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**ANALYSIS OF THE FUNCTIONING OF THE UKRAINIAN
BANKING SECTOR THROUGH THE PRISM OF PRUDENTIAL
BANKING SUPERVISION**

Abstract. In Article were investigated features implementation prudential Banking supervision in Ukraine. The conducted calculation and analysis activities Banking sector indicators of Ukraine on the basis of data of national report of the National Bank of Ukraine, that caused attempt to detect Indicators of the effectiveness Banking sector. Factual level of the effectiveness prudential Banking supervision in Ukraine has been substantiated and the direction of its increase with current trend of the Economic development in the country has been proposed.

Keywords: bank, banking supervision, prudential banking supervision, economic standards, economic indicators.

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JEL Classification: G12, G18, G21, G28

Introduction. As a key tasks of the current research the generalization indicators of Ukrainian banking sector, the structuring of such conditions in dependence on predictability of the information environment prudential banking supervision, the determination of basic advantages and shortages of the prudential banking supervision in modern conditions.

Literature review and the problem statement. The practicability of research of the task of analysis prudential banking supervision. This importance is confirmed by domestic scientists' research, among which: Sydorenko [Sydorenko 2013], Khrystoforova [Khrystoforova 2009], Schvets [Schvets 2009, 2011], Tsytsyk [Tsytsyk 2014], Diakonova [Diakonova 2008]. The substantial contribution in development of theoretical approaches for banking supervision is made by next famous scientist: Vasyurenko [Vasyurenko 2011], Yatsenyuk [Yatsenyuk 2004], Lyubun [Lyubun, Raievskiy 2005], Kovalenko [Kovalenko 2007], Zintchenko [Zintchenko 2006].

The purpose of this article is developing and grounding of the theoretical and methodological aspects of prudential banking supervision according to the economic performance of the Ukrainian banking system.

Research results. National Bank of Ukraine does the prudential banking supervision based on the existing regulatory framework. The main recommendations for the organization and practical implementation of prudential banking supervision activities in fixed positions: the Constitution of Ukraine; Laws of Ukraine ("On banks and banking activity", "On the National Bank of Ukraine" and "On amendments to some legislative acts of Ukraine to prevent negative consequences for the stability of the banking system", "On the prevention of legalization (laundering) of proceeds from crime, or financing of terrorism", "On Financial Services and State Regulation of Financial Markets "); Decisions and orders of the National Bank ("Instruction on the regulation of banks in Ukraine", "Guidelines for the inspection of banks' risk assessment

system", "Guidelines for the organization and operation of risk management in banks Ukraine", "Guidelines on the procedure analyzing the financial condition and report on the monitoring of the bank – legal entity", "Guidelines on procedure of stress testing in banks Ukraine", "On organization of internal audit in commercial banks of Ukraine", "On the procedure for the determination of ratings rating system CAMELS "); and other legal acts of Ukraine [Vasyurenko, Sydorenko 2011]

National legal framework governing prudential bank supervision supplemented by foreign regulatory acts, including: EU Directive, regulations and recommendations of the Basel Committee on Banking Supervision, the basic of which are: Core Principles for Effective Banking Supervision, 1997 and updated 2006 edition. and 2012, Basel I – "International Convergence on measurement and capital requirements" in 1988 and updated edition 1996, Basel II – "International Convergence on measurement and capital requirements: New Approaches", 2004 Basel III – in 2010, 2013 and so on. In particular, the implementation of the requirements of the Basel Committee on Banking Supervision and the Core Principles for Effective Banking Supervision in Ukraine started in the early 2000s, and since 2008 the NBU declared a policy of transition to supervision of banks based on risk assessment. This allowed Ukraine as close as possible to international standards of prudential banking supervision and make reorientation of retrospective surveillance in perspective.

In terms of the concept of prudential banking supervision based on risk assessment, the National Bank aims to determine the scope of banking activities, which together may pose an unacceptable risk to the banking system. In this context, the National Bank of Ukraine identified nine categories of risk: credit risk, liquidity risk, interest rate risk, market risk, currency risk, operational and technological risk, reputational risk, legal risk, strategic risk and so on. Resolution of the National Bank of Ukraine "Guidelines for the inspection of banks' system risk" of 15 March 2004 p. №104 shows that the risk assessment in the evaluation system of bank risks must reflect as actual and potential risk profile of the bank. In this assessment and based strategy and actions of the banking supervision. Using this approach, representatives of the banking supervision NBU should determine how certain existing or potential problems faced by the bank or banking system, affect the nature and level of risks in the bank, and provide a greater amount of focus supervisory resources to areas of high risk. National Bank of Ukraine defined system for evaluation of each risk category. The system of risk assessment, using appropriate methods and criteria for risk management allows the NBU, as a body of prudential banking supervision, to determine which program supervisory action should be developed for each bank [Mishkin 2001, Yatsenyuk 2004, Lyubun' 2005, Basel III: A global regulatory framework for more resilient banks and banking systems 2011].

