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## NEGOTIATING CHAPTER “FINANCIAL SERVICES” AND UKRAINE'S ACCESSION TO THE EU: WHERE DO WE STAND AND WHAT NEEDS TO BE DONE?

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## KEY POINTS ON THE REGULATION OF FINANCIAL SERVICES IN THE EU

Following the financial and debt crisis, the regulatory environment for financial services in the EU has been significantly strengthened

- EU values - in particular, equality and stability - have also been reflected in financial legislation, which prioritises prudential requirements, consumer protection and transparency.
- The financial crisis of 2007-2008 had a significant impact on the regulatory environment in the EU; since then, the body of the *acquis* has been significantly expanded to prevent future crises. One of the innovations was the creation of **ESMA**.
- However, individual member states still show significant differences in the regulatory environment for financial services.
- Hence, new regulations are usually regulations rather than directives (or directives accompanied by regulations).

# IMPLEMENTATION OF THE EUROPEAN COMMISSION'S RECOMMENDATIONS

# URGENT RECOMMENDATIONS OF THE EUROPEAN COMMISSION

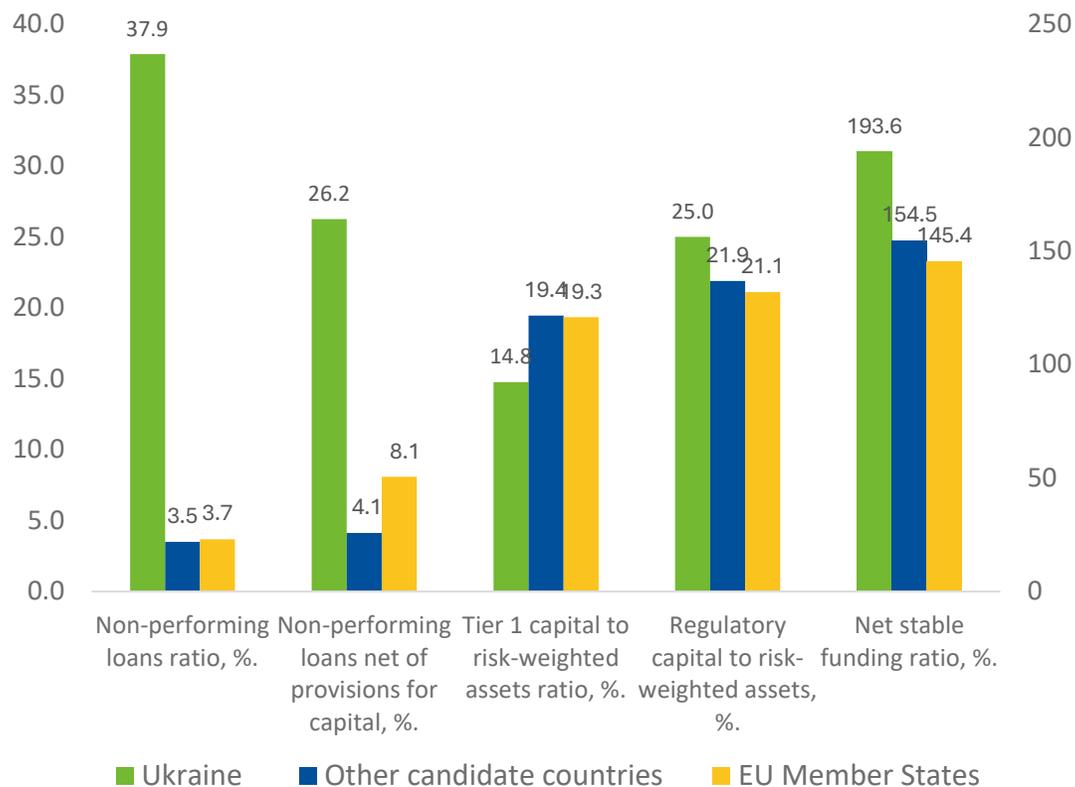
According to the latest available report of the European Commission dated 08.11.2023, Ukraine has some level of preparation for accession in the context of the 9th negotiating chapter “Financial Services”

## Recommendations for 2024 include:

- prepare an assessment of the quality of the banking sector's assets;
- to strengthen the regulatory powers of the National Securities and Stock Market Commission in accordance with the principles of the **International Organisation of Securities Commissions (ISOCO)**;
- continue work on the approximation of Ukrainian legislation to EU legislation related to the regulation of the banking and insurance sectors (including bank insolvency resolution and the bank deposit guarantee system) and the regulation of securities markets, investment funds and investment services.

