

Principles of State Banking Sector Strategic Reforming

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Ministry of **Finance**
of Ukraine



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Summary

Ministry of Finance of Ukraine (MoF), National Bank of Ukraine, management of state owned banks (SOBs) and representatives of international financial institutions agree that the current mechanism of corporate governance in SOBs, responsibility for the results of their activity and decision making processes in these banks require reformation. Historically it happened, that such state activities in managing its share in the equity of banks is, in fact, a direct control over the activity of such banks, limiting the commercial independence of Supervisory and Management boards and creates the risk of possible political or administrative influence, and this can negatively reflect on the value of assets for taxpayers, who are the final beneficiaries of state property.

To ensure state banks activities in the interests of taxpayers, it is imperative that the government manages its investments in banks on a commercial basis. We express our intention to introduce fundamental changes of the system of corporate governance of SOBs and mechanism of their cooperation with MoF, as owner`s representative, taking into account best world practices.

We propose transition to politically isolated management of SOBs activities through Supervisory boards that are comprised completely from independent experts. The government will strengthen the protection of its interests through the introduction of contractual relations between the Cabinet of Ministers of Ukraine and SOBs. MoF will staff the team in an corresponding structural unit with market professionals to perform coordinating functions, and to realize the mission of management of state interests in SOBs.

Considering the importance of SOBs for financial system, MoF divides them into core (Oschadbank and Ukreximbank) and non-core SOBs.

MoF defines goals and strategic tasks for these two groups of banks:

- **In the short term, the core SOBs will remain in state property.** Thus, the State ensures clear principles of development and strategic goals, the SOBs implement in their individual strategies.
- **Implementation of best corporate governance practices and achievement of strategic goals by core SOBs, will create conditions for their privatization in 2018-2019.** This will facilitate commercial orientation and banks` profits maximization, and ultimately - increase the value of banks to taxpayers.
- **State expresses its firm intention not to be a long-term owner of non-core SOBs and return them to private ownership by end2017.**

Successful implementation of the strategy will be complex and will require strong political will, given that for implementation of the changes it is necessary to make amendments to the legislation and regulations of Ukraine.

Abbreviations and Glossary

VRU	Verkhovna Rada of Ukraine (Parliament)
EBRD	European Bank for Reconstruction and Development
CMU	Cabinet of Ministers of Ukraine
IMF	International Monetary Fund
MoF	Ministry of Finance of Ukraine
IFC	International Finance Corporation
IFI	International Financial Institutions
NBU	National Bank of Ukraine
DEG	Deutsche Investitions- und Entwicklungsgesellschaft
CEE	Central and Eastern Europe
DGF	Deposit Guarantee Fund
Planning horizons	Short-term – 2016
	Mid-term – 2017-2019
	Long-term – 2020-2025

Introduction

1. This document defines principles of state banking sector reforming till the year 2025 (hereinafter – the Strategy), as well as general procedure and conditions of its implementation. The current structure of the state-owned banking sector of Ukraine comprises a number of nominal groups: the historically state-owned banks (Oschadbank, Ukreximbank), nationalized banks (Ukrghazbank, Rodovid) and non-functioning state banks (the State Land Bank, the Ukrainian Bank for Reconstruction and Development). The strategy does not include banks with indirect minority presence of the state in the capital (Khreschatyk, Express-Bank, Bank Novy).
2. The state banking sector was initially assigned the task to promote economic development, including the support of export-import activities and guaranteeing deposits of the population. During the 2008-2009 crisis, shares in certain commercial banks, currently owned by the State, were purchased through direct recapitalization. In order to fulfil special tasks, functional banks were established.

Oschadbank, Ukreximbank and Ukrghazbank have gradually developed as universal banking institutions operating in all sectors of Ukraine's economy, having a possibility to, *inter alia*, grant large-sized loans to legal entities. In 2014 and 2015, operations of the banks were loss-making. Sub-standard loans constitute considerable portion in loan portfolio of these banks (as well as in whole banking system).

- a.
3. Issues pertaining to the work with non-performing loans are referred to operational management tasks and are not considered in detail in the Strategy. At the same time, legislation will require amendments aimed at creating conditions for the effective work of banks with bad debts, including through:
 - a. giving adequate powers to newly elected Supervisory boards of banks to make decision on the non-performing loans;
 - b. approval of the effective mechanism to protect creditors' rights and simplify conditions for bankruptcy of borrowers.
4. The quality of corporate governance produced a significant negative impact on the process of formation of credit portfolios and investment decisions by state-owned banks. The current level of involvement of the state administrative authorities in corporate decision-making, stipulated by the limits of the applicable legislation, weakens the banks' ability to function as commercial market entities, prevents reaching the adequate transparency level for potential investors and taxpayers, and does not contribute to the overall stability of state banks.