Ukraine's banking sector has structural features of the structure, which undoubtedly affects the specific organization of prudential banking supervision. Thus, all banks divided into four groups by assets. As of 1 January 2015 Ukraine registered a total of 163 banks with a banking license to 155 as of February 1, 2015, of which 1 bank licensed sanation bank, one bank is under restructuring (JSC "Bank Renaissance Capital"). As of March 20, 2015 – 38 banks are under liquidation, the introduction of the interim administration – 16 institutions (Fig. 1).

As of January 1, 2015 and a group of banks accounted for 15 institutions, the second group – 19 banks, III group – 33 banks and IV group – 95 banks respectively.

As of 01.02.2015 in Ukraine there are 50 banks with foreign capital, including 19 banks with 100% foreign capital.

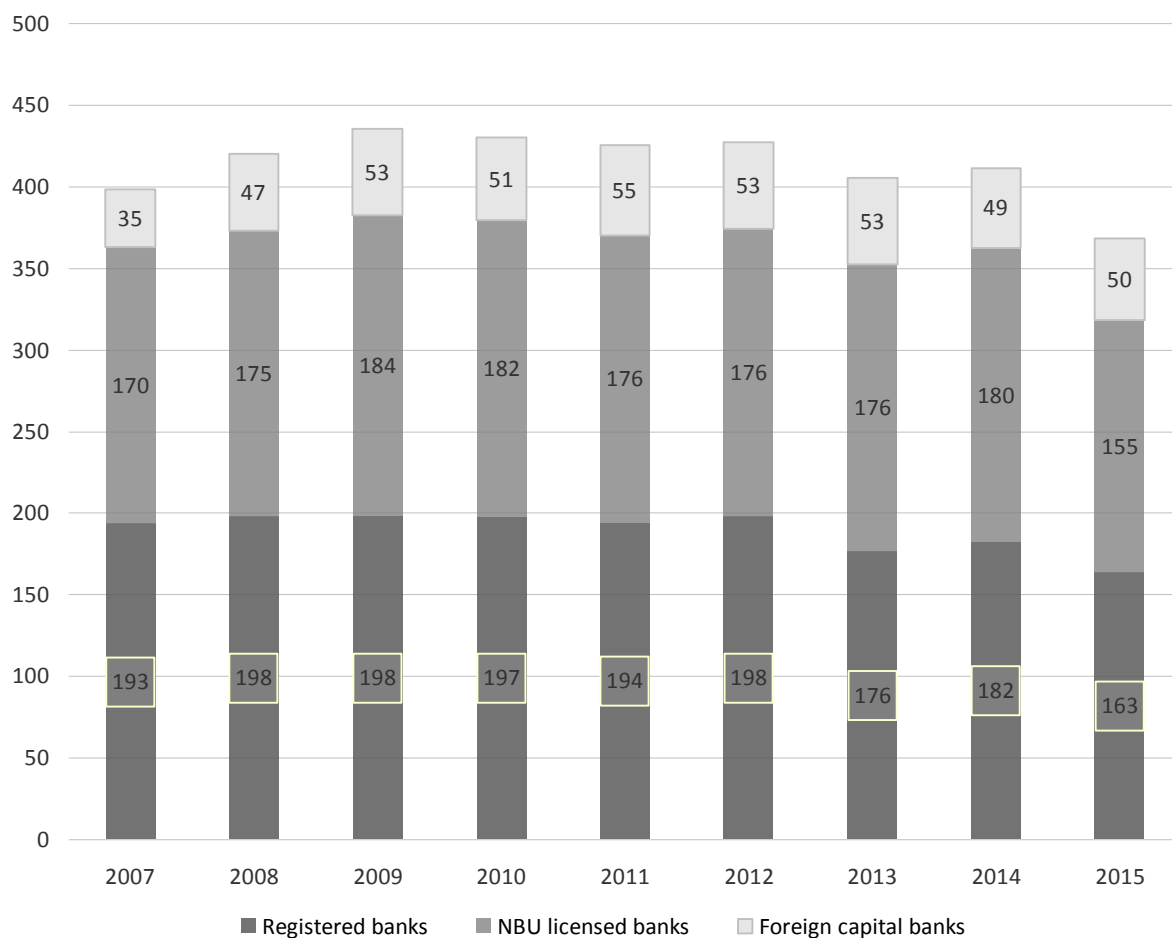


Figure 1 – Changes in the number of banks and the structure of the Ukrainian banking sector in 2007-2015 yy

Source: built on the basis of [Osnovni pokaznyky diyalnosti bankiv Ukraini za berezen 2015 rik 2015]

The share of foreign capital in the authorized capital of banks amounted to: in 2010 - 35.8%, 2011 - 40.6%, 2012 - 41.9%, 2013 - 39.5%, 2014 - 34.0% on 01.01.2015 - 32.5%, for 02.01.2015 - 32.6% at the beginning of the year (Table 1). In the continuation of certain trends in the share of foreign capital in Ukrainian banks from January 2014 to February 2015 decreased by 1.4 percentage points to 32.6%. This trend is due to the fact that banks with foreign capital continued to curtail activity in the retail banking market in Ukraine and shifts corporate segment. Some of them continue the process of leaving the Ukrainian banking market in the absence of short-term essential prerequisite for improving the business climate and favorable business environment in Ukraine (Figure 1).