# ASSESSING THE QUALITY OF BANKING SECTOR ASSETS

Ukraine is among the five countries with the highest share of NPLs in 2023, according to the IMF.  
NPLs amount to 98.4% of total non-performing assets in Ukraine



- Ukraine does not significantly differ from EU countries in most financial stability indicators, but the share of non-performing loans (NPLs) in the Ukrainian banking sector is significantly higher than in EU candidate and member states.
- The high NPL ratio could become an obstacle to Ukraine's accession to the EU due to the threat to financial stability and restricted access to credit.
- By the second quarter of 2025, the NBU is to develop a strategy for resolving NPLs, including toughening requirements and improving information exchange between financial institutions, and is working on a lending development strategy.
- The Lending Development Strategy, approved by the Financial Stability Council in June 2024, includes a number of measures to improve banks' portfolios and prevent the accumulation of NPLs in the future.

## Comparison of banking sector asset quality by key indicators in Ukraine, EU candidate countries, and EU member states at the end of 2023

Source: CES visualisation based on IMF Financial Soundness Indicators.

Note: For each country, the latest available quarterly data from 2023 were used. Given the partial availability of data, the sample for each indicator may vary slightly.

# POWERS OF THE NATIONAL SECURITIES AND STOCK MARKET COMMISSION

The scope and depth of the NSSMC's powers do not fully comply with ISOCO standards

- The current Law “On Amendments to the Law of Ukraine “On State Regulation of Capital Markets and Organised Commodity Markets”” and Certain Other Legislative Acts of Ukraine on “Improving State Regulation and Supervision of Capital Markets and Organised Commodity Markets” significantly expands the powers of the NSSMC.
- The main differences between the provisions on the powers of the NSSMC in the updated and previous versions include
  - **defining mechanisms for adapting to new challenges;**
  - **recognition of international standards and the importance of international cooperation;**
  - **consideration of technological development and digitalisation of markets;**
  - **strengthening the regulatory function.**

# HARMONISATION OF LEGISLATION WITH THE EUROPEAN FINANCIAL ACQUIS

# ANALYSIS OF THE EUROPEAN ACQUIS AND UKRAINIAN LEGISLATION

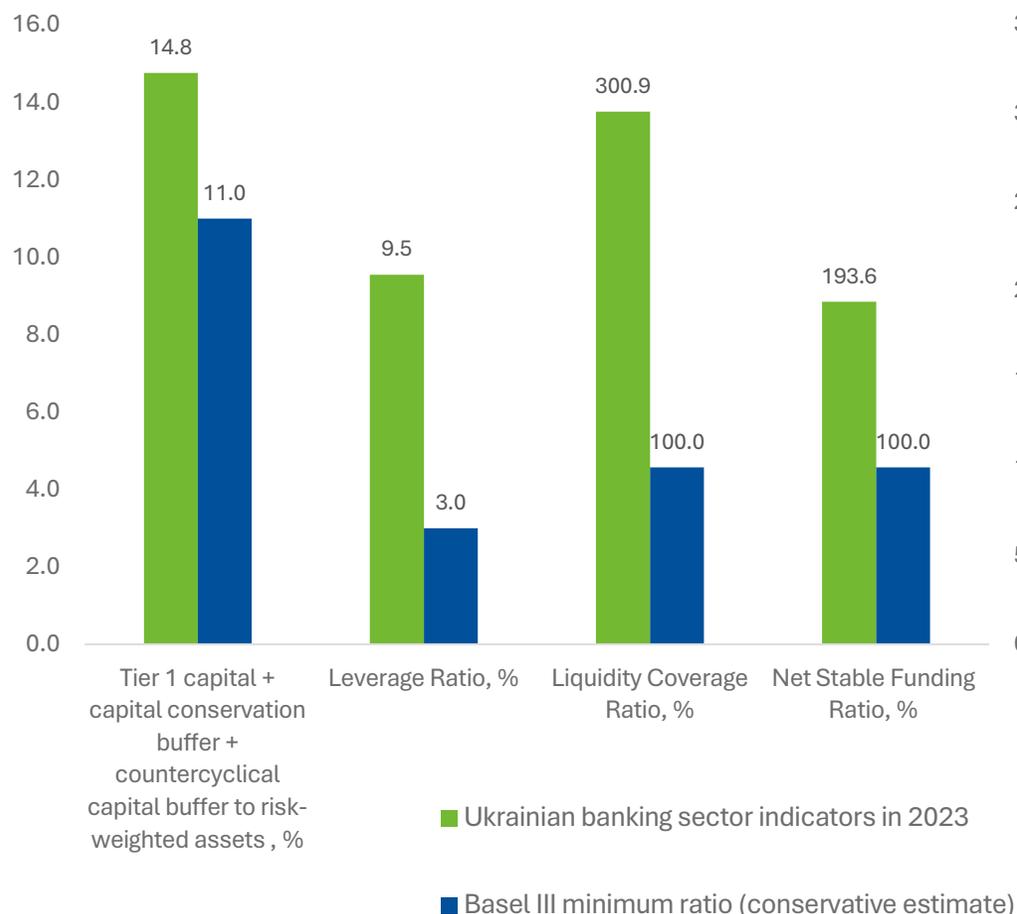
European law governing the provision of financial services is surprisingly complex.