In our opinion, the principles and mechanisms of corporate governance must be reviewed in a fundamental way and constitute a priority under the Strategy. The respective legislation and regulations should be brought in compliance with international standards and best practices, which will improve the efficiency of decision-making in the interests of the state and taxpayers, and ensure the independence of operational management of state banks from possible political or administrative influence.

5. The Strategy has been formulated with account to the decision, adopted at the state level, on increasing financial efficiency of operation of the banks, and transparency of management (*one of the projects within the comprehensive program of the Ukrainian financial market development¹, in accordance with the requirements of the Extended Fund Facility Arrangement between Ukraine and the IMF²*).
6. The priority in development for the 2016 to 2025 is given to an increase in value of banks that meets taxpayers' long-term interests, including:
 - a. improvement of banks' financial results rather than through additional capitalization on part of the state;

- b. abidance by the self-sufficiency principle as well as use of prudent credit policy by the management of SOBs;
 - c. top-down directive style in the relations between the government and the banks must be ruled out;
 - d. ensuring responsibility for SOBs management in case of confirmation of bank losses, connected with inappropriately made decisions or excessive exposure.
7. Proceeding from the vision of a shareholder and the size of banks' assets, state-owned banks are proposed to be divided into two groups:
 - a. systemically important (core) ones - Oschadbank and Ukreximbank;
 - b. non-core (all other banks).
 8. Implementation of the Strategy will provide for a transition to independent commercial corporate governance of the banks, improved financial stability of banks and in turn will create necessary preconditions for their privatization.
 9. The Strategy for systemically important banks will be adjusted after partial or complete sale of banks' shares.
 10. There exists a possibility for a temporary growth of the public share through possible changes in the banking sector of the country. That growth is not desirable, but may be connected with the need for a proactive involvement of the state in solving problems of the banking system. The ultimate goal of those actions is to ensure stability of the banking market.
 11. The results of the Strategy implementation are to a large extent dependent on external factors, including macroeconomic dynamics. The Strategy was developed based on economic assumptions of a gradual improvement of the economic situation. The following external macroeconomic factors may affect the successful implementation of the strategy:
 - a. decrease in the GDP during two quarters by more than 10% per annum as compared to the previous period;
 - b. the level of inflation during two quarters is higher than 20% per annum as compared to the previous period;
 - c. access to and cost of resources in the banking system (increase in the refinancing rate up to 40% per annum);
 - d. risk of sovereign default.

We will regularly monitor the situation and, if needed, adjust the assumptions, on the basis whereof the Strategy was developed.

Global Experience

12. Analysis of the international experience testifies to the existence of different approaches to the place and role of the state in the state banking sector. In the circumstances of a significant deterioration of the economic situation, actions by governments are primarily focused towards providing additional liquidity to banks that can be aimed at supporting certain programs specified by the state.
13. Typical problems in the current operations of the state banks are as follows:
 - a. political influence on the decision making process;
 - b. substitution of the real corporate governance, based on best world practices, for a top-down directive approach on part of governments; reduction of the role of Supervisory boards;
 - c. development of the banks is different from missions assigned to them and their priority activities directions, and as a result transformation of state banks into universal banks.
14. In 2009, the share of the state in the banking sector was at the level of 8% in developed countries and 22% in developing countries (before the 2008 crisis, the share of the state in banking assets in developed countries was somewhat lower and equaled 6.5%). During the

crisis, in UK and Ireland share of the state grew to 20%, but in recent years it has been gradually decreasing.

15. Decisions regarding the conduct of the state in the market are taken in view of the general economic policy of the government and the current economic situation. In that connection, the world practice knows examples of successful changes of the model for the state involvement in the banking sector and the transition to private ownership (Poland, the Czech Republic).
16. Typical factors of success for state owned banks are:
 - a. independence of the supervisory and management boards from political influence;
 - b. presence of toehr shareholders in the capital of a bank (private investors, IFC, etc);
 - c. orientation of banks on servicing commercial clients;
 - d. efficient operational models and fucntional structures of banks comparable to privately-owned banks.