Dynamics for 2014 and the values of economic standards in the banking system of Ukraine as of 01.01.2015:

- *Capital Standards:*

N1: Regulatory Capital (mln. UAH). - As of 01.01.2015 p. 188 amounted to 948.90 mln. UAH. - A decline of -16 027.00 mln. UAH., Or -7.82%;

N2: adequacy (the adequacy) regulatory capital (minimum 10%) - as at 01.01.2015 was 15.60 - a decline of -2.66 or at -14.57%;

Table 1 – Performance of the Ukrainian banking sector in 2007-2015 yy

| Indicator | Years | | | | | | | | |
|---|-------|-------|-------|-------|-------|--------|--------|--------|--------|
| | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 |
| Registered banks | 193 | 198 | 198 | 197 | 194 | 198 | 176 | 182 | 163 |
| NBU licensed banks | 170 | 175 | 184 | 182 | 176 | 176 | 176 | 180 | 155 |
| Assets of banks, bln. UAH | 340,2 | 599,4 | 926,1 | 880,3 | 942,1 | 1054,3 | 1127,2 | 1278,1 | 1306,2 |
| Granted loans, bln UAH | 269,3 | 485,4 | 792,2 | 747,3 | 755,0 | 825,3 | 815,3 | 911,4 | 1000,2 |
| Long-term loans, bln. UAH | 157,2 | 292,0 | 507,7 | 441,8 | 420,1 | 426,4 | 394,2 | 464,2 | 516,2 |
| The ratio of long-term loans to granted loans, % | 58,4 | 60,2 | 64,1 | 59,1 | 55,6 | 51,7 | 48,4 | 50,9 | 51,6 |
| The share of overdue loans in total loans, % | 1,1 | 1,3 | 2,3 | 9,4 | 11,2 | 9,6 | 8,9 | 7,7 | 14,6 |
| Liabilities of banks, bln. UAH | 340,2 | 599,4 | 926,1 | 880,3 | 942,1 | 1054,3 | 1127,2 | 1278,1 | 1306,2 |
| Equity, bln. UAH | 42,6 | 69,6 | 119,3 | 115,2 | 137,7 | 155,5 | 169,3 | 192,6 | 142,4 |
| Regulatory capital, bln. UAH | 41,1 | 72,3 | 123,1 | 135,8 | 160,9 | 178,5 | 178,9 | 204,9 | 188,9 |
| Authorized capital, bln. UAH | 26,3 | 42,9 | 82,5 | 119,2 | 145,9 | 171,9 | 175,2 | 185,2 | 180 |
| The share of foreign capital in the authorized capital, % | 27,6 | 35,0 | 36,7 | 35,8 | 40,6 | 41,9 | 39,5 | 34,0 | 32,6 |
| Liabilities of banks, bln. UAH | 297,6 | 529,8 | 806,8 | 765,1 | 804,4 | 898,8 | 957,9 | 1085,5 | 1163,8 |
| The regulatory capital adequacy (H2), % | 14,2 | 13,9 | 14,0 | 18,1 | 20,8 | 18,9 | 18,1 | 18,3 | 13,81 |
| The share of capital in liabilities, % | 12,5 | 11,6 | 12,9 | 13,1 | 14,6 | 14,7 | 15,0 | 15,1 | 15,0 |

Source: built on the basis of [Osnovni pokaznyky diyalnosti bankiv Ukraini za berezen 2015 rik 2015]

- Liquidity ratios:

N4: Instant liquidity ratio (not less than 20%) - as at 01.01.2015 was 57.13 - an increase of 0.14, or 0.25%;

N5: Current liquidity ratio (not less than 40%) - as at 01.01.2015 was 79.91 - a decline of -0.95 or -1.17% to;

N6: Short-term liquidity (no less than 60%) - as at 01.01.2015 was 86.14 - a decline of -2.97 or -3.33% to;

- Standards credit risk:

N7: the maximum credit risk per one counterparty (no more than 25%) - as at 01.01.2015 was 22.01 - a decline of -0.32 or -1.43% to;

N8: The ratio of large credit risks (no more than 8 times the amount of regulatory capital) - as at 01.01.2015 was 250.04 - an increase of 77.99 or at 45.33%;

N9: Maximum loan, guarantees and sureties granted to one insider (no more than 5%) - as at 01.01.2015 was 0.13 - a decline of -0.23 or at -63.89%;

N10: Maximum total amount of loans, guarantees and sureties issued to insiders (no more than 30%) - as at 01.01.2015 was 1.37 - a decline of -0.26 or at -15.95%;

- Standards investment:

N11: The ratio of investment in securities by each institution (maximum 15%) - as at 01.01.2015 was 0.01 - a decline of -0.03 or at -75.00%;

N12: Ratio of total investment (up 60%) - as at 01.01.2015 was 2.97 - a decline of -0.18 or -5.71% (Fig. 2).

