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NEGOTIATING CHAPTER “FREE MOVEMENT OF CAPITAL”: WHAT NEEDS TO BE DONE TO BRING UKRAINE’S ACCESSION TO THE EU CLOSER?

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BACKGROUND INFO ON CAPITAL MOBILITY IN THE EU

Free movement of capital is a key element of EU integration that promotes economic development and requires candidate countries to comprehensively align their legislation and regulatory mechanisms

- The free movement of capital is one of the four fundamental freedoms of the European Union. It allows individuals and legal entities to freely move financial resources between member states without restriction.
- Articles 63–66 of the Treaty on the Functioning of the European Union (TFEU) regulate the free movement of capital. These articles prohibit any restrictions on the transfer of capital or payments between Member States and between Member States and third countries.
- As part of the EU accession negotiations, candidate countries must demonstrate a willingness to remove all restrictions on the movement of capital and harmonise national legislation with EU law.
- Despite the general principle of the free movement of capital, the EU allows for temporary or permanent exemptions, particularly to combat money laundering, prevent financial risks, or protect national security.

IMPLEMENTATION OF THE EUROPEAN COMMISSION'S RECOMMENDATIONS

RECOMMENDATIONS FOR 2023 AND 2024

According to the European Commission, Ukraine is **between having some level of preparation and a moderate level of preparation** with regard to accession in the context of the negotiating chapter “Free movement of capital”

- **Key challenges:**
 - Barriers to capital movement existed even before the full-scale invasion.
 - The NBU’s currency control restrictions (starting from March 2022) are contrary to the Association Agreement and Directive 88/361.
- **Overall position:** the EC does not call for the lifting of formal restrictions until the war is over but insists on preparing the infrastructure for further liberalisation.
- Recommendations for 2024 (no significant changes compared to 2023):
- On **Single Euro Payment Area (SEPA):** To continue preparations for the application.
- **On FATF standards:**
 - To bring legislation in line with FATF standards.
 - To prepare and conduct a National Money Laundering and Terrorist Financing Risk Assessment.
- **On beneficial ownership:**
 - To establish the Register for holders of bank accounts and payment accounts.
 - To ensure registration of beneficiaries for all types of legal entities in accordance with EU standards.

JOINING SEPA

- **Progress in harmonisation:**
 - Law of Ukraine “On payment services.”
 - The transition of the NBU to ISO 20022 international standard.
- **Start of accession negotiations in 2024.**
- FISMA requirements: Strengthening of prudential supervision for banks
- **NBU roadmap (2024–2027):** Implementation of cross-border bank transfers with SEPA member states.
- **Conditions:**
 - Technical, legal, and regulatory compliance with SEPA standards.
 - Signing agreements with the European Payment Council (EPC).
- **Benefits:**
 - Reduced transaction costs.
 - Integration into the EU internal market.



PROGRESS IN COMPLIANCE WITH FATF STANDARDS

- In Ukraine, the Law **“On Prevention and Counteraction to Legalisation (Laundering) of Criminal Proceeds, Terrorist Financing and Financing of Proliferation of Weapons of Mass Destruction”** serves as the framework for combating money laundering and terrorist financing.
- The law was amended at the end of 2023 to align its terminology with international standards and improve the risk-based approach to business relationships with politically exposed persons. A number of by-laws have been adopted to detail certain provisions of the law. In addition, a recent Resolution of the NBU Board, **“On Amendments to Certain Regulatory Acts of the National Bank of Ukraine on Supervision,”** strengthened the NBU’s supervisory powers and extended them to non-financial institutions, bringing Ukrainian legislation in line with European standards.
- The draft law **“On Amendments to Certain Laws of Ukraine on Adaptation of Ukrainian Legislation to Certain Standards of the Financial Action Task Force (FATF) on Money Laundering”** was registered in September 2023. In general, **Ukrainian anti-money laundering legislation is in line with the key FATF recommendations but needs to be expanded.**
- **The State Financial Monitoring Service of Ukraine must update and implement the Methodology for the National Risk Assessment of Money Laundering and Financing of Terrorism in Ukraine.**

BENEFICIAL OWNERSHIP, REGISTER FOR HOLDERS AND BENEFICIAL OWNERS OF BANK ACCOUNTS, PAYMENT ACCOUNTS AND SAFE-DEPOSIT BOXES