## **We have identified 12 key areas:**

- prudential requirements for the banking sector;
- resolution of bank insolvency;
- payment services;
- regulation of central counterparties and clearing;
- general framework for regulating the financial instruments market;
- rules for the development and presentation of securities prospectuses;
- use of benchmarks;
- assessments by credit rating agencies;
- regulation of investment funds;
- requirements for insurance companies;
- digital operational resilience;
- and regulation of the virtual asset market.



# PRUDENTIAL REQUIREMENTS FOR THE BANKING SECTOR



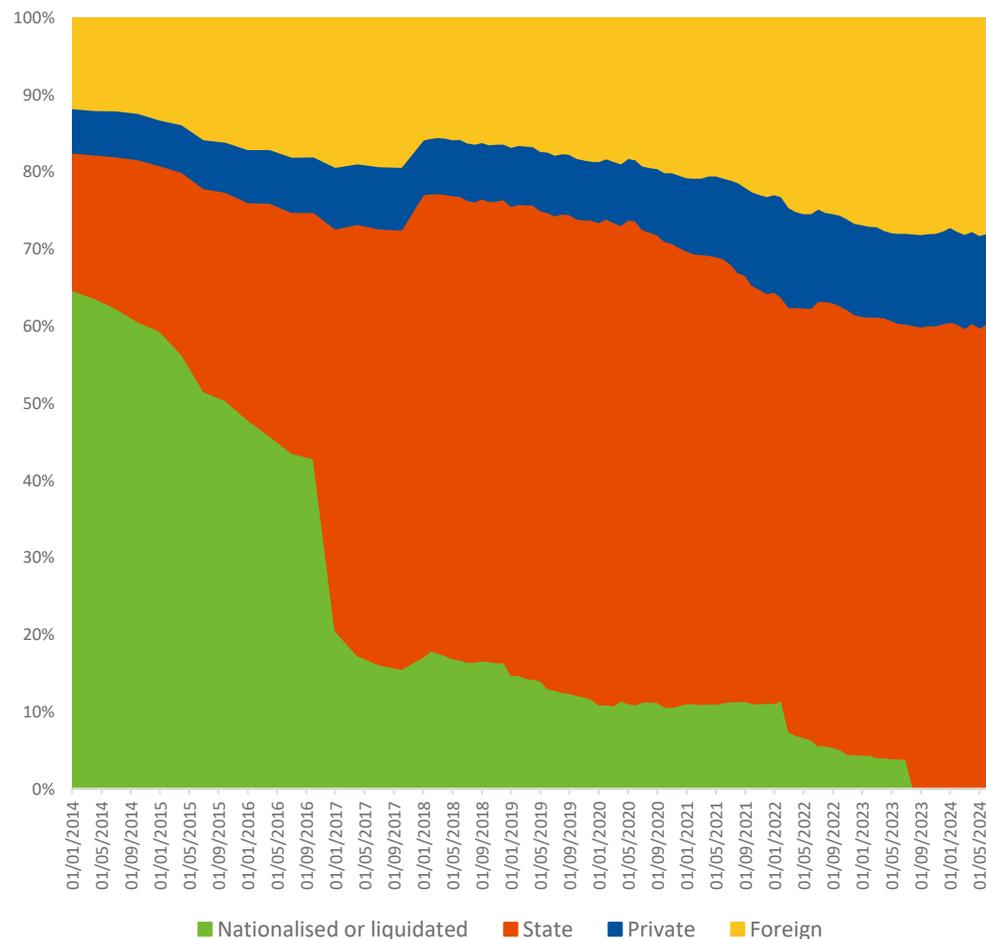
**Comparison of key financial stability indicators according to Basel III with the same indicators in Ukraine at the end of 2023**

Source: CES calculations and visualisation based on IMF Financial Soundness Indicators.