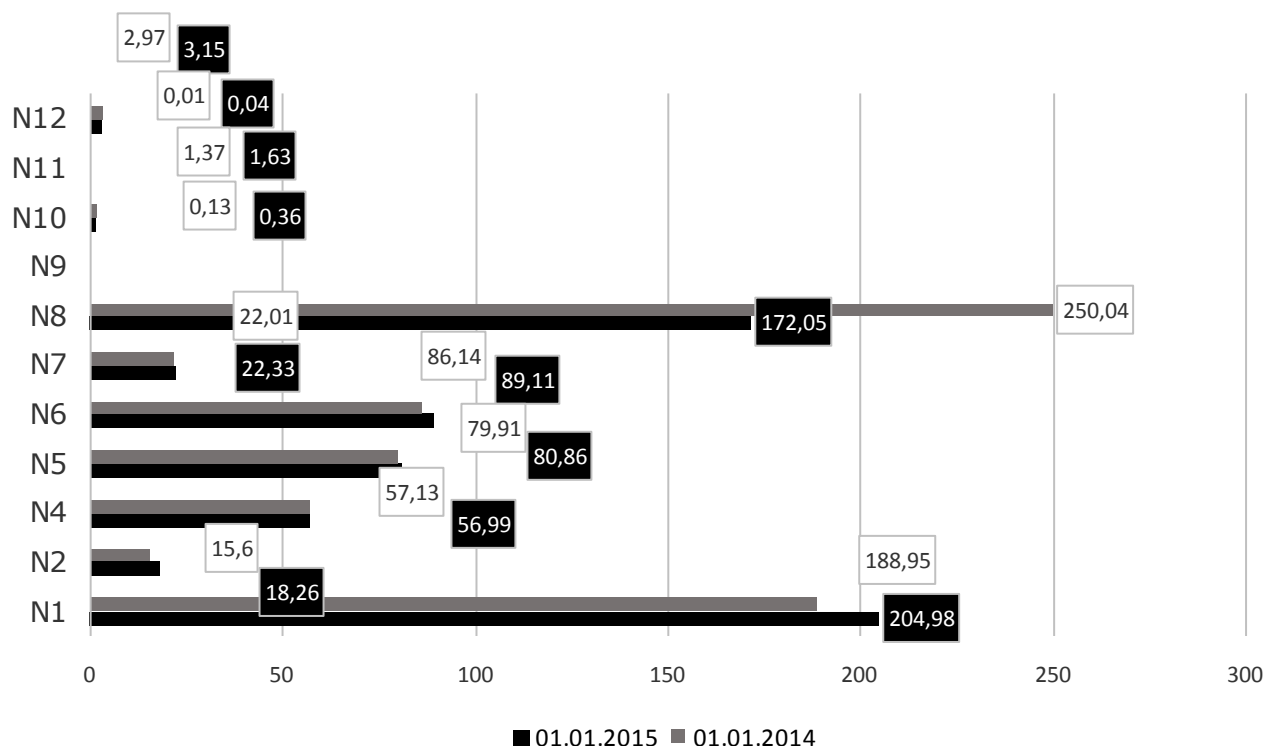


Figure 2 – Dynamics of economic standards in the Ukrainian banking system as of 01.01.2014 and 01.01.2015

Source: built on the basis of [Osnovni pokaznyky diyalnosti bankiv Ukraini za berezen 2015 rik 2015]

Main indicators of banks in Ukraine.

Assets of banks in Ukraine 01.01.2015. Totaled 1.3169 trillion. UAH. (on 01.01.2014. - 1278.0 bln. UAH.), the total assets (not adjusted for reserves under active transactions) -1.5208 trillion. UAH. (on 01.01.2014 - 1.4086 trillion. UAH.).

The breakdown of total assets at 01.01.2015:

- Highly liquid assets - 10.2%
- Investments in securities - 11.1%
- Credit transactions - 66.2%
- Other assets - 12.5%.

Capital of banks 01.01.2015 Was 148.0 bln. UAH., Or 11.2% of banks' liabilities. The authorized capital of banks amounted to 180.1 billion. UAH (Fig. 3).