Current State

17. The current share of state banks' assets in the Ukrainian market³ is roughly equal to 26%. Its growth was affected by the 2008-2009 crisis (limited lending to Ukrainian businesses by subsidiaries of foreign banking groups) and by the economic and political situation in 2014 and 2015 (actual freezing of lending activities by commercial banks).
18. The credit portfolio of state banks at the end of the third quarter of 2015 amounted to UAH 231 billion (including provisions) and was formed to a large extent by loans to corporate borrowers. Banks' financial state, is characterized by high levels of bad debt (at the end of the third quarter of 2015 - almost UAH 89 billion), formation of provisions for impaired clients' loans and, consequently, by the considerable losses (at the end of the third quarter of 2015, the net loss exceeded UAH 13 billion, and the net loss for 2014 – almost UAH 26 billion). Banks' capital is at the level of UAH 31 billion and the total assets amounted to about UAH 339 billion.
19. The aforementioned situation is largely connected with the following:
 - a. absence of efficient risk management systems and effective system of restructuring and collecting;
 - b. poor level of diversification of credit portfolio (major part of the SOBs` portfolios are credits to large enterprises);
 - c. unbalanced structure of banks` liabilities, including relatively low part of external funding sources;
 - d. impact of external factors that significantly worsened the quality of credit portfolios and collateral portfolios.

Goal and Strategic Objectives

20. In view of the distinction between the core and non-core state-owned banks, we put different goals and strategic objectives for the two groups of banks.
21. The ultimate ownership goal of the state for the core banks is to gain the highest possible risk weighed income and manage its investments from the perspective of increasing their value:
 - a. In the short-term, the core banks must acheive two key strategic objectives:
 - i. to implement fundamental changes in corporate governance that will ensure their independence from political and administrative influence;
 - ii. to implement changes in business and operation models with a view at achievement of the highest efficiency and maximal commercial orientation.
 - b. In the mid-term (by mid-2018), in case of implementation of the updated strategies for core banks, the state will try to sell at least 20% of shares of the core banks (to a qualified investor or IFI via transparent tender.

To implement this goal, in 2018 the Supervisory boards of core SOBs, given the results of banks during 2017, should select priority method of selling shares of banks and coordinate it with MoF. The final decision on the sale of shares must be made by CMU not later than first quarter of the 2018. Then, banks with the help of experts should prepare investment memorandum and "information room for data exchange".

The state is interested in attraction of such international financial institutions (e.g. IFC, EBRD, DEG) as partial owners or investors in a subordinated debt (with the respective justified covenants and rights).

- c. In the long-term, the state will consider possibilities of full privatization of SOBs, as it does not intend to preserve its ownership share longer than it is needed to maximize a value for taxpayers (whereas fulfillment of item 21b is binding). The decision on the amount of shares for sale and the terms of such sale will be made by CMU not later than the end of 2020.
22. The goal of the state in relation to the non-core banks is withdrawal from capital – banks will be privatized/liquidated within timeframes specified for each bank individually. Quick withdrawal from capital of such banks will give a clear signal to the market that the government does not intend to own a significant share of the banking sector, which will facilitate increased competition and growing quality of banking services in Ukraine.
23. Establishment of new state banks is deemed inexpedient. The existing banks or IFIs can successfully fulfill all of the above tasks of state banks, in their entire scope.
24. In order to gain the strategic objectives, change implementation schedules have been designed (attached) (see section "Next Steps for 2016").

Corporate Governance

Purpose

25. We regard bank management as being outside politics. The aim is to reform the corporate governance system and bring it into compliance with the recommendations of the Organization of Economic Cooperation and Development, the European Commission and the Basel Committee on Banking Supervision and NBU, which should ensure stable functioning of the business and the highest assessment on the part of potential investors. In order to implement the changes, the respective changes in the legislation of Ukraine will have to be implemented.

Independent Corporate Governance

26. Independent corporate governance, free from political and administrative influence, can be implemented by appointment of independent Supervisory board members by competitive selection through following steps:
 - a. MoF will develop the procedure for selecting members of supervisory boards, each consisting of 7 members;
 - b. MoF with support of IFIs will develop and implement a compensation mechanism for board members based on market conditions;
 - c. MoF will select an internationally recognized recruiting agency, based abroad, which will carry out the process of selection of all Supervisory board members for both SOBs (both Ukrainian and foreign citizens). Taking into consideration new NBU requirements to corporate governance this company will provide the list of candidates by end-June 2016 (at least 42 persons), from which the selection committee (composed of equal amount of representatives from President of Ukraine and Cabinet of Ministers) will select new independent members of supervisory boards of core SOBs by end-July 2016;
 - d. to ensure independence of boards of core SOBs, representatives of state authority organs (including VRU, CMU, etc.) may be included in the Supervisory or Management board of SOBs under conditions of passing through competitive selection and only after their dismissal from public service posts.
27. We recommend to ensure the activities of the Supervisory boards at state banks on the basis of the following principles:

