a more adequate response to these shortcomings would consist of legislative improvements that help to facilitate mergers and acquisitions.

Thus, we propose to put the primary focus on improving merger legislation. Once legislation is improved, we believe M&A will take place and consolidation will go ahead, driven by market forces. Without respective improvements in legislation, market-based consolidation towards an optimal structure of the banking sector will not materialize.

Recommendation 3: While a process of consolidation and concentration may help to improve the efficiency of financial intermediation, the current legislative framework for M&A is a serious impediment for this. The authorities thus need to take the respective steps to create a positive legal environment, which gives the right incentives for a market-driven process of consolidation.

4.4 Asset side

The major challenge during the crisis is the deterioration in asset quality, as non-performing loans increased rapidly, putting pressure on banks' profitability and constraining their ability to issue new loans. While the NPL-ratios differ according to the specific definition used (narrow versus wide), the dynamics point in the same direction. Recently, according to the data, some stabilisation seems to have been achieved.

Even if the NPL ratio may have peaked, the question what to do with the chunk of bad assets in the banks' portfolio remains. Without tackling this problem, a sustainable restart in lending activities seems distant.

It is obvious that the legal framework for bad debt resolution is far from perfect, as a well-defined mechanism for the disposal of NLPs is currently missing. This includes the sale of impaired loans to collection agencies, issues of taxation related to provisioning and the write-off of NPLs, the regulations governing NPLs and provisions, etc. The authorities share a similar position, and want to improve the overall legislation framework for bad debt resolution.

A related question is the establishment of a “bad bank”, which takes over bad assets from financial institutions. While international experience is quite diverse on this issue, i.e. different models and modes of operation for such a bad bank (e.g. one central or one bad bank per bank) can be found, Ukraine has recently announced similar plans for its recapitalised institutions. The authorities’ action plan foresees to use Rodovid Bank as a bad bank, which takes over impaired assets from state-owned Ukrgazbank and Bank Kyiv, while the performing assets remain. Rodovid, which will not be able to attract new deposits and issue new loans will then specialise in loan recovery and thus try to maximise loan recovery value, or, in other words, minimise taxpayer’s losses.

Recommendation 4: Tackling the high level of bad debt must become a major policy priority, as otherwise banks will be reluctant to provide new credit. It is encouraging that the NBU seems willing to push for changes in the legal framework for bad debt resolution. Furthermore, the announced plans to create a bad bank for state-owned banks seem encouraging, as long as the authorities have the clear objective of maximising recovery value and thus protecting public funds.

4.5 Liability side

During the crisis, the implications of the right of depositors to withdraw time deposits any time became suddenly obvious. This created massive liquidity problems for a number of banks, and the NBU introduced a temporary moratorium to stop such deposit withdrawals.

The authorities should scratch the right of depositors to withdraw time deposits any time to contribute to the development of a sustainable deposit base which facilitates long-term lending. We thus support the NBU’s initiative to prohibit the early withdrawal of time deposits and amend Art. 1060 of the Civil Code in this direction. On February 3, 2011 the NBU published an invitation to banks to discuss this reform jointly.

Recommendation 5: We support current plans to cancel the right of depositors to withdraw time deposits any time, as this will eventually mitigate liquidity risks and facilitate long-term lending.

4.6 Relationship between asset and liability side

The lending boom prior to the crisis was accompanied by increasing imbalances in the balance sheet of the banking sector, as leverage was excessive and mainly financed by short-term external debt. During the crisis, banks were confronted with deposit withdrawals and limited refinancing of their external debt.

While the development of deposits during 2010 is encouraging, both in local and foreign currency, access to longer-term resources is predominantly in foreign currency available. In order to be able to issue more long-term loans in Hryvnia, a mechanism to swap FX surplus liquidity into UAH loans needs to be implemented in the short-term. The permission to conduct FX hedging transactions like forwards and swaps would help banks to deal with these FX mismatches and this could lead to an increase in long-term loans in UAH. It is important to note that the introduction of FX derivatives like forwards and swaps needs to go hand in hand with the further liberalization of the FX spot market. Important steps in this regard have been taken, e.g. was the Pension Fund duty on the FX market abolished on January 27, 2011.