- The Law “**On Amendments to Certain Laws of Ukraine on Improving the Regulation of Ultimate Beneficial Ownership and Ownership Structure of Legal Entities**” simplifies the submission of information on ultimate beneficial owners and ownership structure, establishes a mechanism for verification of such information by state registrars, etc.
- The Law was supplemented by a number of by-laws of the Ministry of Justice. In addition, the Cabinet of Ministers and the NBU jointly approved the methodology for determining the ultimate beneficial owner. Thus, the procedure for verifying the ultimate beneficial owner was postponed until 1 September 2024.
- Despite certain progress in implementing EU legislation on beneficial ownership, the establishment of the Register for holders and beneficial owners of bank accounts, payment accounts, and safe deposit boxes will require further steps.
- It is important to ensure that legislation is harmonised with European standards, in particular in the areas of data protection, transparency, and banking secrecy.
- Additionally, bylaws must be adopted to define the technical and administrative aspects of the registry.

IMPLEMENTATION OF THE EUROPEAN ACQUIS



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- The Treaty on the Functioning of the European Union stipulates the obligation to ensure the free movement of capital. However, the safe and effective functioning of a zone for free movement of capital requires unified regulation.
- **Fundamentals of the free movement of capital in the EU**
- **The functioning of the single payment system**
- **Preventing criminal practices (terrorist financing and money laundering).**

BASIC PRINCIPLES OF FREE MOVEMENT OF CAPITAL IN THE EU

Directive 88/361 enshrines and elaborates on the principle of free movement of capital in the EU countries, as defined in the Treaty on the Functioning of the European Union

- Defines various categories of capital movements that are subject to full liberalisation within the economic union. The list covers almost all “traditional” current account and capital account transactions.
- Defines the circumstances under which Member States may impose restrictions on the free movement of capital: if short-term capital movements of exceptional magnitude impose severe strains on foreign exchange markets and lead to serious disturbances in the conduct of a Member State’s monetary and exchange rate policies, being reflected in particular in substantial variations in domestic liquidity, the Commission may, after consulting the Monetary Committee and the Committee of Governors of Central Banks, authorise that Member State to take protective measures to the capital movements, the list of which includes:
 - operations in securities and other instruments normally dealt in on the money market;
 - operations in current and deposit accounts with financial institutions;
 - investment activities in securities or instruments normally dealt in on the money market;
 - short-term financial loans and credits;
 - movement of securities normally dealt in on the money market and means of payment;
 - other short-term operations similar to those listed above.
- Introduces oversight and reporting mechanisms.
- Prohibits restrictions on the free movement of capital between EU Member States and between Member States and non-EU countries.

RESTRICTIONS ON THE SALE OF AGRICULTURAL LAND AS AN EXAMPLE OF A VIOLATION OF THE PRINCIPLE OF FREE MOVEMENT OF CAPITAL

- **Current restrictions on the sale of agricultural land in Ukraine can be interpreted as a violation of Article 1 of Directive 88/361.**
- However, certain restrictions apply to the acquisition of non-agricultural land. Foreigners may acquire land within settlements or provided that real estate owned by a foreigner is located on the land. At the same time, foreigners are not entitled to purchase agricultural land.
- EU law does not provide for an exemption for agricultural land, it is also subject to Directive 88/361 on the free movement of capital. However, restrictions on land acquisition by foreigners from third countries exist in most “new” EU member states. New EU member states have the right to restrict land sale to foreigners during a so-called “transition period” to allow landowners to adjust to new – higher – real estate prices in the EU.
- No country has introduced a mandatory ban on the purchase of agricultural land by foreign legal entities and individuals. Under EU policy, such a ban is considered justified only in exceptional cases, including in the absence of a legal framework or administrative capacity to prevent likely and significant risks.
- **Under martial law, lifting the moratorium can hardly be called expedient; however, this issue will undoubtedly be on the agenda after the war is over.**