- a. all members of Supervisory Board are selected based on a competition; chairman of the Supervisory board should be elected by its members;
- b. members of the Supervisory board should⁴ meet the following criteria:
 - i. possess knowledge, education, professional skills, functional competencies, experience and other characteristics needed for independent performance of the functions of the members of the supervisory board, in particular: (1) higher education in the sphere of economics, finances, law or business administration; (2) 5 years of experience in banking sphere or finances on managerial positions;
 - ii. fairness, objectivity and impeccable business reputation;
 - iii. sufficient financial solvency - absence in Ukraine or other country of decision or court rulings as to payment of debt or other liability, which remains outstanding and has not been performed in the defined period of time;
 - iv. each member of the supervisory board should devote sufficient amount of time (at least 25% of its working time) to the work at the supervisory board and be a member of supervisory or management body of no more than three other companies/organization/institutions.
- c. Members of Supervisory board must be independent; he/she has no business, family or other relationships with the bank (its management), its majority shareholder (its management), which creates a conflict of interest that could negatively affect his/her impartiality. The criteria for the independence of nominees to the position of a Supervisory Board member may, in particular, be as follows:
 - i. the person did not occupy a position of a member of the relevant bank's management board for the five preceding years;
 - ii. the person is not and has not been receiving compensation from the relevant banks during past 5 years (except for member of supervisory board).
 - iii. the person was not an employee of the relevant bank for the three preceding years;
 - iv. the person did not and does not have significant business relations (including obtaining financing) with the relevant bank during past five years and was not in the management of organizations that had such relations;
 - v. is not in the management of other entity, where any of the management board members of the relevant banks serve on the supervisory board;
 - vi. is not and has not been the employee of the current or past auditors of the relevant banks over past five years;
 - vii. apart from the formal compensation, the person does not receive any additional remuneration from third parties for the performance of his/her duties as a Supervisory Board member of the relevant bank;
 - viii. the person is not a family member or is close to a member of the relevant bank's management Board⁵;
 - ix. the person is not a member of a Supervisory board of a bank, which is a key competitor (unless this is another bank where state owns at least 50% stake);
 - x. the person is not a member of management governing body, committee and is not advisor to the bank, which is a key competitor;
- d. the level of compensation for members of Supervisory Boards of state-owned banks should be close to the level of remuneration in the private sector⁶;
- e. establishment of specialized Supervisory Board committees⁷;
- f. responsibility for the bank performance results should be delegated from the CMU and Minister of Finance to the bank's Supervisory board and Management board,
- g. the Supervisory board must have efficient instruments to control activities of Management board and to take appropriate measures, including making changes of the management board in line with the authority defined by the charters of the banks;

- h. Chairperson of the Management board shall be entitled to participate in meetings of the Supervisory board in an advisory capacity.

Supervision from the Perspective of the State

- 28. The CMU represents the state, but the State, as a controlling shareholder should not exercise the same level of direct control of banks as an ordinary market-controlling shareholder. MoF is still the direct representative of state interests in controlling management of its shares in SOBs. The strategy involves strengthening of Department of Financial Policy of the Ministry of Finance (hereinafter – the department) and its staffing by market professionals (bank employees, consultants, lawyers, etc.). To this end, the MoF will have the ability to employ independent experts from consulting, legal or other firms based on short-term contracts or assignments. The department will perform the management function of state interests in SOBs as well as the advisory function. By the end-May 2016 the MOF will perform the evaluation of the Department with the technical assistance by IMF and will define the roadmap of actions needed by end-September, 2016 to ensure the efficient implementation of the MOF function regarding managing the shares in SOBs.
- 29. To improve the efficiency of "shareholder functions" of the state, in consultations with IMF experts we will develop framework agreement on interaction between the MoF and each SOB with the aim to:
 - a. define clear mechanism of iteration between MOF and a bank;
 - b. ensure due level of banks commercial independence in achieving their goals and establish responsibility for decisions made;
 - c. Provide MOF with due access to the information about significant aspects of banks activities, which is needed for realization of MOF's shareholder function;
 - d. determination of certain issues that need to be consulted upon and agreed with the MoF.
- 30. Signatories of Agreement from SOBS are a newly elected chairperson of the Supervisory board. This Agreement will be published.
- 31. Agreement must also establish a list of key performance indicators of Supervisory board members activities and provide for periodic assessment of the board members activities in terms of their performance these key performance indicators (every six months/ year). Member of Supervisory board may be dismissed, in particular, on the following grounds:
 - a. underperformance in relation to key performance indicators by the results of periodic evaluation;
 - b. at the request of the National Bank or the Supervisory board if the member of the Supervisory board does not properly perform his/ her functions;
 - c. finding of non-compliance to the criteria of independence of the board members of SOBs, as stated by law;
 - d. other respectable significant reasons.

