National Bank
of Ukraine

Macroprudential Policy Strategy

August 2021

Macroprudential Policy Strategy of the National Bank of Ukraine: the summary

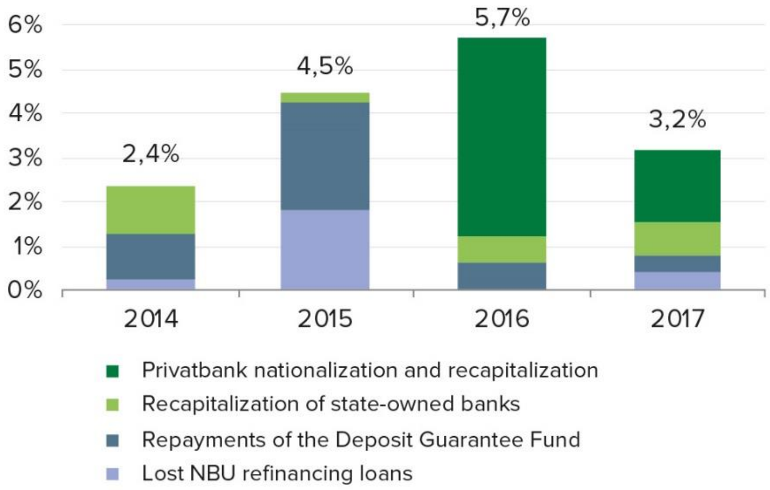
- Macroprudential Policy Strategy (Strategy) is a high-level document, which outlines ultimate and intermediate objectives that the NBU pursues in the area of financial stability, and gives a tentative list of tools the NBU intends to apply in order to achieve those objectives.
- The Strategy aims at wider audience of various backgrounds. Thus this is not a technical document.
- Macroprudential regulation (including application of macroprudential instruments) will be implemented through separate NBU regulations.
- The Strategy was discussed at the meeting of the Financial Stability Committee and approved by the NBU Board in late 2018.
- On 1 July 2020, the NBU became the regulator for insurers, finance companies, credit unions, and pawnshops. Thus, the Strategy was to be updated. The updated Strategy was approved by the NBU Board and published in December 2020.

Overview and Purpose of Macroprudential Regulation

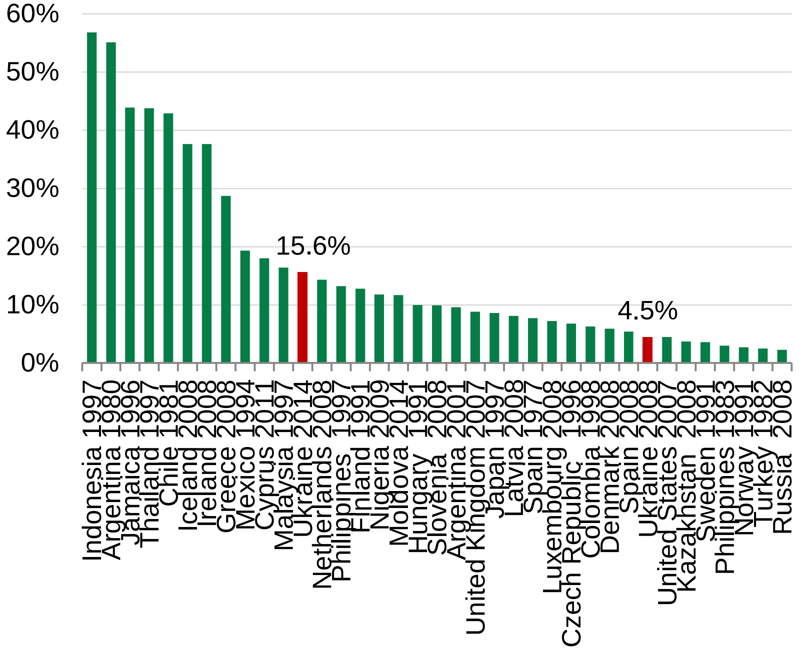
- Macroprudential policy aims to prevent the build-up and materialization of systemic risks in the financial sector and to enhance its resilience.
- The ultimate objective of macroprudential policy is to ensure financial stability, defined as the state in which the financial system is able to properly perform its main functions like financial intermediation and enabling payments, and also to withstand crises.
- The key reason why we need to develop a macroprudential policy is that a system is not a mere sum of all its elements. The sector must be regulated not only at the level of individual institutions but also as a system.
- Macroprudential policy can not eradicate systemic risks, yet it can prevent their excessive build up and decrease probability of their materialization.
- Empirical studies show that efficient macroprudential policy enhances resilience of an economy and limits volatility of GDP.

