



**The Business & Law Readers Digest**

**Regulation  
of Financial Services**

Banking and Finance // Beverages Industry // Corporate // Corporate Dispute Resolution // Due Diligence // Employment // **Financial Services** // Insurance // Investments // Kyoto Protocol Implementation // Logistics // Mergers and Acquisitions // Natural Resources // Oil and Gas // Representative Office // Land // Ukraine and the WTO // Ukraine and Russia // Tourism



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## General overview

Financial services are regulated by the following principal laws, enacted by the Ukrainian Parliament:

- the Law "On Financial Services and the State Regulation of Financial Markets" of 12 July 2001;
- the Law "On Securities and the Stock Market" of 23 February 2006;
- the Law "On State Regulation of the Securities Market" of 30 October 1996;
- the Law "On Financial Leasing" of 16 December 1997;
- the Law "On Non-State Pension Insurance" of 9 July 2003;
- the Law "On Insurance" of 7 March 1996,
- the Law "On Credit Unions" of 20 December 2001.

Ukrainian law recognises the following financial institutions:

- banks;
- credit unions;
- leasing companies;
- trust companies;
- insurance companies;
- non-state pension funds;
- investment funds and investment companies;
- pawn shops;
- other legal persons who provide financial services.

A financial institution may engage in the following financial services, according to its declared activities:

- issuance of payment orders/cards, travelers cheques, other forms of settlement;
- trust management of assets;
- currency exchange;
- financial leasing;
- provision of loans/credits;
- issuance of guarantees and suretyships;
- money transfers;
- insurance;
- non-state pension funds;
- securities trading;
- factoring.

A person obtains the status of a financial institution once he is recorded by the State Register of Financial Institutions, maintained by the State Commission on Financial Services Markets (the "Financial Services Commission"). Persons that are not financial institutions are generally prohibited from providing financial services.

Financial services markets are supervised by two state authorities: the Financial Services Commission, which is a regulator for non-bank financial institutions, and the State Commission on Securities and the Stock Market (the "Securities Commission"), which supervises the activities of stock market participants.



The authority of the Financial Services Commission extends to:

- regulating the activities of non-bank financial institutions;
- registering financial institutions and maintaining the State Register of Financial Institutions;
- the licencing of financial institutions and monitoring their compliance with licencing requirements;
- regulation of requirements regarding capital adequacy and other requirements for operations with financial assets;
- conducting audits of financial institutions.

The authority of the Securities Commission includes:

- regulating activities on the stock market, adopting licencing procedures for securities traders;
- regulating procedures for the issuance and circulation of securities and derivatives within the territory of Ukraine;
- regulating the activities of foreign issuers in Ukraine and the placement of Ukrainian issuers' securities outside of Ukraine;
- monitoring participants' compliance with securities legislation.

## Regulation of financial institutions

The Law "On Financial Services and the State Regulation of Financial Markets" sets licencing and reporting requirements for financial institutions, their liability for non-compliance with such requirements, and legal protection of the interests of consumers of financial services.

The Financial Services Commission issues licences to the following financial institutions:

- insurance companies;
- non-state pension funds;
- credit unions;
- persons that attract financial

investments from individual consumers of financial services.

The law provides several legal guarantees to individual consumers regarding protection of their rights, by imposing restrictions upon financial institutions relating to minimum amount of capital, certification and qualifications of directors and staff, and regular reporting procedures. In addition, financial institutions are required to provide - at their customers' request - information regarding the financial standing of a financial institution, the identity of its directors, or applicable tariffs for financial services.



The Financial Services Commission is entitled to review the activities of financial institutions and impose penalties for their non-compliance with statutory regulations.

The law regulates the format of financial services agreements between a financial institution and individual consumers. A financial services agreement should reflect inter alia the following provisions:

- name of agreement, names and addresses of financial institution

and recipient of financial services, details of licence issued to a financial institution;

- type of financial operation;
- description of the financial asset that is the subject of an agreement, terms of settlements;
- period of validity of financial services agreement;
- provisions regarding amendment and termination of an agreement;
- rights and duties of parties,
- liability for non-performance;
- other agreed terms.

## Regulation of securities trading

According to the Law "On Financial Services and the State Regulation of Financial Markets", securities trading is viewed as a financial service. Securities trading may be provided by persons who have received the necessary licence from the Securities Commission.

The new Law "On Securities and the Stock Market" was adopted in 2006. This law regulates activities in relation to the placement and circulation of securities and conducting of professional activities on the stock market, with a principal objective of ensuring that the stock market is transparent and efficient.

By law, the Securities Commission is authorised to issue licences for:

- brokers/dealers;
- underwriting, management of securities;
- asset management;
- management of mortgage assets;
- depositary/custody/registrar activities;
- organisation of trade on the stock market;
- clearing settlements.