In case of dismissal of a member of Supervisory board the Selection committee appoints the replacement among the candidates identified in the short list on the basis of selection conducted by the aforementioned recruiting agency, or as a result of a new competition.

Market Mechanisms for Labor Compensation

- 32. Of principal importance is the combination of clear definition and transparency of remuneration to Supervisory board members and Management board at state-owned banks. In that connection, an important step is to develop a policy for remuneration and compensation for management of state banks. The policy applied to all state banks will be the same. The remuneration policy will define the relationship between performance and the compensation levels, and will define measurable indicators targeted at medium- and long-term interests of the employer banks (first of all, increasing banks economical value). The policy must define both the basic salary size and the maximum size of additional remuneration (bonuses), and approaches

to the division of the fixed and variable parts of the remuneration. In addition, the remuneration policy will outline the parameters for conclusion/ termination of respectable employment contracts, and conditions of owning/ trading equity shares of according banks.

Committees

33. For areas that require special attention, Committees of the Supervisory boards will be formed. Committees are consulting and advisory bodies that are created for preliminary discussion of the most important issues in the activities of the Board, and prepare appropriate recommendations for final decisions. The list of Committees is formed by the bank Board, but must mandatorily include the following:
 - a. Audit Committee;
 - b. Risk Management;
 - c. Committee for Human Resources and Remunerations.

Decisions made by Committees are of recommendatory nature. For that purpose, provisions will be developed to define activities by the Board Committees, specifying their rights and obligations, membership, interaction with executive bodies of the bank, the procedures for work and decision making, as well as specific criteria for qualifications of the Committee Chairperson and members.

The directions of reforms of Core Banks

34. Achieving the goal of the state for the core banks requires significant restructuring of the business model and implementation of new management mechanisms.
Further development of the banks will focus on two main directions of transformation that envisage significant changes in all areas of activities by the banks:
 - a. maximum focus on target customer segments to meet the entire range of their customers' demand for financial services and, by doing so, to maximize their income;
 - b. reform of operation models and carrying out "industrialization" of systems and processes to improve the degree of manageability and scalability, reduce costs, improve customer service quality, which will also enable the banks to more effectively manage credit and other types of risks.
35. For a long time the core SOBs have oriented themselves to building universal banking institutions. Accordingly, the transformation processes require action to free the banks' balance sheets from positions that are not related to priority activities. Those measures must take into account market conditions and the demand of the target customer segments, limitation of the existing credit portfolio and investment portfolio, and availability of funding sources.
36. Based on the defined tasks, Ukreximbank will develop a development strategy and Oschadbank will adjust the existing development strategy through approval of an action plan.
37. After appointment of new Supervisory boards, core SOBs can update strategies to maximize the shareholding value, so that the strategies of these institutions could benefit from the experience of the new members of Supervisory boards.
38. The state will consider a possibility of a partial and/ or full privatization of banks. Privatization may serve as a catalyst of changes, implemented in the business and operational model of a bank. Accordingly, strategy of Oschadbank and Ukreximbank may be reviewed after partial/full sale of ownership stakes to other shareholders.
39. Growth will be achieved organically and providing the availability of commercially interesting and economically-justifies possibilities – non-organically.

Business directions

40. For both core banks, the Strategy identifies target customer segments, the work with which will make it possible to maximize the value of banks. The implementation of improved credit risk management system envisaged by paragraphs 54c-I and 55b-I should be made by core SOBs as a precondition for full-fledged recovery of lending to target customer segments.