In the medium-term, the implementation of a proper monetary framework centered on inflation targeting and a flexible exchange rate system seems to be the only way to facilitate lending in local currency (see section 4.1). This lending will be primarily funded by a stable deposit base in local currency. Given the high share of the shadow economy in Ukraine, as well as the holdings of FX cash outside the formal banking system, the potential to attract considerable resources into the system seems vast, given that confidence in banks can be increased. Such a sustainable model will be based on a lower loan-deposit-ratio, which is projected to decrease further.

Recommendation 6: Given the current restricted amount of long-term funding in local currency, one way to facilitate the increase in long-term lending in local currency would be the introduction of FX hedging mechanisms via forwards/swaps. In the medium term, the development model for the banking sector must follow the principle "domestic deposits fund domestic loans". For this, a stable macroeconomic framework is a key prerequisite.

4.7 Capital

The rapid deterioration in asset quality had a massive impact on banks' capital position. The stress-tests conducted revealed a lack of capital in many institutions, and plans to recapitalise banks were agreed upon. Indeed, recapitalisation is a major step forward in the process of rehabilitating the sector, as only with an adequately capitalised sector stability can be achieved.

While most foreign-owned banks in general did provide the necessary funds and increased their capital, many private domestically-owned banks seem to be reluctant to provide the necessary funds. This in turn increases the vulnerability to further shocks, as parts of the system remain undercapitalised. While the authorities should insist on the completion of the agreed recapitalisation plans, the suggested improvement in the legislation framework for M&A (see section 4.3) can play an additional role. Domestic owners unable or unwilling to provide fresh capital can sell their banks easier and the new owners can then provide the necessary funds.

The group of banks recapitalised by the state (including as a special case also Nadra) needs further funds, as the results of an end-2010 audit revealed. Here, in addition to the plans to establish a bad bank, the state should think hard about the best resolution/restructuring framework, having in mind the interests of the taxpayers. An additional recapitalisation can only succeed in combination with strategic decisions on what to do with these banks. In case a viable commercial business model can be identified, the state should divest it's shareholdings for an adequate compensation. If these banks stay in state-hands longer without a clear strategic focus, the risk of these banks being used for directed lending operations is evident.

Recommendation 7: An adequate capitalisation of the sector is a key element in the rehabilitation process. The fulfillment of recapitalisation plans by all actors is thus needed. For the state-recapitalised banks, a strategic decision on what to do with these banks is needed.

4.8 Rights of lenders and borrowers

Before the crisis, when credit was growing rapidly, and NPLs were relatively low, the quality of the legal framework governing the rights of borrowers and lenders (e.g. regarding foreclosure and bankruptcy procedures) were never put to a real test. This changed quickly during the crisis, when many borrowers were not able to repay their loans, and the lenders tried to foreclose and gain possession of the collateral. In this situation it became obvious that the legal framework is de-facto rather unfavorable to lenders (banks), which created also moral-hazard effects, e.g. solvent borrowers decided to default due to the limited consequences of such actions for them. Further elements were certain populist decisions by policy makers in the parliament, which aggravated the problems for the banking sector further.

A major lesson from these observations is that the rights of lenders have to be clearly protected and expanded. Amendments to the legislative framework in the fields of corporate insolvency and personal bankruptcy are needed, but also ways to speed up court cases have to be found. Otherwise, a risk premium will be charged with new credit, which implies higher interest rates, making loans less affordable also for well-intended ("good") borrowers. It becomes obvious that protecting lenders' rights is not just in the own interest of the banking sector, but also in the wider interest of the public, i.e. the demand side for loans[25].

It is encouraging that the NBU has reacted to these challenges in the right direction. It drafted jointly with commercial banks a relevant law where the protection of creditor rights is strengthened and submitted it to parliament.