The main components of liabilities on 01.01.2015:

- Means individuals - 416.3 billion. UAH. (35.6%);
- Funds legal entity - 261.3 billion. UAH. (22.4%).

Deposit portfolio:

- Individuals decreased in December to -0.2% or -871 000 000. UAH. The share of fixed-term funds is 76.6%;
- Entities rose in December by 3.8% or 9.111 billion. UAH., Term funds share is 39.2% (Fig. 4).

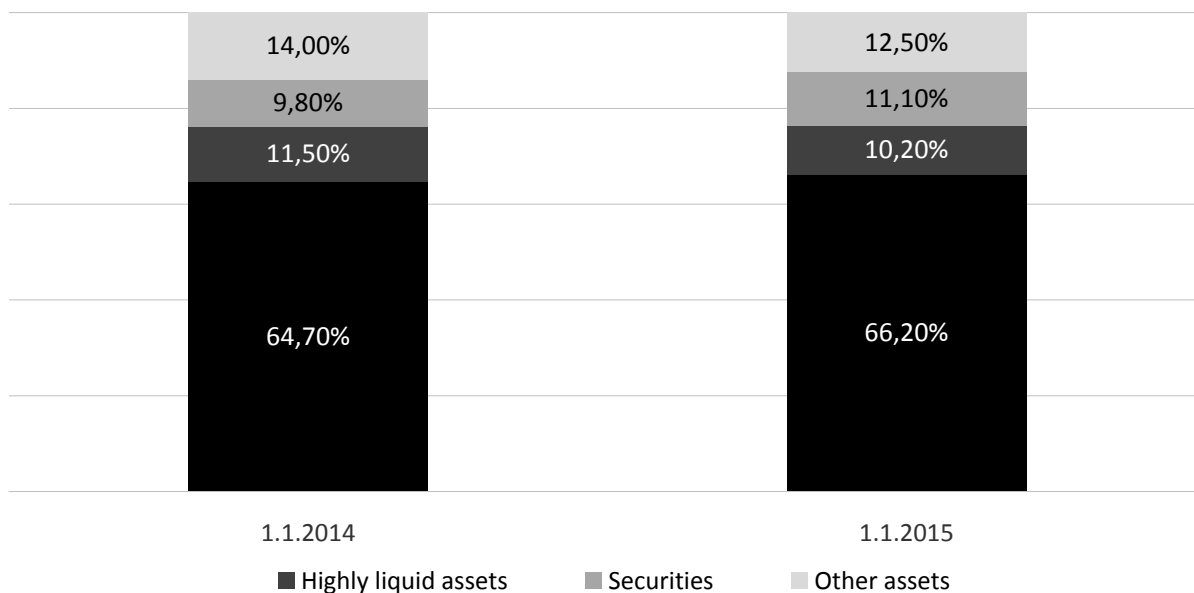


Figure 3 – Asset structure, %

Source: built on the basis of [Osnovni pokaznyky diyalnosti bankiv Ukraini za berezen 2015 rik 2015]

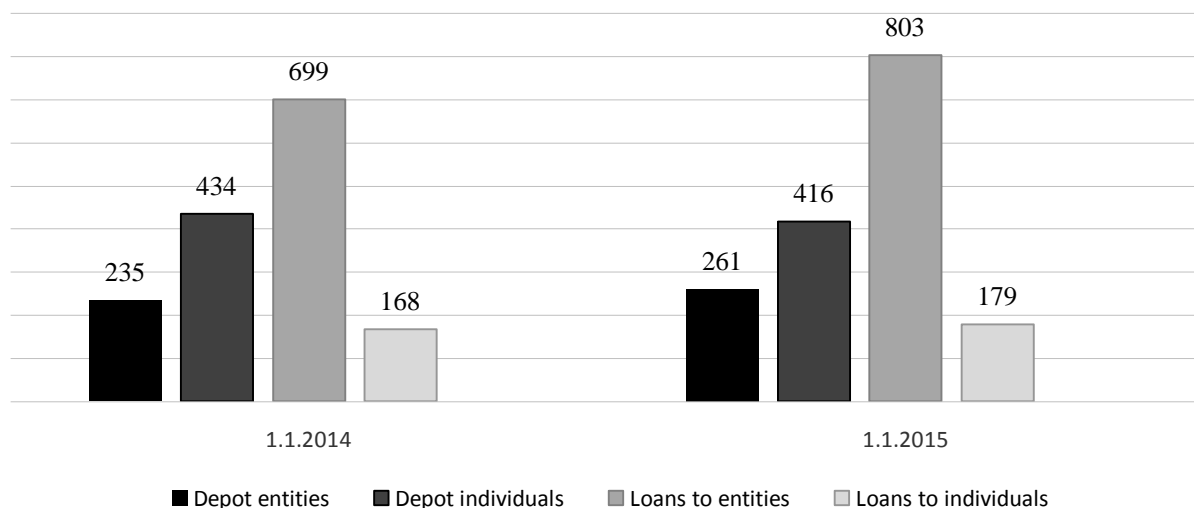


Figure 4 – Deposit and loan portfolios, bln. UAH

Source: built on the basis of [Richnyy zvit Natsional'noho banku Ukrayiny za 2014 rik 2014]

Credit portfolio:

- Individuals decreased in December to -0.7% or 1.222 billion. UAH.