THE FUNCTIONING OF THE SINGLE PAYMENT SYSTEM

- **Directive 2009/110:** Regulates the activities of issuers of electronic money in the EU, including banks, financial institutions and central banks that do not perform monetary functions. The Law of Ukraine “On Payment Services” (2022) establishes a similar framework, regulating the issuance and use of electronic money and the activities of issuers, including banks and non-bank institutions.
- **Directive 2015/2366 (PSD2):** Introduces regulation of new payment services such as payment initiation and provision of account information, extends coverage to one-way transactions and all currencies. The Law “On Payment Services” introduces a similar regulatory framework in Ukraine, taking into account the main provisions of PSD2.
- **Regulation 2021/1230:** Aimed at transparency in cross-border payments and currency conversion in the EU, it requires disclosure of fees before the transaction. Similar requirements are not yet fully in place in Ukraine.
- **Regulation 260/2012:** Defines technical requirements for transfers in euros, including the use of IBAN, BIC and the ISO 20022 XML format. Ukraine implemented the relevant standard through an NBU Resolution on using ISO 20022 in payment infrastructure.
- **Regulation 2015/751:** Sets limits on interchange fees for card-based payment transactions in the EU. There is no similar regulation in Ukraine, but the NBU controls interbank fees within national payment systems
- **Ukraine is gradually aligning its legislation with EU norms, but additional reforms are needed to harmonise standards in the payment services sector.**



PREVENTION OF CRIMINAL PRACTICES

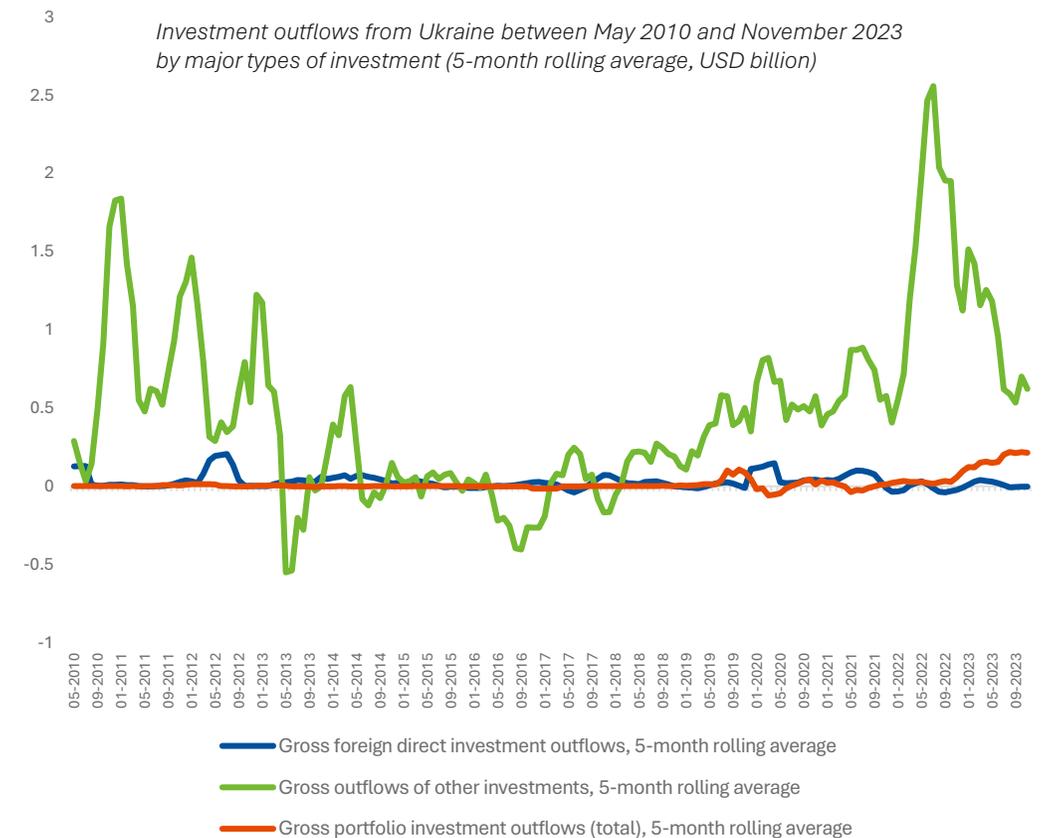
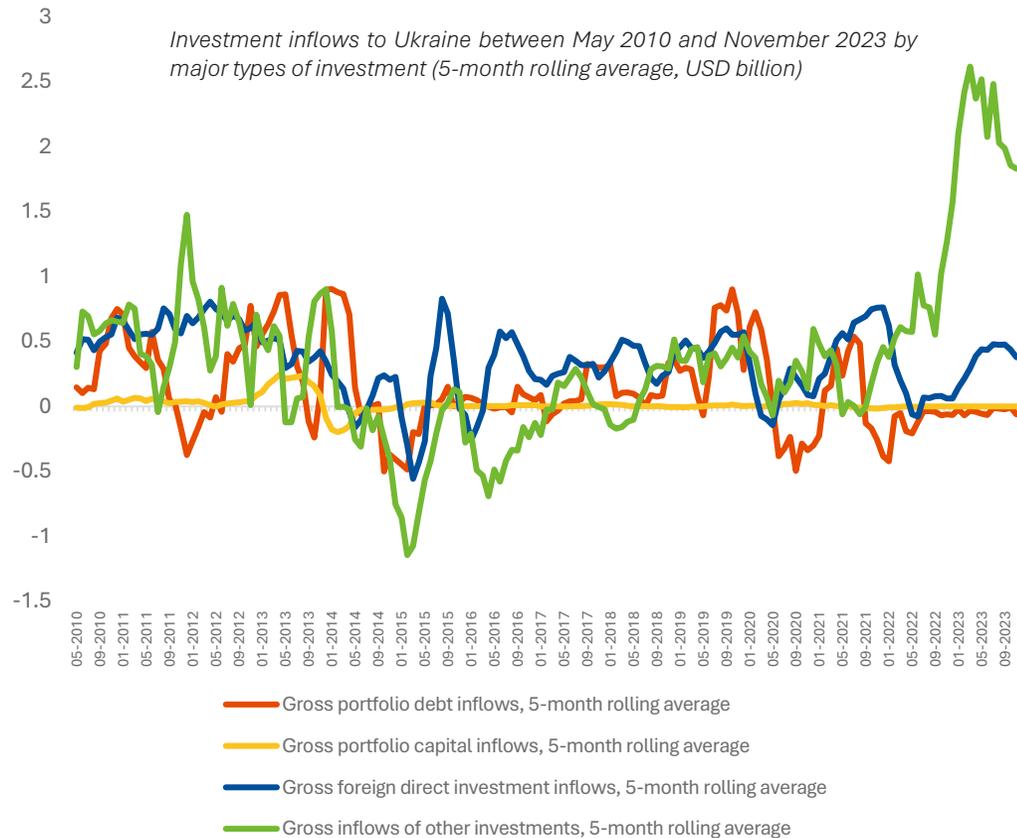
- **4AMLD (Directive 2015/849):** Requires money laundering risk assessments, customer due diligence, central registers of beneficial ownership, monitoring of suspicious transactions and data retention for 5 years.
- **5AMLD (Directive 2018/843):** Extends regulation to cryptocurrency platforms, art dealers, and real estate agents, enhances the transparency of beneficiary data, and prohibits anonymous accounts.
- **6AMLD (Directive 2018/1673):** Introduces stricter penalties for money laundering, criminalises complicity, and expands the scope of predicate offences (e.g. cybercrime).
- **Regulations (2015/847, 2023/1113):** Regulate the tracing of money transfers, including crypto assets, and set transparency requirements.
- **Ukraine has successfully implemented the framework legislation but is not yet close to fully transposing 5AMLD and 6AMLD. Full implementation of European practices will require, but not be limited to, integration into EU systems.**