Recommendation 8: The protection of lenders' rights is crucial for fostering sustainable lending. This is in the joint interest of both lenders and reliable clients, as it decreases interest rates and improves access to finance. The authorities need to take relevant measures for improving the legal and judicial environment.

[25] We cover this issue in more detail in our Policy Briefing PB/09/2010 „The influence of creditors' protection on credit markets".

Annex

Figure 39

Number of banks[26]

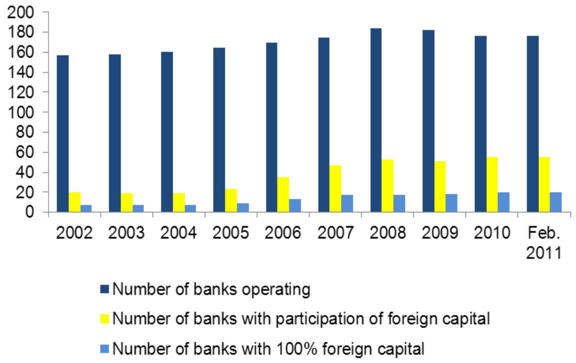
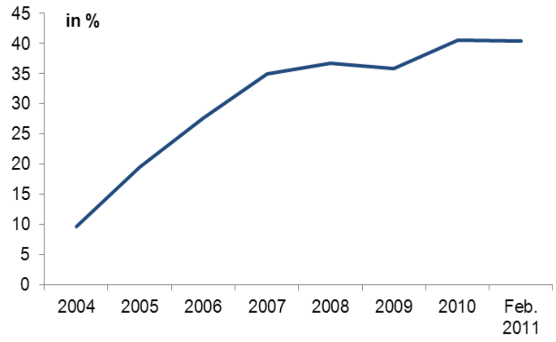


Figure 40

Share of foreign capital in the banking sector



Source: National Bank of Ukraine

Table 2

International comparison

Data as of 2008	Ukraine	Belarus	Bulgaria	Hungary	Kazakhstan	Poland	Romania	Russia	Turkey
Number of banks (foreign-owned)	184 (46)	31 (20)	30 (22)	39 (25)	37 (13)	70 (60)	32 (27)	1108 (102)	49 (24)
Asset share of state-owned banks (in per cent)	11.5	77.9	2.0	3.5	0.5	18.3	5.6	37.5	30.5
Asset share of foreign-owned banks (in per cent)	51.1	20.6	83.9	84.0	12.9	76.5	87.7	18.7	17.0
Non-performing loans (in per cent of total loans)	2.3	1.7	3.2	3.3	7.1	4.7	4.5	3.9	3.7
Credit growth from 2004 to 2008 (in per cent)	612.5	282.6	223.7	84.3	336.2	135.5	377.9	154.0	116.0
Domestic credit to private sector (in per cent to GDP)	79.8	28.8	74.5	67.6	48.8	55.0	38.5	41.0	32.6
Domestic credit to households (in per cent to GDP)	29.5	9.8	26.0	27.4	12.6	27.0	18.8	9.6	12.8
of which mortgage lending (in per cent of GDP)	15.1	5.2	12.4	21.5	4.9	15.0	3.8	2.5	4.1
Eurobond issuance (in per cent of GDP)	0.5	0.0	0.0	2.1	2.6	0.4	0.2	1.1	0.6
EBRD index of banking sector reform	3.0	2.0	3.7	4.0	3.0	3.7	3.3	2.7	3.0

Source: EBRD

[26] In this respect it’s noteworthy to mention the purchase of Bank Aval by the Austrian Raiffeisenbank in October 2005 as well as the acquisition of Ukrsotsbank by the Italian Banca Intesa in February 2006. Both banks are ranking amongst the Top 5 of the Ukrainian banking sector.