41. Formation of target customer segments is based on understanding of the banks' strengths – strategic assets (what will be difficult/ impossible for competitors to copy).
Those strategic assets are as follows:
 - a. for Oschadbank – a large customer base, the largest network of branches and experience in customer services in certain sectors of the economy (energy, agriculture, infrastructure);
 - b. for Ukreximbank - experience in analysis and service of export-oriented enterprises, long-standing practice of foreign trade agreements structuring, availability of experience in financial servicing in cooperation with IFIs.
42. In addition, was considered the prospects of development of certain economic segments that are expected to influence the future economic growth, namely:
 - a. micro-, small and medium-sized businesses;
 - b. export-oriented enterprises.
43. In view of the above, the following target customer segments were formulated for Oschadbank:
 - a. credit risk and currency risk entailing products:
 - i. retail, micro-, small and medium-sized businesses (especially the agricultural sector and projects in the area of energy efficiency);
 - ii. large businesses – economic sectors have been determined (energy, agricultural sector and infrastructure), which will enable a managed transition to diversification. If the loan size exceeds 5% of the regulatory capital, Oschadbank should give prevalence to participation/ organization of syndicate loans with private banks/IFIs, which will allow for the risk sharing;
 - b. credit risk and currency risk free products: all segments.
44. Taking into account everything mentioned above, key client segments were formulated for Ukreximbank:
 - a. credit risk and currency risk entailing products– small, medium and large-sized businesses:
 - i. export oriented enterprises;
 - ii. enterprises that implement import related projects: (1) invest projects; (2) trade projects with the engagement of IFIs and first-class banking institutions;
 - iii. (Ukrainian) companies that fulfill contracts abroad.
 - b. credit risk and currency risk free products– small, medium and large-sized businesses;
 - c. servicing of international/ intergovernmental trade/ investment agreements.
45. Provision of credit risk entailing products to enterprises, that are under state programs and/ or are state-owned must be provided with account to credit risk management policies of core SOBs. In addition, loans to customer groups (including state enterprises) should be extended considering the NBU's economic norms.
46. Development of the product range must be aimed at selling to customers the entire line of banking products adapted to the needs of the defined segments identified. New products will be launched based on their market potential and technological capacity of the banks. The goal of introducing new products and services is increase in the share of income from credit risk and currency risk free products.

Operation directions

47. The banks must reform their operation models, bring them in line with their business strategies and achieve the target level of development, commensurate with the leading peers:
 - a. functional structure that meets the standards in Ukraine and CEE countries;
 - b. efficiency of the end-to-end business processes at the CEE level.
48. Risk management should be harmonized with international standards and best world practices.
 - a.
49. Function of restructuring and collections – should ensure rapid, scalable and efficient process of debt collection and debt servicing for different client sectors.

50. Function of human resources management – should ensure improvement of the bank personnel work efficiency to a level that will lead to optimization of staff numbers.
51. Information technologies – the main task on the short-term planning horizon is the development of a complex strategy for IT transformation, with the purpose of transition to full servicing of defined client sectors.
52. Operating system of core SOBs has to ensure formation of business processes, infrastructure and functional structure that will be effective in terms of costs and ensure target levels of customer service quality.
53. Marketing function should ensure a very high level of brand awareness to reduce the cost of product/ services promotion and to improve the target customer sectors loyalty.
54. Channels management function of sales and servicing – optimization of a network of offices with a focus on geomarketing for target customer groups is necessary; in doing so, it is imperative to significantly increase the importance of the role of remote channels of banking services as an important source to reduce costs and to improve the quality and availability of services.

Key performance indicators (mid-term, till 2019 including)

55. For Oschadbank:
 - a. Financial indicators – break-even operations and market targets for rates of profit, ROE and CIR;
 - b. market indicators – not worse than the top 5 on the Ukrainian market for retail lending and TOP-3 for crediting and deposits on the MSMB market;
 - c. quality indicators:
 - i. compliance of risk management system to the NBU guidelines (during 2016) and implementation of ICAAP (during 2017);
 - ii. reaching the target state of the operation model development;
 - iii. diversification of the credit portfolio and investment portfolio of large businesses in relation to assets generating interest income (step-by-step reduction to 50% in equal proportions per annum).
56. For Ukreximbank:
 - a. financial indicators – break-even operations and market targets for rates of profit, ROE and CIR;
 - b. quality indicators:
 - i. compliance of risk management system to the NBU guidelines (during 2016) and implementation of ICAAP (during 2017);
 - ii. reaching the target state of the operation model development;
 - iii. withdrawal from servicing retail and small business.

Other matters of the core SOBs strategy

57. Oschadbank: the state will make decision on timeframes and conditions of gradual joining the DGF starting from beginning 2017. based on an economic analysis of consequences and risks for the bank and the banking sector. The MoF with participation of independent experts will carry out the analysis, and its recommendations will be submitted to the Government before the end of 2016.
58. Ukreximbank: the State will review the commercial expediency of:
 - a. acting as a bank route to channel the financing from supranational bodies into the economy, and
 - b. formation of a center for support of exports and establishment of operational interaction between Ukreximbank and the Agency for insurance of export risks (in case of its creation).

