INTERNATIONAL RESEARCH CENTER
OF BANKING & CORPORATE GOVERNANCE

HEADQUARTER:
Ukrainian Academy of
Banking of the National Bank
of Ukraine
Petropavlivska Str. 57
Sumy, 40030, Ukraine

BANKING & CORPORATE GOVERNANCE

INSTITUTIONAL FOUNDERS:
Ukrainian Academy of Banking
of the National Bank of Ukraine
Belgrade Banking Academy
Telfer School of Management
at the University of Ottawa

From: Prof. Alexander Kostyuk, Executive Director,
International Research Center of Banking & Corporate Governance,
Ukraine

Date: 21 March, 2010

To: Secretariat of the Basel Committee on Banking Supervision,
Bank for International Settlements, CH-4002 Basel, Switzerland

Subject: Comments to the Consultative Document
"Strengthening the resilience of the banking sector"

Dear Sir/Madam.

I enclose our comments to your Consultative Document "Strengthening the resilience of the banking sector". These comments have been prepared by the team of researchers at the International Research Center of Banking & Corporate Governance at Ukrainian Academy of Banking of the National Bank of Ukraine (Ukraine) consisting of Prof. Alexander Kostyuk, Ms. Katya Kondrunina and Ms. Olga Neselevskaya. We hope that the comments would be taken into consideration when approving the final Paper. Your feedback would be appreciated by us.

With the best regards,
Prof. Alexander Kostyuk

BANKING & CORPORATE GOVERNANCE

Comments on the consultative document "Strengthening the resilience of the banking sector"

by

International Research Center of Banking & Corporate Governance,
Ukrainian Academy of Banking of the National Bank of Ukraine
Petropavlivska Str. 57, Sumy, 40030, Ukraine

Clause, page	Comments on the issue	Suggestions
c.7.4, p.3 c.14, p.4 c.35-37, p.8-9	"The Committee is promoting stronger provisioning practices through three related initiatives (c.35)" – this clause and following suggestions are external by their nature and tend to be a step-back from deregulation of the banking sphere.	Initiatives should be internally oriented (involves changes in the home policy of banks).
	"…The crisis demonstrated that credit losses and writedowns come out of retained earnings…(c.13)" "Fourth, the Committee is introducing a series of measures to promote the build up of capital buffers in good times that can be drawn upon in periods of stress (c.7.4)" Hence the Committee's measures involve indicators of the capitals of the different levels etc.	To include indicators describing connection between bank's remuneration policy and its capital: - stimulation of the building up of capital buffers through its correlation to the variable part of the compensation package of the executive directors; - strengthening the resilience of the banking sector with introducing the ratio which includes a high quality capital base, retained earnings and compensation packages of the executive directors.

c.39, p.9 c.62.3, p.13 c.71, p.15 c.80, p.16	"At the onset of the financial crisis, a number of banks continued to make large distributions in the form of dividends, share buy backs and generous compensation payments even though their individual financial condition and the outlook for the sector were deteriorating (c.39)" "…banks will be required to disclose the following: - a full reconciliation of regulatory capital elements back to the balance sheet in the audited financial statements; - separate disclosure of all regulatory adjustments; - a description of all limits and minima, identifying the positive and negative elements of capital to which the limits and minima apply; - a description of the main features of capital instruments issued; and - banks which disclose ratios involving components of regulatory capital (eg "Equity Tier 1", "Core Tier 1" or "Tangible Common Equity" ratios) to accompany these with a comprehensive explanation of how these ratios are calculated (c.80)"	The disclosure of the information: - concerning the correlation between financial performance and distributions in the form of dividends, share buy backs and compensation payments is needed; -concerning acquisitions and mergers of the bank.

c.262.2, p.71	"For each jurisdiction, when the variable breached certain pre-defined thresholds this would give rise to a benchmark buffer requirement. This could then be used by national jurisdictions to expand the size of the capital conservation buffer (c.262.2)". This might lead to the outflow of capital from the markets with higher requirements to the more attractive regions (e.g. regions with higher ROI).	To work out the common size of the capital conservation buffer for Basel Member countries.
c.114.3, p.28, c.29.3, p.7	"Large financial institutions were more interconnected than currently reflected in the capital framework (c.114.3)".Banking sphere can face the dilemma- on the one hand economic growth might be downsized by the framework, on the other hand interconnection might be increased in case capital buffets are reserved in banking sector.	The Committee is to give a deeper consideration of the issue.
p.177.49, p.54	The bank must have an independent risk control unit that is responsible for the design and implementation of the bank's counterparty credit risk management system. The unit should produce and analyse daily reports on the output of the bank's risk measurement model, including an evaluation of the relationship between measured of counterparty credit exposure and trading limits. The unit must be independent from the business trading units and should report directly to senior management of the bank.	The independence can be considered either as a fitting in a set of requirements or as being external independent structure. The last mentioned could be an option only in the context of long-term perspective due to the fact that it takes time to establish a new sector on the consultative service market. Another issue that should be considered whether these new consulting companies will cooperate with a group of banks or the one only. That's why speaking about short-term perspective it's important to decide on the following issues:

		- criteria of independence - compiling procedure - putting into the framework of the whole organisational structure The criteria of independence for the members of the proposed risk control unit can be worked out from the pattern of independent directors criteria, namely: - no ties of relationship with senior and top management - not being a major shareholder (maximum of 5%) - not obtaining the executive or senior management position for at least 5 years - not obtaining the same position in the another bank Compiling procedure should involve neither GSM (because of the complexness and frequency) nor any Committee (because of information distortion). Hence The members of the risk control unit are to be appointed by the specific majority of the Board of Directors: majority (including at least 75% of the independent directors) is to vote in favour. At the moment there is a body under CFO which is responsible for the operating risks analyses, while strategic risks are under competence of the the Risk committee. An

		independent body which is proposed to be established aiming at reporting on the daily and monthly base on the operating risks of the bank and their strategic influence. These daily reports are to be sent to the CFO for the every day running of the business, while monthly reports are to be considered on the matter of long-term influence of the operating risks after approval of the CFO by the Risk committee. CFO is responsible for taking decision on the relevance of the operating risks and their possible influence on the strategic position of the bank. After Risk committee's approval, the report is to be discussed on the meeting of the Board.