- Key EU regulations:
  - **Directive 2013/36** (Capital Requirements Directive - CRD IV)
    - ❖ detailed management principles;
    - ❖ remuneration policy;
    - ❖ supervisory mechanisms.
  - **Directive 2019/878** (CRD V) introduced additional environmental, social and governance criteria (the so-called ESGs).
  - **Regulation 575/2013** contains detailed requirements for capital, leverage, liquidity and funding.
- In general (and given that the NBU has managed to achieve high financial stability indicators), the Ukrainian regulatory environment in terms of prudential standards can be considered equivalent to the European one.
- **EU legislation in the financial sector is quite dynamic; to accelerate Ukraine's accession to the EU, it is also necessary to take into account the expected changes in the regulatory framework. In particular, the provisions of Regulation 575/2013 are unable to minimise banking risks sufficiently, according to the European Central Bank**

# EUROPEAN BANK PASSPORTING SYSTEM

## CRD IV transposition will pave the way for a system of "bank passports"



- The European Bank Passporting System ("bank passport" or "financial services passporting") is a mechanism that allows banks and other financial institutions licensed in one of the European Union's member states to provide their services throughout the EU without the need to obtain separate licences in other member states.
- As of June 2024, more than half of the banking sector's assets were held by state-owned banks.
- More than 90% of banking assets are held by the 25% largest banks.
- **A system of "bank passports" could significantly improve the Ukrainian banking sector by providing an inflow of European capital.**

### Banking sector assets by type of bank in 2014-2024

Source: CES calculations and visualisation based on open NBU data

# RESOLVING BANK INSOLVENCY

To bring Ukrainian law in compliance with European law, it is necessary to develop and implement a mechanism for preventing and resolving bank insolvency without liquidation

- **Directive 2014/59** establishes a framework for the recovery and resolution of insolvent banks, requiring them to develop recovery plans and the authorities to use the necessary tools to prevent the destabilisation of the financial system through bankruptcy.
- The Law of Ukraine “**On Banks and Banking Activity**” assigns the Deposit Guarantee Fund with the responsibility for the management and liquidation of insolvent banks.
- EU guarantees cover deposits of individuals and some legal entities, including small and medium-sized enterprises (SMEs), which extends the range of protected entities compared to the Ukrainian system.
- The European legal framework is aimed at preventing bankruptcy with minimal involvement of public funds, while Ukrainian legislation focuses on deposit insurance and financial stability.
- **Possible steps:** expanding the regulator's powers to prevent bankruptcy and limiting public funding of the DGF.



# PAYMENT SERVICES

- **Directive(EU) 2015/2366**, or the Revised Payment Services Directive (PSD2), was a complement to CRD IV and
  - extended the EU regulatory framework to third-party payment service providers (under the so-called ‘open banking’ concept), obliging the latter to implement secure and efficient interfaces;
  - included all payment service providers in the list of institutions subject to regulatory supervision (previously, only banks were subject to regulation);
  - strengthened requirements for transparency of information provided to users (in particular, information on transaction payments);
  - introduced requirements for user authentication and certain provisions that should facilitate the development of new technical solutions and competition in the banking sector.
- The Law of **Ukraine "On Payment Services"** introduced a similar regulatory framework in Ukraine.
- **The overall regulatory framework in Ukraine is in line with the European one; however, the payment services sector is still under-regulated.**



# CENTRAL COUNTERPARTIES AND CLEARING

- In the EU, the activities of central counterparties are regulated by
  - **Regulation 648/2012** (also known as EMIR - European Market Infrastructure Regulation), which regulates the purchase and sale of over-the-counter derivatives;
  - **Regulation 2021/23**, setting out the principles of sustainable finance, requiring financial market participants to integrate sustainability considerations into their decision-making processes and to disclose relevant information to investors.
- The Law of Ukraine "**On Capital Markets and Organised Commodity Markets**" sets out the basic principles of central counterparties in Ukraine. The Regulation of the National Securities and Stock Market Commission "**On Prudential Standards of Professional Activity in the Stock Market and Requirements to the Risk Management System**" contains quantitative risk assessment indicators for clearing institutions. The updated version of the **Law "On State Regulation of Capital Markets and Organised Commodity Markets"** sets additional requirements for the central counterparty, control measures for the central counterparty, and conditions for mandatory clearing.
- The requirements of EU legislation are primarily related to procedures and practices, while Ukrainian legislation focuses mainly on quantifiable financial risks. In addition, Regulation 2021/23 sets out a framework for the development of resolution plans for central counterparties, while Ukraine lacks a similarly clear and comprehensive framework
- **Possible steps: Extend the requirements for procedures and practices (obligations to develop risk mitigation strategies, principles of stakeholder engagement, etc.) and establish a framework for the development of resolution plans for central counterparties (similar to Regulation 2021/23).**