- Entities rose in December by 5.0%, or 37.313 billion. UAH (Fig. 5).

The share of bad loans in the total loans to 01.01.2015 was 13.5% or 135.8 billion. UAH.

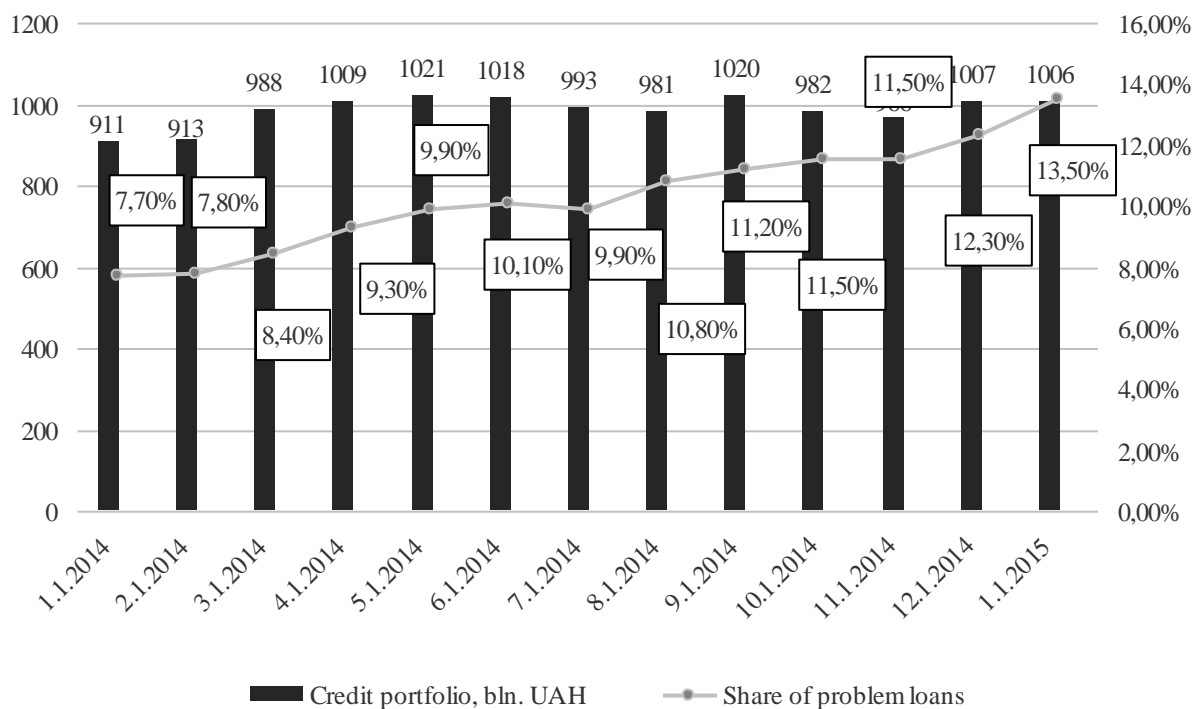


Figure 5 – The quality of the credit portfolio of the Ukrainian banking system
 Source: built on the basis of [Richnyy zvit Natsional'noho banku Ukrayiny za 2014 rik 2014]

The structure of income and costs of banks on 01.01.2015.

Income and expenses of banks by 2014 compared to 2013:

- Revenues increased by 24.5% to 210.2 billion. UAH;

- Costs increased by 57.2% to 263.2 billion. UAH

The loss of the banking system of Ukraine totaled 52.9 billion. UAH.

On the financial result of the banking system of Ukraine adversely affected losses of troubled banks -19.9 billion. UAH.

Excluding the losses of the banks loss on the banking system amounted to - 33,1 bln. UAH (Fig. 6, Fig. 7).