Table 3

Top 17 bank's balance sheet volumes and their market share (in %), per January 2011

	Name of the bank	Assets (bn UAH)	Market share
1	Privatbank	113.437	12%
2	Ukreximbank	73.172	8%
3	Oschadbank	59.019	6%
4	Raiffeisen Bank Aval	55.100	6%
5	Ukrsibbank	46.128	5%
6	Ukrsotsbank	41.603	4%
7	Prominvestbank	34.613	4%
8	VTB Bank	33.145	4%
9	Alfa-Bank	26.595	3%
10	OTP Bank	24.682	3%
11	Nadra	22.908	2%
12	Finance and Credit Bank	22.367	2%
13	First Ukr. International Bank	18.098	2%
14	Brokbusinessbank	15.826	2%
15	Kreditprombank	14.235	2%
16	Bank Forum	14.021	1%
17	Ukrgazbank	13.837	1%
	Sum	628.786	**67%**

Source: National Bank of Ukraine

Table 4

Overview of banks under administration/liquidation

		Assets (as of 1.1.2009) bn UAH	Ranking
Prominvestbank	Acquired by VEB (75% + 3 shares, subsequently increased to almost 94%); came out of administration in March 2009	27.5	11
National Credit	Came out of administration in December 2009	0.5	123
Ukrprombank	Being liquidated from January 2010, decision taken in October 2009 . Deposits were transferred partly to Rodovid Bank, assets as well.	10.2	18
Bank Kyiv	Nationalised (99.94%); came out of administration in September 2009	4.9	39
Zakhidinkombank	Moratorium extended from August 2009 to February 2010, came out of administration in February 2010	1.3	72
Nadra	Under administration from March 2009 extended twice most recently until August 2011	30.6	9
Sotscombank	Under administration from October 2010 to April 2011. Moratorium ended in January 2011	0.84	98
Dialogbank	Under administration from November 2010 until May 2011. Moratorium ended in February	0.17	159
Volodymyrskiy	In administration from July 2009 to June 2010 and moratorium until January 2010. Moratorium and administration reintroduced from January 2011 to April 2011	0.45	136
Bank Prichernomorje	Being liquidated from May 2009	0.31	144
Odesa Bank	Being liquidated from July 2009	0.63	111
Transbank	Moratorium extended (twice) from September 2009 to December 2009 and further to February 2010; Being liquidated from March 2010	1.21	78
Rodovid	Nationalised (99.97%); moratorium extended (twice) from September 2009 to December 2009 and further to March 2010; NBU extended the term of temporary administration in RODOVID BANK till September, 16, 2010 Temporary administration extended three times most recently to September 15 2011. Household deposits may be transferred to Oshchadbank Moratorium officially ended but clients have problems retrieving deposits	13.2	20
BIG Energija	Moratorium extended from September 2009 to March 2010. Being liquidated from March 2010	1.52	65
Bank for Regional Development	Being liquidated from December 2009	1.12	83
Arma	Moratorium expired in November 2009; The National Bank of Ukraine by its resolution No. 70 recalled a banking license from the LLC CB Arma and initiated a liquidation procedure.	0.69	105
Dnister	Moratorium extended from October 2009 to April 2010, Being liquidated from March 2010	1.43	68
National Standard	Being liquidated from August 2009	1.02	88
Evropeyskij	Being liquidated from August 2009	2.2	55
Ukrgazbank	Nationalised (81.6%); came out of administration in September 2009	14.8	17
Stolitsa	Moratorium extended from January 2010 to July 2010. Was out of administration but administration and moratorium reimposed in January 2011 until April 2011	0.46	128
Ukrainian Financial Group	Being liquidated from December 2009	0.36	139
Ipobank	Being liquidated from March 2010	1.45	67

Skhidno-Evropeyskij bank	Being liquidated from December 2009	1.10	84
Syntes	Liquidated from November 2010	0.66	108
Zemelniy bank(land bank)	Administration since May 2010 Liquidated from August 2010	0.99	91

Source: Different market reports, NBU, Deposit Guarantee Fund

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