# GENERAL FRAMEWORK FOR THE REGULATION OF THE FINANCIAL INSTRUMENTS MARKET (1)

- **Directive 2014/65** (Markets in Financial Instruments Directive - MiFID II) and **Regulation 600/2014** (Markets in Financial Instruments Regulation - MiFIR) regulate the operation of financial markets in the EU.
- Ukrainian legislation is more fragmented compared to EU legislation.
- The Ukrainian regulatory framework is narrower than the European one:
  - **Measures of regulatory intervention in the financial instruments market.** The powers of the regulators under MiFIR are broader than under the NSSMC - in particular, this includes 'pre-emptive action'.
  - **Transparency and reporting requirements.** MiFIR introduces detailed transparency and reporting requirements, requiring real-time trade reporting, public disclosure of trade data and transaction reporting to regulators. The Law on State Regulation of Capital Markets and Organised Commodity Markets contains similar, but less detailed, provisions.
  - **No discrimination in access to trading venues and central counterparties.** MiFIR ensures that there is no discrimination in access to trading venues and central counterparties in order to promote competition and efficiency in EU financial markets. The NSSMC is only planning to introduce similar regulatory mechanisms.

# GENERAL FRAMEWORK FOR THE REGULATION OF THE FINANCIAL INSTRUMENTS MARKET (2)

- **Position reporting and limits on commodity derivatives.** MiFIR contains specific reporting provisions for investment firms and trading platforms and sets position limits for commodity derivatives to prevent abuse and maintain market integrity. The Law on "Capital Markets and Organised Commodity Markets" assigns the obligation to set limits on derivative positions to the NSSMC; the NBU also approves the specification of money market derivative contracts.
- **Combating market abuse.** Regulation 596/2014 complements the MiFID II and MiFIR framework with provisions on market abuse, focusing on unfair practices specific to financial markets, such as insider dealing, unlawful transmission of insider information, and market manipulation. In Ukraine, the legal framework for the prevention of market abuse is provided by the Law on "Capital Markets and Organised Commodity Markets", which describes abuse practices similar to those set out in Regulation 596/2014. The updated version of the Law "On State Regulation of Capital Markets and Organised Commodity Markets" details measures to combat market abuse and expands the NSSMC's powers in this area.
- The Regulation of the NSSMC "On Conducting Professional Activity in Financial Instruments Trading" details the rules for the functioning of securities markets. The Regulation "On the Form and Content of the Ownership Structure" sets out additional requirements for reporting and internal control. However, both provisions will only come into force after the end of martial law.
- **Possible steps: expanding the regulator's powers to prevent market crises; detailing transparency and reporting requirements.**