Reasons for introduction of macroprudential policy

Public costs related to the resolution of the banking crisis in Ukraine in 2014-2017 (fiscal costs), % GDP



Fiscal costs of banking crisis resolution, % GDP



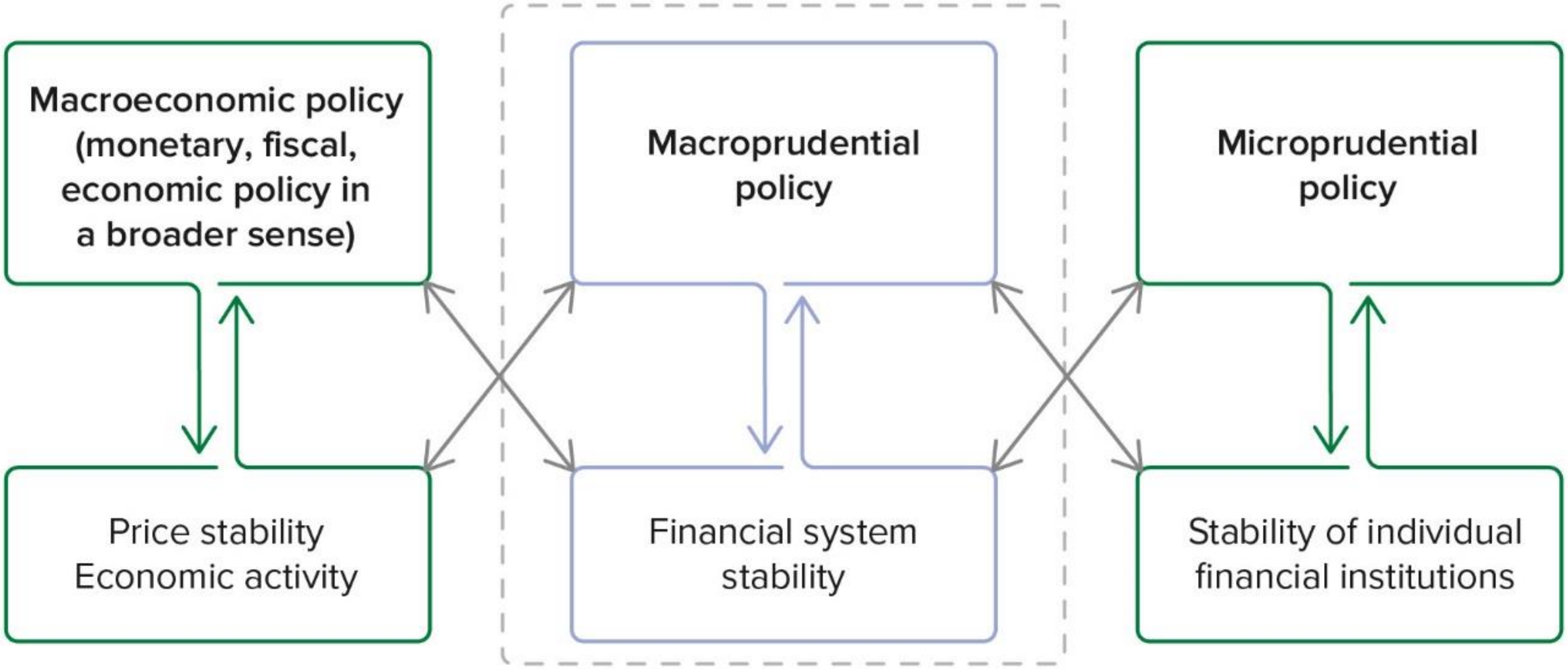
Sources: NBU, DGF, IMF

- Ukraine has experienced three deep banking (financial) crises that caused substantial long-term losses to the economy.
- Fiscal costs of 2014-16 crisis resolution amounted to almost 16% GDP, costs to the economy reached 40% GDP.
- The scale of the crisis shows how high the price of inadequate financial sector regulation can be both for individual institutions and system as a whole.

Institutional framework of macroprudential policy

- Law *On the National Bank of Ukraine* stipulates that financial stability is the second priority goal of the NBU.
- The Law thus actually gives the NBU a mandate for design and implementation of macroprudential policy.
- Within the NBU, the Financial Stability Committee (FSC) is the key platform for identification of systemic risks and discussions on macroprudential measures. This is a strategy-level committee headed by the NBU Governor.
- The FSC makes recommendations to the NBU Board, which makes decisions on macroprudential interventions.
- In promoting financial stability, the NBU is guided by the recommendations of the Basel Committee on Banking Supervision, the ESRB, and CRR/CRD.
- If the FSC has identified a risk beyond the NBU's mandate, the FSC may ask the interagency Financial Stability Council to step in. The Council is a high-level platform for identification of threats to financial stability. It comprises heads of member institutions: the NBU, the Ministry of Finance of Ukraine, the Deposit Guarantee Fund, and the National Commission for Securities and Stock Market. The Council makes recommendations on mitigation of the risks. Institutions addressed must implement the recommendations or explain their reasons behind the non-compliance.

Interaction of economic policies



Macroeconomic policy (monetary, fiscal, economic policy in a broader sense)

Macroprudential policy

Microprudential policy

Price stability
Economic activity

Financial system stability

Stability of individual financial institutions

- Monetary, micro- and macroprudential policies mostly complement each other. Effective implementation of one facilitates attainment of others' objectives.
- However, different policies' objectives may eventually run into a conflict. Then a cost-benefit analysis is required.
- Foreign exchange liberalization and shift to principle of free movement of capital is a process that may call for macroprudential regulation.