Under Article 17 of the Law "On Securities and the Stock Market", securities trading includes:

- broker activity, or purchase by a trader of securities for a client at the client's expense;
- dealer activity, or purchase by a trader of securities for himself for



- the purpose of their re-sale;
- underwriting, or placement of securities on behalf of the issuer;
  - securities management.

The Securities Law sets the following minimum capital requirements for securities traders:

- UAH 120,000 for dealer activity;
- UAH 300,000 for broker activity and securities management;
- UAH 600,000 for underwriting.

The Licencing Regulations of the Securities Commission No. 346 of 26 May 2006 establish the following licencing requirements for securities traders:

- 1) a trader should join at least one self-regulating trading organisation;
- 2) a trader should conduct trading activities at its registered address as indicated in the company registration certificate;
- 3) a trader's certified specialists should comply with the qualification requirements established by the Securities Commission, the trader should employ at least three specialists (who have passed qualification exams by the Securities Commission);
- 4) a trader should have the necessary office equipment and software, equipment to supply non-interrupted electricity, not less than two computers, and necessary means of communication (electronic mail, telephone, facsimile).

5) a trader should comply with the following requirements regarding the organisation of its activities:

- it should prepare corporate regulations on conducting activities in relation to securities trading;
- it should prepare a regulation on branch offices (if it has any);
- it should prepare corporate regulations on internal control and appoint an internal controller;
- it should prepare regulations on financial monitoring and appoint an employee to be responsible for such monitoring;

6) a trader should comply with the requirements of applicable legislation on prevention of and counteraction against money laundering;

7) actual capital of a trader at the end of a financial year should be not less than the registered capital;

8) a trader should open a specific bank account to account for clients' funds separately from its own;

9) a trader should account separately for the securities and funds of each client, separate from its own securities and funds.

Regulations of the Securities Commission No. 1449 of 12 December 2006 "Rules for Securities Trading: Broker, Dealer, Underwriting and Management Activity" sets detailed requirements regarding securities traders' activities.



According to the Regulations, a trader should:

- act in the client's best interests;
- agree with each client an acceptable level of risk during the purchase of securities;
- at the client's request, advise on all possible risks for securities transaction;
- at the client's request, provide information on the market value of securities;
- only perform its own operations having first performed all operations ordered by a client;
- immediately inform clients of any conflict of interest;
- open a separate bank account for clients' funds provided for management;
- comply with the liquidity requirements established by the Securities Commission.

A trader is prohibited from:

- disclosing a client's confidential information, except if so required by law;
- making statements to a client assuring him of guaranteed return and absence of risk of losses from investment;
- performing transactions without obtaining client's instructions.

The law requires each trader to establish internal accounting procedures, which should include:

- ledger of registration of contracts and one-off orders; and
- register of internal accounting of contracts (one-off orders)

Each trader should perform internal accounting in paper and/or electronic form.

## Regulation of other financial services

The provision of other financial services is addressed by laws regulating leasing, non-state pension funds, and credit unions. The draft Law "On Pawn Shops" is currently being reviewed by Parliament.

### a. Leasing companies

The Law "On Financial Leasing" of 16 December 1997, as amended, is the principal legislation regulating leasing transac-

tions within Ukraine and also international leasing contracts.

The Law sets the rights and duties of the lessor, lessee and supplier (seller) of a leasing object, as well as requirements applicable to a leasing contract.

Leasing companies should obtain prior registration with the Financial Services



Commission and register with the State Register of Financial Institutions before engaging in leasing activities.

### **b. Non-state pension funds**

The Law "On Non-State Pension Insurance" of 9 July 2003 regulates the structure for the provision of non-state pension insurance by private non-state pension funds.

According to the Law, non-state pension insurance is performed by:

- non-state pension funds;
- insurance companies through contracts of insurance or life-time pensions;
- bank institutions through contracts on opening pension deposit accounts.

Non-state pension funds may be established as:

- open pension funds;
- corporate pension funds;
- professional pension funds.

Non-state pension funds are registered by the Financial Services Commission.

Recipients of non-state pension funds may be either citizens of Ukraine or foreign nationals. A person may be a participant of several non-state pension funds.

A pension contract is made between an insured person and an administrator of a non-state pension fund and establishes the rights of the insured person.

A non-state pension fund may implement several pension plans, each of which should be registered with the Financial Services Commission.

### **c. Credit unions**

The Law "On Credit Unions" of 20 December 2001 regulates the activities of credit unions. A credit union is a financial institution which is established for the purpose of providing loans to its participants.

A credit union may be established either by citizens of Ukraine or by foreign nationals, who have a common place of employment, study, profession, or residence. A credit union should have not less than 50 individual participants.

Participants should make monetary contributions to a credit union, as specified in the credit union statutes. The principal activities of a credit union are defined as the provision of loans to participants from its own funds, management of assets, and obtainment of bank loans for on-lending to participants of a credit union.

A credit union is registered by the Financial Services Commission with the State Register of Financial Institutions.