# REGULATION OF THE SECURITIES ISSUANCE PROSPECTUS (1)

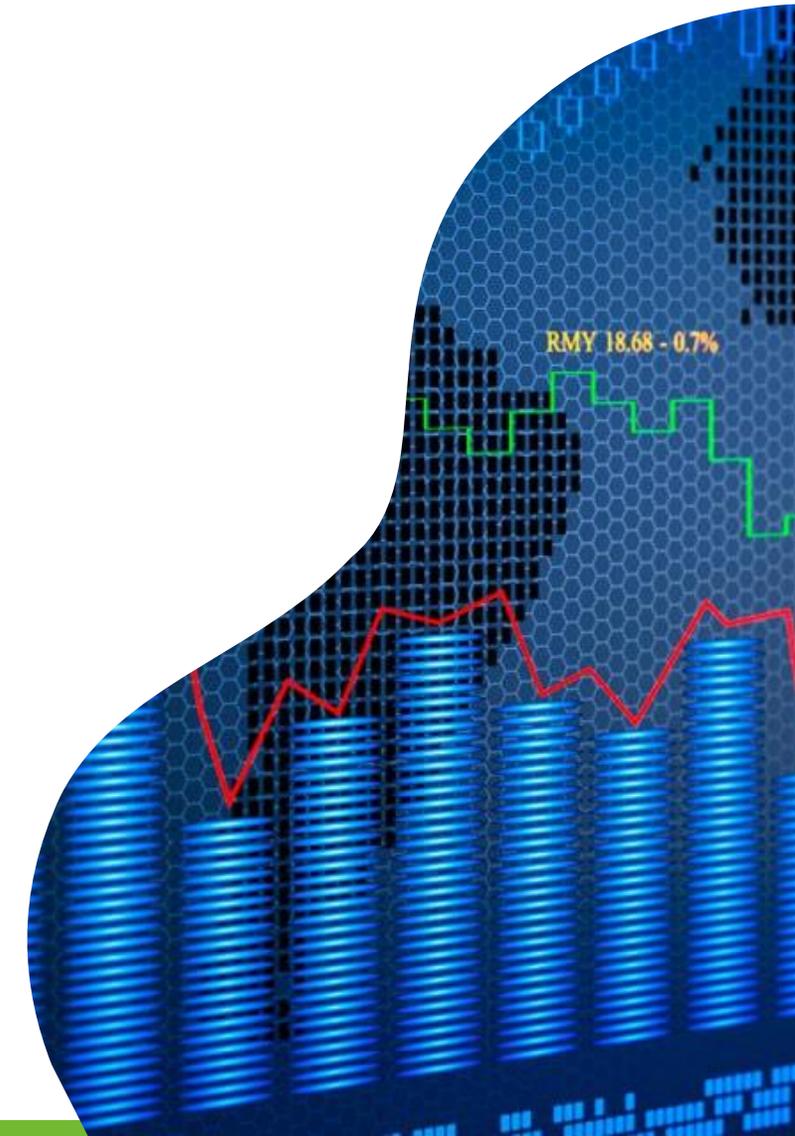
- The EU Prospectus Regulation aims to harmonize the rules and requirements for prospectuses for all potential issuers (public limited companies, investment funds, etc.). The main provisions of the regulation include:
  - Thresholds for issuance volumes that trigger the requirement for a prospectus;
  - A universal registration document that simplifies the registration process for frequent issuers, allowing them to submit a single document to the national regulator;
  - A simplified disclosure regime for secondary issuances;
  - Specific requirements for the presentation of risk factors;
  - The option to publish prospectuses to in digital form;
  - Mutual recognition of prospectuses issued in different EU member states.

# REGULATION OF THE SECURITIES ISSUANCE PROSPECTUS (2)

- Differences between Ukrainian and European legislation governing prospectus requirements include:
  - **Cases when a prospectus is not required for a public placement of securities.** The Law on “Capital Markets and Organised Commodity Markets” contains a list of cases when registration and publication of a prospectus is not required for a public placement, similar to **Regulation 2017/1129**. However, unlike European legislation, Ukrainian law does not set specific monetary limits.
  - **Requirements to describe the issuer's risks.** Issuers are required to disclose risks in the prospectus as required by both European and Ukrainian law. However, the key difference between Ukrainian and European law in this section is that the latter is much more specific in its requirements for issuer risks. In particular, Delegated **Regulation 2019/980** defines the types of risks; requires them to be described in a language understandable to investors; and describes the structure and presentation of risks. The NSSMC's regulatory framework is less detailed and comprehensive.
  - **Requirements for key financial information.** According to the NSSMC's regulations, the prospectus must contain financial statements, and issuers must submit an auditor's conclusion to the NSSMC for registration of the prospectus. However, delegated **regulation 2019/979** contains a detailed description of the financial statements to be included in the prospectus, which is not fully equivalent in Ukrainian law.
- **Possible steps: consolidate the bylaws governing the form and content of the prospectus and harmonise the requirements for the prospectus with EU legislation.**

# USING BENCHMARKS

- In the EU, the use of benchmarks is regulated by **Regulation 2016/1011** (BMR - Benchmark regulation), which:
  - defines the procedure for authorisation of benchmark administrators;
  - obliges benchmark administrators to be accountable and transparent;
  - defines critical benchmarks;
  - defines the procedure for recognising benchmarks from non-EU countries;
  - defines sanctions for non-compliance with the regulation;
  - defines the procedure for excluding low-quality benchmarks;
  - guarantees access to benchmarks for all stakeholders.
- Although Ukrainian regulators use certain benchmarks (e.g., UONIA - Ukrainian Overnight Index Average), the use of BMR-regulated indices is limited. The updated law **“On State Regulation of Capital Markets and Organised Commodity Markets”** defines benchmarks, declares their manipulation illegal, and gives the NSSMC the power to counteract this.
- **Possible steps: to expand the legal framework for the use of benchmarks used in the EU in Ukraine; this will require the adoption and development of relevant regulations by the NSSMC within the new provisions of the Law on State Regulation of Capital Markets and Organised Commodity Markets.**