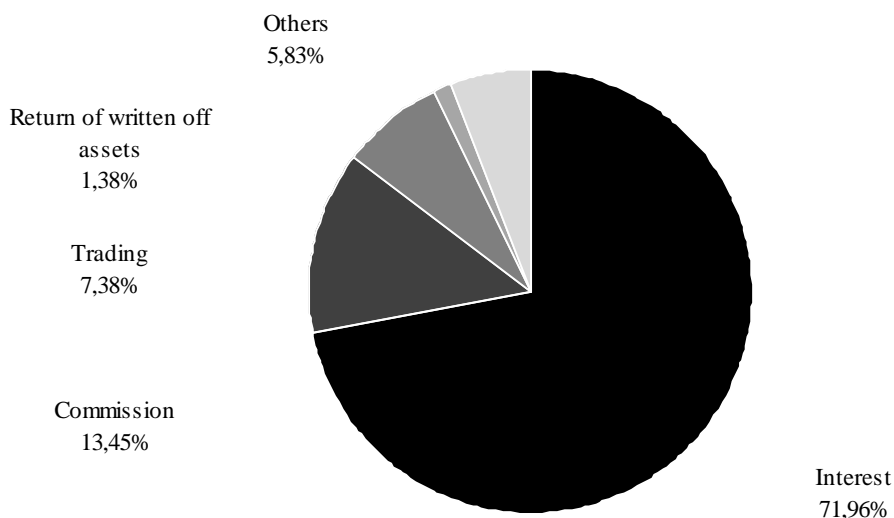


Figure 6 – Income as to 01.01.2015

Source: built on the basis of [Richnyy zvit Natsional'noho banku Ukrayiny za 2014 rik 2014]

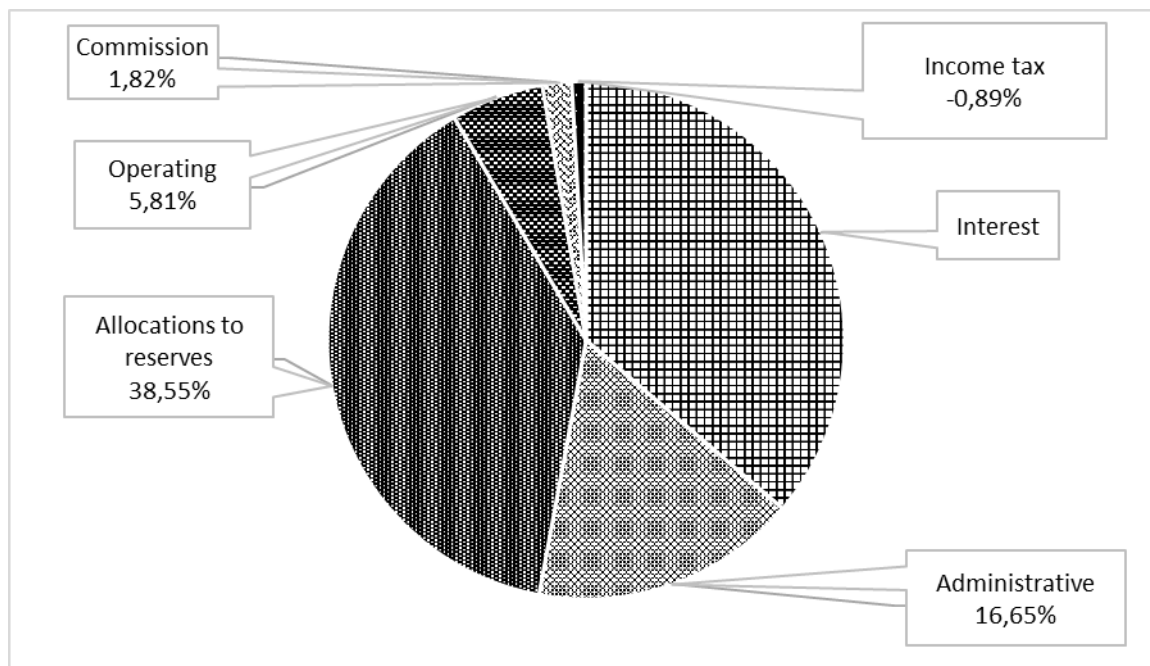


Figure 7 – Costs as to 01.01.2015

Source: built on the basis of [Richnyy zvit Natsional'noho banku Ukrayiny za 2014 rik 2014]

The volume of refinancing of banks in December totaled 42.9 billion. UAH. (From the beginning of the year - 222.3 billion. UAH).

The weighted average interest rate was 17.95% per annum (YTD - 15.57%).

The volume of mobilization operations in December amounted to 155.5 billion. UAH. (YTD - 1.4727 trillion. UAH).

The weighted average interest rate - 8.34% (YTD 5,68%) (Fig. 8).