The Directions of Reforms of Non-Core Banks

Ukrghazbank

59. Ukrghazbank will prepare the bank development strategy, with the purpose of selling the state owned stake in the banks by end-2017. To that end, the bank management will define its competitive advantages and formulate a vision regarding the target business and operational models. The strategy will be prepared during the first three months of 2016 and submitted to MoF.
60. In parallel MoF will prepare a complex analysis of Ukgazbank activity and will submit it to the Government for appraisal during the first five month of 2016. The analysis will include:
 - a. analysis of financial condition and the calculation of net present value of the bank;
 - b. evaluation and recommendations concerning strategic alternatives of bank development.
61. Under any chosen option, the state will withdraw partially or completely from the capital of Ukgazbank by the end of 2017.

Rodovid Bank

62. The state will withdraw from ownership in Rodovid Bank during the year 2016. During the first three months of 2016, the MoF will develop a schedule of withdrawal from Rodovid Bank capital.

Other banks

63. The state will withdraw from capital of other banks in 2016. During the first three months of 2016, the MoF together with relevant Ministries and agencies will develop an exhaustive withdrawal schedule.

Banks with Minority Participation of the State

64. During the first three months of 2016, the MoF together with relevant Ministries and agencies will carry out an analysis of ways how to reduce the public stake in the ownership in those banks.

Other Issues of the Strategy

65. The Strategy defines the principle of equality of state-owned banks and private banks, which is ensured through creation of equal conditions for all banks and will facilitate increase in the investment value and attractiveness of state banks for future privatization.
66. The core SOBs can take into consideration possibilities of other large state infrastructure players to increase their banking business. (For example, use of Ukrposhta offices as channels for the sale of banking products).
67. Introduction of a uniform approach to client segmentation in accordance with the Commercial Code of Ukraine⁸, enabling a standardized approach to defining of customer sectors and making it possible to make comparisons with other banks/ countries.
68. In order to improve efficiency of management of client base/ sales channels/ infrastructure, core SOBs may agree with each other and with private banks to use the possibilities of each other.
69. In case of making an according decision, privatization/ sale of shares of core/non-core SOBs will be carried out in accordance with the laws of Ukraine, and at a price not lower than the market value determined by reputable international company that meets criteria established by legislation of Ukraine.

Next Steps for the Year 2016

Summary of Recommendations				
<i>Step</i>	<i>Action</i>	<i>Previous step</i>	<i>Time limit</i>	<i>Responsible entity</i>
1	Approve the Strategy	-	Within the shortest time possible	CMU
2	Prepare necessary changes to legislation and regulations to implement the target system of SOBs corporate governance	1	Within 6 months	CMU, MoF
2a	<ul style="list-style-type: none"> • Approve regulations • Approve changes to legislation 	-	Within 3 months	
2b	Send the changes to legislation to VRU	2a	Within 3 months	
3	Strengthening of MoF financial policy department	1	Within 6 months	MoF
4	Carry out renewal of Supervisory boards of state banks	1, 2	Within 5 months	MoF
4a	Search for candidates in Supervisory boards	-	Within 3 months	
4b	Approval of candidates by the Cabinet of Ministers of Ukraine	4a	Within 1 months	
4c	Sign Agreement on Cooperation with banks	4b	Within 1 months	
5	Bring the development strategies of SOBs to conformity with this Strategy	1	Within 3 months	Core SOBs
5a	Prepare the action plan	-	Within 3 months	Oschadbank
5b	Finalize the bank development strategy	-	Within 3 months	Ukreximbank
6	Carefully examine bank strategies in terms of their compliance	5	Within 2 months	MoF
7	Draft the bank development strategy	1	Within 3 months	Ukrgazbank
8	Analyze strategic alternatives of Ukrgazbank's further existence	7	Within 3 months	MoF
9	Make a decision on the timeframes for privatization/ liquidation of other non-core banks	1	Within 3 months	MoF
10	Prepare an analysis of state guarantee cancellation mechanism	1	Within 12 months	MoF