# CREDIT RATING

- **Regulation 1060/2009** (Credit Rating Agency Regulation – CRAR) governs the activities of credit rating agencies in the EU. It establishes:
  - The obligation for rating agencies to be registered with ESMA (European Securities and Markets Authority);
  - Rules for organization and operations, including independence and objectivity;
  - Procedures for monitoring agencies;
  - The rules for interactions between agencies and the entities being assessed;
  - The obligation for agencies to avoid conflicts of interest.
- Ukraine’s law "**On State Regulation of Capital Markets and Organized Commodity Markets**" requires credit rating agencies to be authorized by the National Securities and Stock Market Commission (NSSMC). However, these rules are not fully compatible with CRAR, as they lack detailed criteria on transparency, objectivity, and impartiality for rating agencies. Moreover, the rating scale defined by the NSSMC differs from the standard international scale used in EU countries.
- The Law "**On Credit Rating**" establishes a framework similar to CRAR. Specifically, the law defines a national rating scale, detailing its criteria and obligating authorized rating agencies to use this scale in credit ratings.

## REGULATION OF INVESTMENT FUNDS (1)

- **UCITSD V** (Undertakings for Collective Investment in Transferable Securities Directive) regulates mutual funds that provide services to the general investors:
  - requirements for depositories (asset protection, liability for losses);
  - supervision of management companies (remuneration policies, risk management);
  - investor protection (transparency of charges, daily valuation of assets).The
- **AIFMD** (Alternative Investment Fund Managers Directive) regulates the activities of managers of alternative investment funds (AIFs), which include hedge funds, private equity funds, real estate funds and other types of institutional funds that typically provide services to professional and institutional investors:
  - regulation of managers (risks, capital);
  - restrictions on marketing to retail investors;
  - transparency and reporting of leverage and fees.



## REGULATION OF INVESTMENT FUNDS (2)

- **Regulation (EU) 2015/760** regulates European Long-Term Investment Funds (ELTIFs). ELTIFs specifically aim to encourage long-term investments in the real sector of the economy (such as unlisted infrastructure projects, which typically involve long-term investments).
- The transposition of the acquis in the area of investment fund regulation will mean:
  - full and automatic recognition of UCITS, AIFs and ELTIFs authorised in any EU country
  - the possibility for Ukrainian investment funds to provide services in all EU member states.
- UCITSD V and AIFMD regulate risk management by aligning the long-term interests of investors and managers, while the Ukrainian regulatory framework is more focused on operational limitations of funds.
- **Priority recommendations: amendments to the Law "On Collective Investment Institutions" or adoption of a new regulatory act that would define the requirements for Ukrainian funds wishing to provide services throughout the EU and would establish the right of UCITS and AIFMs to provide services in Ukraine without the need for authorisation; changes in the approach to risk management.**

# REQUIREMENTS FOR INSURANCE COMPANIES (1)

- **Directive Solvency II** ensures that insurance companies are appropriately capitalised and hold sufficient reserves to cover insurance risks. The Directive introduced new rules in the following areas:
  - risk management and assessment;
  - **quantitative solvency indicators:** The SCR (Solvency capital requirement) stipulates that insurers must calculate their capital to ensure that they can cover all liabilities within 12 months with a 99.5% probability; the MCR (minimum capital requirement) is a capital threshold that ranges from 25% to 45% of the SCR;
  - transparency and reporting;
  - group supervision.
- **Directive 2016/97** regulates the way insurers and intermediaries develop and market products, which sets out
  - qualification requirements for insurers and intermediaries, including regular refresher training;
  - requirements for business practices;
  - product quality;
  - distribution of insurance products in a package;
  - requirements for insurance-based investment products.