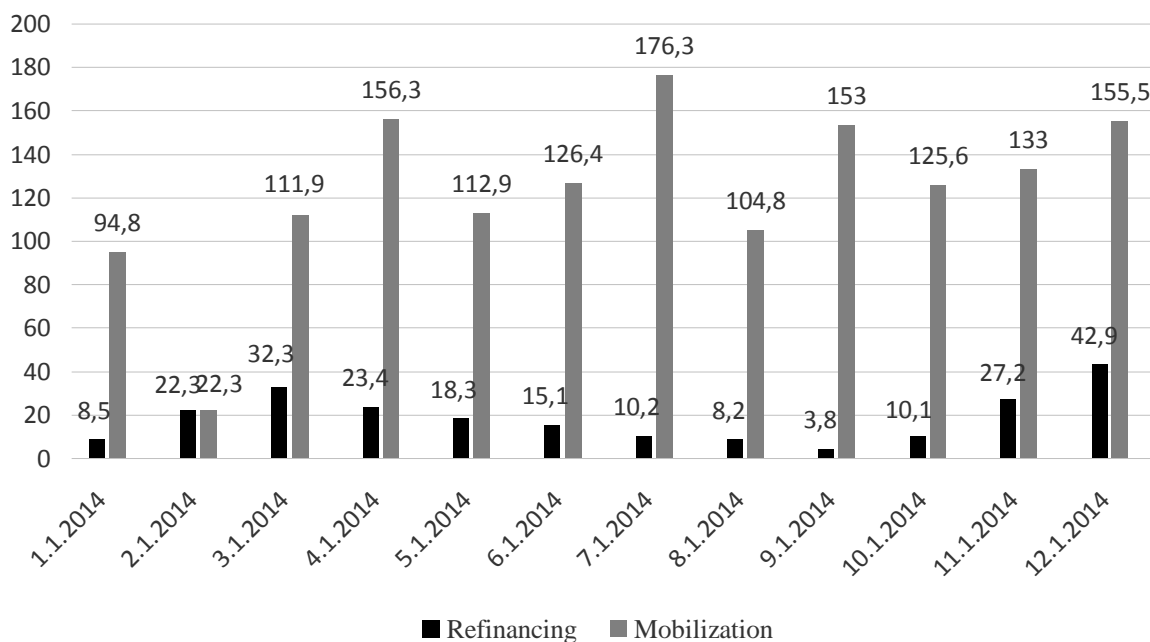


Figure 8 – NBU regulation of bank liquidity, bln. UAH

Source: built on the basis of [Richnyy zvit Natsional'noho banku Ukrayiny za 2014 rik 2014]

Ensuring stability relies on the National Bank of Ukraine as the main supervisor through event prudential banking supervision. NBU, in turn, is intended to influence the management of banking risks at different levels: at the micro level - encouraging banks to actively use and improvement of the internal systems of risk management, directing them to monitor the different categories of sources of risk and improved methods to minimize them; and at the macro level - monitoring compliance with prudential banking supervision and creating favorable framework conditions for the use of modern technologies of risk management through the introduction of targeted risk management.

As seen from the analysis, the banking sector Ukraine is in the process of formation and does not have sufficient capacity, balanced number of participants and the existing legal framework. Therefore, it is fragile. Avoiding risks within banks activities is not possible. That is why the quality of the organization of risk management of banks, their constant control of the Management Board and the appropriate monitoring and supervision by prudential bank supervision is a necessary condition for maintaining stability of the banking system of Ukraine.

Considering the current economic realities and trends of financial markets, there are numerous existing challenges of the banking system of Ukraine: the stabilization of the banking sector, combating corruption through greater automation of banking supervision with the further possibility to increase the transparency of supervision, improve the efficiency of financial management and so on. All these calls signal the urgent need to reform the system of banking supervision, including prudential.

Conclusions. Nowadays in Ukraine are consistently implemented reforms in the financial sector. On the one hand, made reform of public finances, which include: stabilization of the budget deficit, public debt optimization, improving the efficiency of public spending, improve public financial management, strengthening of financial and fiscal discipline, reform of intergovernmental relations. On the other hand the reforms of the financial sector, aimed, in particular, the maintenance of low inflation, stability and level of capitalization of the financial system, increasing the amount of financial services, restore lending to the economy with a simultaneous reduction in the risk of financial system, growth and development of the stock market and financial services market. However, in reality there is a situation where the financial system, designed to ensure sustainable economic development of the state is not able to fully function and carry out its functions. Among these reasons: the decrease in financial services, particularly in lending business and the public; lack of long-term financial resources; underdevelopment and low financial market transparency and more.

Prudential risk-based banking supervision, the conditions for its effective implementation, ensure the stability of the banking system to risks and the ability to manage them. In order to achieve maximum stabilizing effect in the country should operate an effective system of prudential banking supervision from the local level (supervision within an individual bank) and moving to regional (within the territorial offices of the central banks) national (at the central bank) and supranational levels of supervision. This organizational structure will ensure maximum coverage of the internal and external environment for the effective management of banking risks. In general, strengthening the role of the NBU within the context of prudential supervision in the management of banking risks can occur in three scenarios: taking over the National Bank of Ukraine on some risks; the use of leverage, enabling banks to

focus less risky transactions, and compliance with regulations; recognizing that banks are able to manage risk and maintain their independence in the development of risk management.

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