Ultimate objective is achieved through intermediate ones

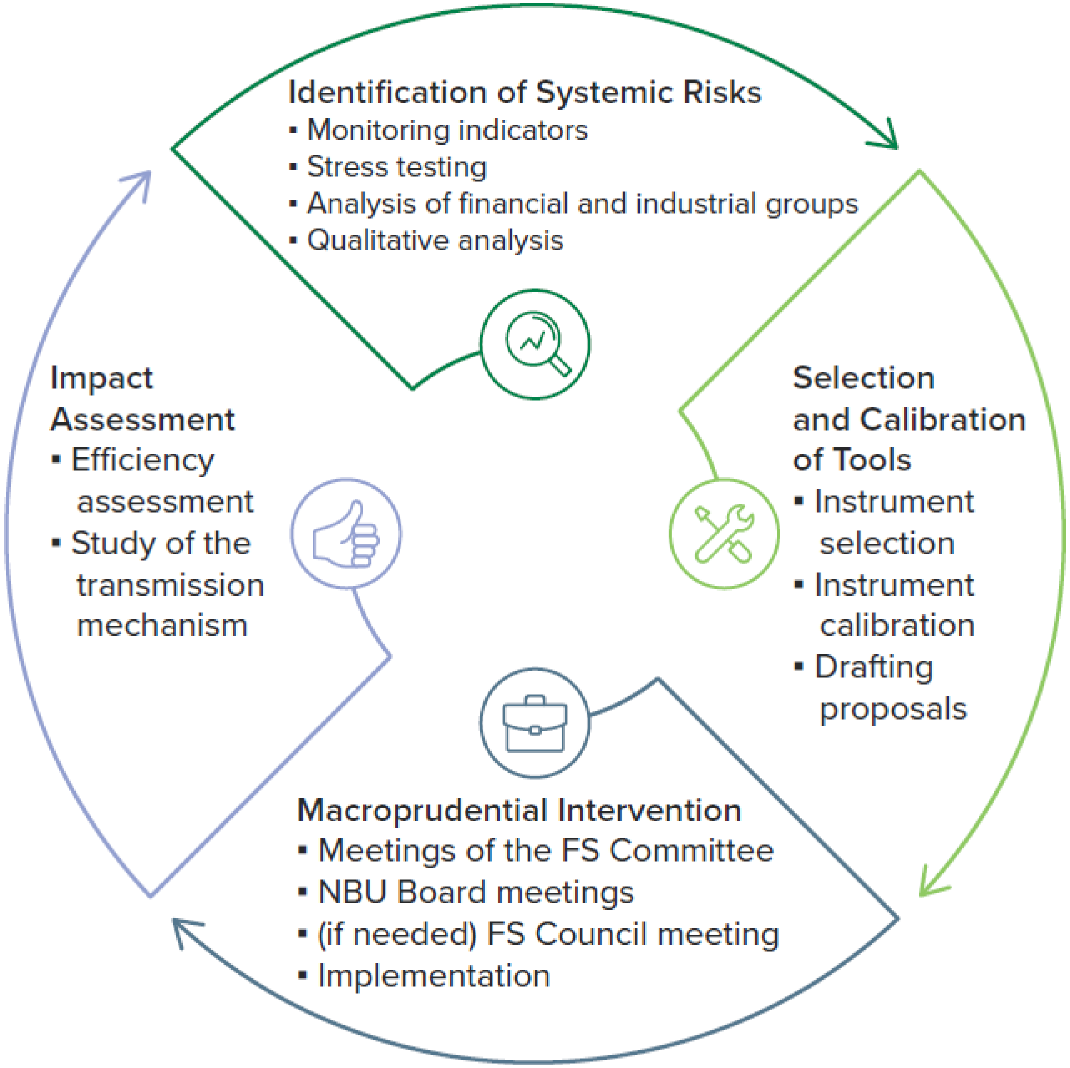
Ultimate goal

Ultimate goal – financial stability through the increased resilience of the financial system and preventing the build-up of systemic risks

Intermediate objectives

- Macroprudential policy aims to achieve intermediate objectives, which, combined, facilitate achievement of strategic ultimate goals.
- On top of five intermediate objectives mentioned in the ESRB recommendations, the NBU defined the sixth intermediate objective of macroprudential policy – to bring down the share of foreign currencies in the banks’ balance sheets and transaction (dedollarization).

Macroprudential policy cycle



Identification of Systemic Risks
- Monitoring indicators
- Stress testing
- Analysis of financial and industrial groups
- Qualitative analysis

Selection and Calibration of Tools
- Instrument selection
- Instrument calibration
- Drafting proposals

Macroprudential Intervention
- Meetings of the FS Committee
- NBU Board meetings
- (if needed) FS Council meeting
- Implementation

Impact Assessment
- Efficiency assessment
- Study of the transmission mechanism

Macroprudential policy focus in Ukraine

Ukrainian financial sector currently faces a few systemic risks that the NBU will monitor:

- Short maturity of bank funding
- High dollarization rate in the banking sector
- High share of state-owned banks in the banking sector
- High growth in unsecured consumer lending
- Risks of non-bank financial sector
- High concentration of exposures
- High NPL ratio.

Should it be required, the NBU stands ready to respond with macroprudential measures.