## REQUIREMENTS FOR INSURANCE COMPANIES (2)

- The **Law “On Financial Services and Financial Companies”** establishes the general framework for the provision of insurance services. The Law **“On Insurance”** regulates the insurance industry in Ukraine. Similarly to **Directive 2009/138**, this law sets quantitative indicators of solvency for insurance companies.
- A set of NBU bylaws approximates Ukrainian legislation to European standards, in particular, by setting requirements for insurer qualifications, insurance policy approval, and consumer protection. However, the quantitative methods for assessing solvency differ from European practices.
- **Ukrainian legislation is more fragmented, with most of the ‘European integration’ provisions set out in the NBU's bylaws. Nevertheless (with the exception of certain quantitative indicators) Ukrainian requirements for insurance companies are quite similar to European ones.**



# DIGITAL OPERATIONAL RESILIENCE

- Regulation 2022/2554 (DORA - Digital Operational Resilience Act) strengthens the operational resilience of the financial sector to cyber threats and disruptions to information and communication systems. Key points:
  - requirements for managing risks associated with the use of telecommunications technologies;
  - reporting on cybersecurity incidents;
  - resilience testing;
  - third-party risk management.
- The Law “**On the Basic Principles of Ensuring Cybersecurity of Ukraine**” establishes a framework for combating cyber risks, in particular in the financial services sector.
- Ukrainian legislation in financial cybersecurity of the banking sector is more fragmented and less detailed than European legislation, but is, overall, equivalent to it.
- **Possible steps: develop a regulatory framework for cybersecurity in the context of the securities market (powers of the NSSMC).**

# REGULATION OF THE VIRTUAL ASSETS MARKET

- **Regulation 2023/1114** (MiCA - Market in crypto-assets) establishes unified requirements for the issuance and servicing of crypto-assets and transactions on the crypto-asset market. The Regulation applies to all entities engaged in the issuance or trading of crypto assets in the EU.
- The Law of Ukraine “**On Virtual Assets**” was adopted back in March 2022, which de facto meant the legalisation of crypto assets in Ukraine. However, it never came into force because it required changes to the Tax Code.
- Work on the updated version of the law is still ongoing. According to the latest available version as of 01.01.2024, the NBU will regulate crypto assets secured by currency values, while the NSSMC will be authorised to regulate virtual assets secured by securities or derivative financial instruments.
- **Possible steps: to detail and deepen the mechanisms for protecting market participants; to develop mechanisms for maintaining financial stability; to tighten requirements for service providers.**



# CONCLUSIONS AND RECOMMENDATIONS



## CONCLUSIONS

- The financial services market in the EU is highly regulated, which is based on the need to ensure a high level of capital mobility without increasing financial risks, and on the core values of EU public policy: stability, justice, and equality.
- The EU's regulatory framework can be characterised as proactive, i.e., aimed at identifying possible threats and acting proactively.
- Thus, all market participants have an obligation to manage risks effectively, and regulators have the right to intervene in a significant way even in the absence of evidence of a violation.
- In contrast, the Ukrainian regulatory framework is narrower; however, recent changes to the relevant legislation provide opportunities for its expansion.

# KEY RECOMMENDATIONS (1)

- **Prudential requirements for banks:** In order to facilitate further integration in other areas (e.g., accession to SEPA), the NBU should complete the process of formal implementation of the updated CRD V standards.
- **Bank insolvency resolution:** A mechanism for preventing and resolving bank insolvency should be developed and implemented.
- **Payment services:** the Law “On Payment Services” has been supplemented by numerous NBU regulations. In this field, Ukrainian legislation is largely harmonised with European legislation.
- **Central counterparties and clearing:** The NSSMC is to adopt additional regulations that will define, in particular, the procedure for resolution of insolvency of central counterparties, etc.
- **Regulation of the financial instruments market:** The NSSMC should introduce an effective mechanism to counteract abuse and minimise the risk of crisis situations.
- **Regulation of securities emission prospectus:** The legal framework requires consolidation and more detailed description of risks and financial indicators (similar to the European one).

## KEY RECOMMENDATIONS (2)

- **Benchmarks:** The NSSMC will need to adopt new regulations to properly regulate the use of benchmarks in Ukraine and to adopt the benchmarks used in the EU.
- **Credit ratings:** The NSSMC should introduce a transparent authorisation procedure (similar to the EU). In addition, it should switch to the international rating scale used in the EU.
- **Operation of investment funds:** The NSSMC should develop a framework for authorisation of UCITS, AIF, ELTIF.
- **Requirements for insurance companies:** Consider accelerating the transition to EU quantitative requirements.
- **Digital operational resilience:** The NSSMC should develop and adopt a number of regulations to effectively implement the DORA principles into Ukrainian law. These acts will define, in particular, the obligation and procedure for testing for operational resilience; the protocol for reporting cybersecurity incidents; the procedure for interacting with service providers, etc.
- **Regulation of the virtual asset market:** the European framework is more proactive and focuses on comprehensive measures to prevent market abuse and maintain financial stability.