## Regulation of foreign companies

Foreign companies have the same rights as Ukrainian companies in relation to providing financial services in accordance with legislation. According to Ukrainian legislation and international agreements on protection of foreign investment, foreign investors in Ukraine are provided with foreign investment guarantees regarding protection of their investment. Under the Law "On the Policy of Foreign Investment" of 19 March 1996, the following legal guarantees apply to foreign investors:

- national processes for investment and other economic activities are established for foreign companies operating in Ukrainian territory; foreign companies are entitled to conduct commercial activities according to the legal policy applied to Ukrainian companies, except for restrictions established by law;
- if legislation is amended in respect of guarantees concerning foreign investment protection, state guarantees with respect to foreign investment protection effective as of the date of investment shall be applied upon the demand of the foreign investor within ten years following the effective date of legislation changes;
- foreign investment may not be the subject of nationalisation; government authorities may not put foreign investments in requisition unless otherwise provided by law;

- foreign investors shall be entitled to recover damages caused by the actions of Ukrainian government authorities or their officials;
- after investment activities are terminated a foreign investor is entitled to repatriation of its investment in kind or in foreign currency as well as repatriation of income from investment;
- after payment of taxes and charges the foreign investor is guaranteed transfer of income in foreign currency abroad gained on a legal basis from activities in the territory of Ukraine.

Additional legal guarantees with respect to foreign investment protection have been established by certain international agreements to which Ukraine is a party. One such agreement is the Partnership and Cooperation Agreement with the European Union of 14 June 1994. According to Article 54 of the Agreement, Ukraine may provide 'favoured nation treatment' to foreign investment, in particular, through:

- the signing of assistance agreements as well as investments protection agreements between EU countries and Ukraine;
- the signing of treaties on the avoidance of double taxation between EU countries and Ukraine;
- arrangement of favourable conditions for attraction of investments into Ukraine's economy.



## Taxation of financial services

The Law "On Taxation of Corporate Profits" of 28 December 1994, as amended, regulates the taxation of financial institutions' activities.

### Securities trading

Gains from securities trading are taxable at the rate of 25%. Losses may be carried forward to future tax periods. Trading of securities is exempt from value added tax.

### Leasing

Transfer of a leasing object to a lessee is viewed as a sale for tax purposes. The lessee has the right to capitalise the lease payments.

Transfer of a leasing object is taxable for the purposes of value added tax.

### Non-state pension funds

Contributions made by employers and employees to non-state pension funds are exempt from taxation.

Contributions to non-state pension funds are tax deductible for both employer and employee up to the maximum amount specified by legislation.

### Credit unions

Credit unions are viewed as non-profit organisations for tax purposes.

Monetary contributions made to a credit union by its participants are not taxable. Income of a credit union derived from its statutory activities is exempt from corporate tax.

## Regulatory Developments in 2007

*a) Regulation of the Securities Commission "On the Register of Financial Institutions" of 16 January 2007*

In 2007, the Financial Services Commission made changes to the registration procedures of the State Register of Financial Institutions.

According to the regulations, in order to register with the State Register of Financial Institutions, the applicant should

submit to the Financial Services Commission the following documents:

- an application containing legal information about the financial institution;
- a registration card in the prescribed format;
- a registration card indicating information about branches;
- all other documents that the Commission has asked for.



The Financial Services Commission should issue a registration certificate to a financial institution within 5 days after submission of the necessary documents.

b) On 10 May 2007 the Financial Services Commission introduced changes to the Regulation "On Financial Monitoring of Financial Institutions", approved by the Financial Services Commission No. 25 of 5 August 2003

The requirements of the Regulation apply to financial institutions, including credit unions, pawn shops, leasing companies, trusts, insurance companies and non-state pension funds.

According to the Regulation, the financial institutions should appoint a person to be responsible for financial monitoring. The appointed person should ensure that the financial institution stays compliant with the legislation regarding financial monitoring.

If it is not possible to appoint a person responsible for financial monitoring, the director of the financial institution shall assume the undertaking of these requirements.

A financial institution should notify the Financial Services Commission on the appointment of a responsible person within 3 days.

The person responsible for financial monitoring carries out the following functions:

- preparation and implementation of internal rules on financial monitoring;
- ensuring compliance by staff of internal financial monitoring procedures;
- staff training;
- consulting staff about financial operations that may be within the scope of financial monitoring;
- notifying law enforcement agencies regarding qualified financial operations.

*c) On 8 May 2007 the Financial Services Commission amended the Regulation "On the Professional Requirements of Directors and Chief Accountants of Financial Institutions", approved by the Resolution of Financial Services Commission No. 1590 of 13 July 2004*

According to the Regulation, a director and a chief accountant of a financial institution should comply with the following qualification criteria:

- should have higher (university) education;
- should have attended required Financial Services Commission courses and obtained certificates;
- should have not less than five years (for director) and two years (for chief accountant) of employment history;
- should not be director, financial director or chief accountant of a financial institution that was declared insolvent.

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