Changes to legislation

Corporate governance

70. Given the fundamental changes proposed to introduce into legislative framework of Ukraine, Article 7 of the Law of Ukraine "On banks and banking" (concerning SOBs) should be amended and include, among others, next points:
 - a. general administrative and organizational principles of management of SOBs, including the role of the CMU and MoF, and powers of MoF;
 - b. the procedure and principles according to which the agreement between MoF and SOBs is concluded; main (essential) conditions of the Agreement;
 - c. the election of members of the Supervisory board of state banks. Requirements for independent directors;
 - d. principles of work of the Supervisory boards, including their work with credits;
 - e. possibility of election to the Supervisory and Management Board of SOBs of any representative of government bodies, provided they pass competitive selection and only after dismissal from public post;
 - f. basic principles of election and functioning of the board of SOBs;
 - g. institution of market level remuneration for the members of the Supervisory and Management board of SOBs.
71. Implementation of new corporate governance practice on the legislative level will also require its harmonization with already proposed changes to the legislation, including:
 - a. The draft №2490 «On Civil Service" (adopted by the VRU on December 10, 2015), amending the law "On the central public authorities» № 3166-VI of March 17, 2011, in the part concerning powers of ministries state secretaries regarding the appointment and dismissal of heads of state enterprises, institutions and organizations, that belong to the management sphere of the relevant Ministry. State secretary should not have such powers when the state company has a Supervisory board;
 - b. The draft №3062 (at the date of the Strategy, the Parliament voted for this draft at first reading), which implies a change in corporate governance in state enterprises.
72. In addition, to introduce the new corporate governance in SOBs a number of regulations should be changed, including:
 - a. Corporate Governance Principles of SOBs of Ukraine;
 - b. Regulation on the procedure of competitive selection to fill the posts of members of SOBs' Supervisory boards;
 - c. Policy of compensation to management of SOBs;
 - d. Code of Ethics.
73. In addition, changes to listed existing laws and regulations are need:

№	Regulation	General description of planned changes
1.	Law "On banks and banking" 2121-III dated December 7, 2000	Edit Article 7, as indicated earlier
2.	Law "On Management of State-owned Objects» № 185-V of September 21, 2006	State that peculiarities of management of SOBs are determined by Law "On banks and banking"
3.	CMU Resolution "On some issues of state corporate rights management» №678 of October 30, 2014	Remove provisions on the tasks of the vote in banks, where state share in authorized capital exceeds 20%

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4.	Provision on the Ministry of Finance of Ukraine approved by the Decree of the President of Ukraine № 446/2011 of 8 April 2011	Provide detailed principles of the MoF work with SOBs
5.	The Criminal Code of Ukraine / Code of Ukraine on Administrative Offences	Introduce amendments regarding administrative and/ or criminal liability violations in corporate governance of public banks (lobbying of personal interests, etc.)
6.	Regulation on the registration and licensing of banks, opening of separate divisions, approved by the NBU number 296 of July 25, 2013	Modify the features of the creation of a state bank and change the size of its share capital
7.	Statutes of JSC "State Savings Bank of Ukraine" (Oschadbank) and JSC "State Export-Import Bank of Ukraine" (Ukreximbank), approved by the relevant resolutions of the CMU	To amend the statutes concerning corporate governance of banks on the basis of the mentioned above amendments to legislative acts of Ukraine
8.	Other regulations	Introduce technical changes to provisions of legislation to comply with the new structure of corporate governance of state banks

SOBs privatization

74. Due to the possible partial or full privatization of core SOBs, it is important to lift prohibition on privatization of SOBs on the legislative level and transparency of such a procedure. In accordance with this, it is necessary to introduce amendments to the following legislative acts:

9.	The Law of Ukraine "On the list of objects of state property not subject to privatization"	Exclude specialized commercial State Savings Bank of Ukraine from the list of state property that can not be privatized, but can be corporatized.
10.	Law of Ukraine "On State Property Privatization"	Introduce possibility of privatization of SOBs shares at a price not lower than the market price. Introduce amendments concerning requirements and procedures for the company, which may make the evaluation of assets of SOBs during their privatization.

References

¹ <https://www.imf.org/external/np/loi/2015/ukr/022715.pdf>

² <http://reforms.in.ua/ua/reforms/reforma-finansovogo-sektoru>

³ http://www.bank.gov.ua/control/uk/publish/category?cat_id=64097

⁴ Comment to Item D Chapter VII of OECD Guidelines on Corporate Governance in State Enterprises (hereinafter – OECD Guidelines)

<http://www.oecd.org/g20/meetings/antalya/Corporate-Governance-Principles-ENG.pdf>

⁵ Item 13, Annex II of Recommendations of the European Commission on non-executive directors

⁶ Comments to sub-item 7, item F, Chapter II of OECD Guidelines

⁷ Item H, Chapter VII of OECD Guidelines

⁸ <http://zakon5.rada.gov.ua/laws/show/436-15/page2>