LIBERALISATION PROSPECTS

DYNAMICS OF INVESTMENT INFLOWS AND OUTFLOWS

Investment flows are dominated by portfolio debt and alternative instruments, compared to portfolio equity and direct investment

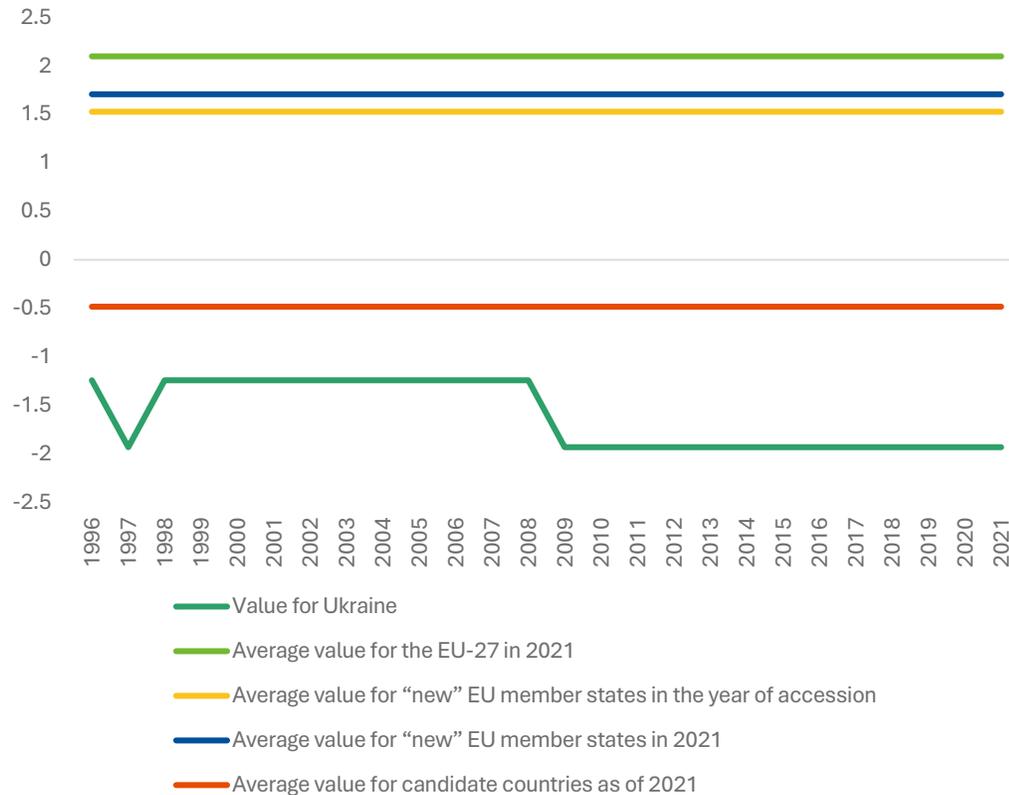


Source: CES calculations and visualisation based on OECD Monthly Capital Flow Dataset (De Crescenzo, A. and Lepers, E. (2021), *Extreme Capital Flow Episodes from the Global Financial Crisis to COVID-19: An Exploration with Monthly Data*. OECD Working Papers on International Investment). Note: Portfolio investments are not classified by type (debt and equity) due to a lack of data.

PRE-WAR RESTRICTIONS ON CAPITAL MOBILITY

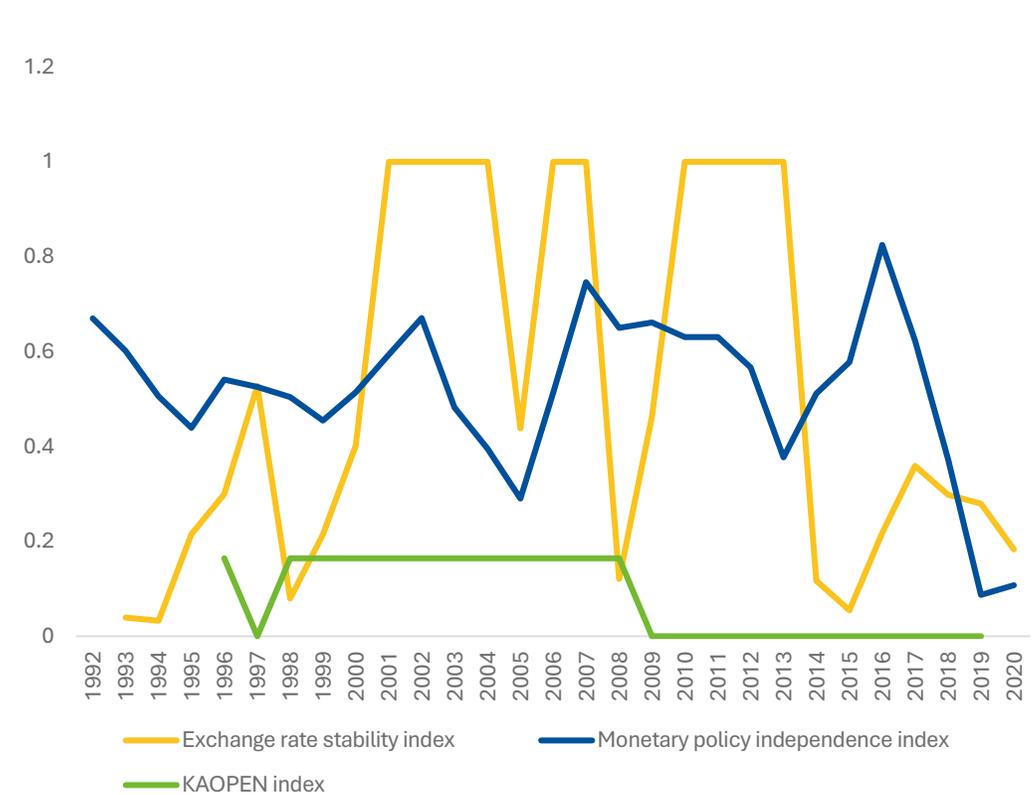
As of 2021, Ukraine’s formal barriers to the free movement of capital far exceeded similar restrictions not only in the EU27 but also in the “new” member states as of the year of accession. Other candidate countries are also ahead of Ukraine in terms of de jure freedom of capital movement