Risks of non-banking financial sector

Non-banking financial institutions currently pose no systemic risks due to their:

- Relatively small sector size
- Limited interconnectedness with banks and other financial institutions
- Specifics of business models

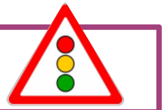
NBU actions in non-banking financial sector

- Not to apply specific macroprudential tools for now
- Establish a framework for micro- and macroprudential regulation and supervision
- Enhance disclosure requirements in order to boost the sector transparency

Expected effect of the measures

- Limiting regulatory arbitrage
- Establishing a level playing field
- Improved regulation and higher resilience of non-banking financial institutions
- Better consumer rights protection

The NBU will monitor the sector’s development closely and stands ready to apply measures as needed



Macroprudential toolkit in Ukraine (1)

Capital instruments

Capital conservation buffer	Builds up in ‘good’ (non-stress) times to cover losses and prevent breaches minimal capital adequacy requirements in future. The buffer will initially be 0.625% and will gradually rise to 2.5%.
Countercyclical capital buffer	To be activated in times of credit expansion, and to be reduced or relaxed during economic downturns. Aims to limit pro-cyclicality of financial system. Depending on stage of economic cycle it will vary in the range of 0% to 2.5%.
Buffer for systemically important banks	Enhances resilience of systemically important institutions. It is set in the range of 1% to 2% depending on the category of systemic importance.
Systemic risk buffer	Limits vulnerability to long-term structural (non-cyclical) systemic risks. The NBU regulations currently do not provide for this buffer.
Leverage ratio	Sets minimal ratio of Tier I capital to total assets and off-balance-sheet liabilities. To be implemented in the future.
Additional risk weights for certain types of loans	Increases the amount of capital available to cover possible losses incurred for certain types of credit. May potentially be used to mitigate FX loans in the future.

Macroprudential toolkit in Ukraine (2)

Liquidity instruments

Liquidity coverage ratio (LCR)	Defines the proportion of high-quality liquid assets a bank is required to hold in order to meet potential net cash outflows over 30 days in a crisis period. Introduced in December 2018.
Net stable funding ratio (NSFR)	Defines minimal proportion of stable (long-term) funding depending on liquidity and residual maturity of assets. Encourages banks to switch to long-term sources of funding. The NSFR was introduced as a regulatory requirement in 2021.

Other instruments

Loan-to-value ratio (LTV)	Caps credit to a household relative to value of available collateral. Mostly applied to mortgages and prevents bubbles on real estate markets. It is unlikely that the instrument will be applied as a hard requirement in the nearest future. However, banks are likely to be recommended to disclose their LTV readings.
Debt-service-to-income ratio (DSTI) or Debt-to-income ratio (DTI)	Caps credit to a household relative to its incomes. Prevents excessive growth of credit and debt burden on households. It is unlikely that the instrument will be applied as a hard requirement in the nearest future. However, banks are likely to be recommended to disclose their indicators.
Enhanced disclosure requirements	The instrument boosts public awareness about business of financial institutions thus contributing to financial system resilience.

Macroprudential tools in Ukraine: functional approach to application

	Banks	Credit unions	Finance companies	+ guarantees	Insurers
Capital buffers, including:					
- countercyclical capital buffer	🟩				
- systemic importance (significance) buffer	🟩	🟩			
- capital conservation buffer	🟩	▨			
- systemic risk buffer	▨				
Liquidity requirements	🟩	🟩		🟩	🟩
Prudential requirements to assets	🟩	🟩			🟩
Borrower-side limitations:					
- LTV[i]	🟦	🟦	🟦	🟦	
- DSTI[i]	🟦	🟦	🟦	🟦	
- Limits on loan maturity[i]	🟦	🟦	🟦	🟦	
Recovery plans	🟩	▨			▨
Limits on exposure concentration	🟩	🟩			🟩
Stress testing	🟩				▨

🟩 already in use or approved for use

▨ implementation scheduled for a later stage

🟦 future implementation possible

Note: [i] – for all loans of certain type (like housing loans)

Cycle of communications on financial stability

- Financial Stability Report
- Stress Test Results
- Systemic Risk Survey
- Banking Sector Review
- Non-bank Financial Sector Review
- Bank Lending Survey
- Bank Funding Survey*

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- Financial Stability Report
- Annual Report on Activities of the FS Council
- Systemic Risk Survey
- Banking Sector Review
- Non-bank Financial Sector Review
- Bank Lending Survey
- Bank Funding Survey*

** Published since Q3 2021*