Dynamics of the capital mobility index (KAOPEN) in Ukraine in 1996–2021 compared to the average for EU member states in 2021, “new” EU member states in 2021, “new” EU member states at the time of accession, and EU accession candidates as of 2021



Source: CES calculations and visualisation based on data from Chinn & Ito (2023).

Dynamics of the KAOPEN index, the monetary policy independence index, and the exchange rate stability index for Ukraine between 1992 and 2020



Source: CES visualisation based on Aizenman, Chinn & Ito (2021).

RESTRICTIONS ON WARTIME CAPITAL MOBILITY

Restrictions	2021	2022	as of December 2024
Repatriation	Partial restrictions, NBU permission for large amounts.	Prohibition on the withdrawal of dividends.	Transfers of funds abroad are allowed with certain restrictions: repatriation of new dividends, limited transfers to parent companies, payments under contracts covering war risks, and payments of coupon income on government bonds held for at least 90 days.
Sale of foreign currency earnings	No restrictions.	The restriction has not been restored.	The restriction has not been restored.
Settlement deadlines	365 days.	Reduced to 90 days with a gradual extension to 180 days.	180 days, and 90 days for oilseeds and grains. Does not apply to defence and dual-use goods etc.
Residents' investments abroad	No restrictions if controlled and supervised.	Prohibition on the withdrawal of capital.	Limits for individuals and restrictions for legal entities apply. Resident legal entities are allowed to transfer funds to the accounts of their foreign branches, representative offices or subdivisions without establishing a legal entity, provided with the following conditions: (1) the total amount of transfers in the current year does not exceed the amount transferred in 2021 for the maintenance of such subdivisions (with supporting documents); (2) no more than 1/4 of this annual amount can be transferred within one month.
Capital transfers by non-residents	No restrictions if controlled and supervised.	Prohibition on the withdrawal of capital.	Prohibition on the withdrawal of capital.
Hryvnia exchange rate	Floating.	Fixed from February 2022.	Managed flexibility mode from October 2023.

INTERNATIONAL CAPITAL MOBILITY IN UKRAINE: CHALLENGES AND RISKS

	Full financial liberalisation	Restrictions on capital movements and currency regulation
Advantages and opportunities	<ul style="list-style-type: none"> • Better access to international investment capital, an opportunity to attract productive investments for post-war recovery • Diversification of investment opportunities for residents 	<ul style="list-style-type: none"> • More efficient monetary policy, the ability to effectively influence aggregate demand in the short term • Ability to maintain a stable exchange rate
Disadvantages and risks	<ul style="list-style-type: none"> • Potentially high volatility of capital flows • The need to introduce high standards of prudential supervision • Less effective monetary policy, the need for fiscal impact 	<ul style="list-style-type: none"> • Restrictions on foreign funding • Limited range of financial instruments for domestic investors • Greater likelihood of rent seeking and corruption

LIBERALISATION PROSPECTS: KEY ISSUES

1. Which of the current currency restrictions have the greatest impact on the real sector?
2. How will the readiness to move to the third stage of the strategy of returning to a flexible exchange rate and inflation targeting be determined?
3. Is it possible to return to the 2021 regulatory regime in the near future?
4. If we imagine that we are back to the 2021 regulatory regime (i.e. to forget about the currency restrictions introduced in February 2022), what would need to be done to liberalise investment by individuals and legal entities?
5. What impact could a potential decline in the effectiveness of monetary policy have?
6. How risky can absolute mobility of capital be for macro stability? What barriers need to be removed last?
7. Leaving aside the current currency restrictions, what other regulations create barriers to investment?