



2020

# “NBU Influence Measures in 2019. Judicial practice. Trends. Expectations”

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# 1. Preface

The NBU published an annual inspection plan for the first time in December 2018.

Bank inspections were carried out according to the approved plan made on the basis of risk-oriented approach that took into account belonging of the bank to a certain category given its size in banking system, character and complexity of operations, level of risks inherent to its activities, as well as on the basis of the determined overall assessment of the SREP (Supervisory Review and Evaluation Process).

**51 bank was included into the list of financial institutions in which it was planned to hold NBU scheduled inspections in 2019.**

In February 2019, the NBU [reported](#) that on February 7, 2019 respectively a new system has been launched currency surveillance based on risk-oriented approach according to the Law of Ukraine “On Currency and Currency Operations”.

Instead of total currency control a fundamentally new approach that was based on the principle: “less risk - less attention, more risk - more attention” was implemented for all operations. An adequate influence measure will be determined taking into account a comprehensive analysis, in particular sums of operations, systematicity, reasons and the consequences of the violation.

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***Has risk-oriented approach applied by the NBU provided weakening of currency supervision and prevention of violations?***

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Has 2019 year really introduced a new currency surveillance approach, cleared a number of bureaucratic barriers away and elimination of need to report to banks for any currency transaction for banking business in Ukraine?

**This Review is the first independent legal evaluation of qualitative and quantitative indicators of the NBU activity in some of the influence measures applied to banks in 2019.**

The results reported in this Review raise rather ambiguous questions for participants of domestic banking business.

However, we are confident that the analysis of quantitative and qualitative metrics, discussion and search for answers to the critical questions that appeared during the supervisory activity of the NBU in 2019 will only promote an increase transparency and predictability of banking business in Ukraine.

Also, we invite you to review our [compliance.sytniuk.com](http://compliance.sytniuk.com) website which contains additional information.

Kind regards,

**Head of compliance practice  
Volodymyr Lytvyniuk**

## 2. Banking Supervision and NBU Influence Measures in 2019

In accordance with the requirements of [Directive \(EU\) 2015/849 of 20 May 2015 “On preventing of abuse of the financial system for money laundering or terrorist financing”](#) Member States shall ensure that decisions on the application of administrative penalties or a measure for breach of national provisions transposing this Directive which has not been appealed to be published by the competent authorities on their website as soon as the punished person was informed about the decision.

Although the rules of the abovementioned Directive allow a competent authority (the NBU) to delay publishing of the decision on the application of administrative punishment or not publishing of the decisions on the application of administrative punishment for stability of financial markets - **2019 was the year of the NBU transparency in part of publicity of decisions on the application of NBU measures of influence for violation of requirements of financial monitoring legislation as well as appeals against such decisions and any further information on the outcome of such an appeal.**

Let's start with the main indicators of the NBU's measures in 2019:



# 51

banks were included in the list of financial institutions in which were carried out planned NBU inspections in 2019, [according to the NBU information of year 2018](#)



# 52 685 400

is the total amount of fines in hryvnia which was applied by the NBU to banks upon results of banking supervision for calendar year 2019 according to announced information and data of the United State Court Register of Court Decisions



# 31

official measures of influence was applied to domestic banks for calendar 2019 year according to the official published information of the NBU



# 36,7%

of the total fines which were applied by the NBU in 2019 year were not appealed by banks in administrative courts (and therefore, it was actually recognized validity of its application)

TOP 5 HIGHEST PENALTIES OF THE NBU IN 2019

14 382 472

**JSC “UNIVERSAL BANK”**

In January 2019 the NBU has decided on application [to the bank measure of influence](#) in the form of a fine in the amount of 14 382 472,28 UAH

7 142 125

**JSC “OTP BANK”**

The NBU by the results of inspections on prevention and counteraction to legalization (laundering) of the proceeds of crimes, terrorist financing and financing of proliferation of mass destruction weapons in March 2019 [applied a fine](#) in the amount of 7 142 125,42 UAH

6 852 526 28

**JSCB “INDUSTRIALBANK”**

In June 2019 banking regulator [decided on application](#) of influence measure in a form of fine in the amount of 6,852 526.49 UAH

6 200 000

**JSC “MEGABANK”**

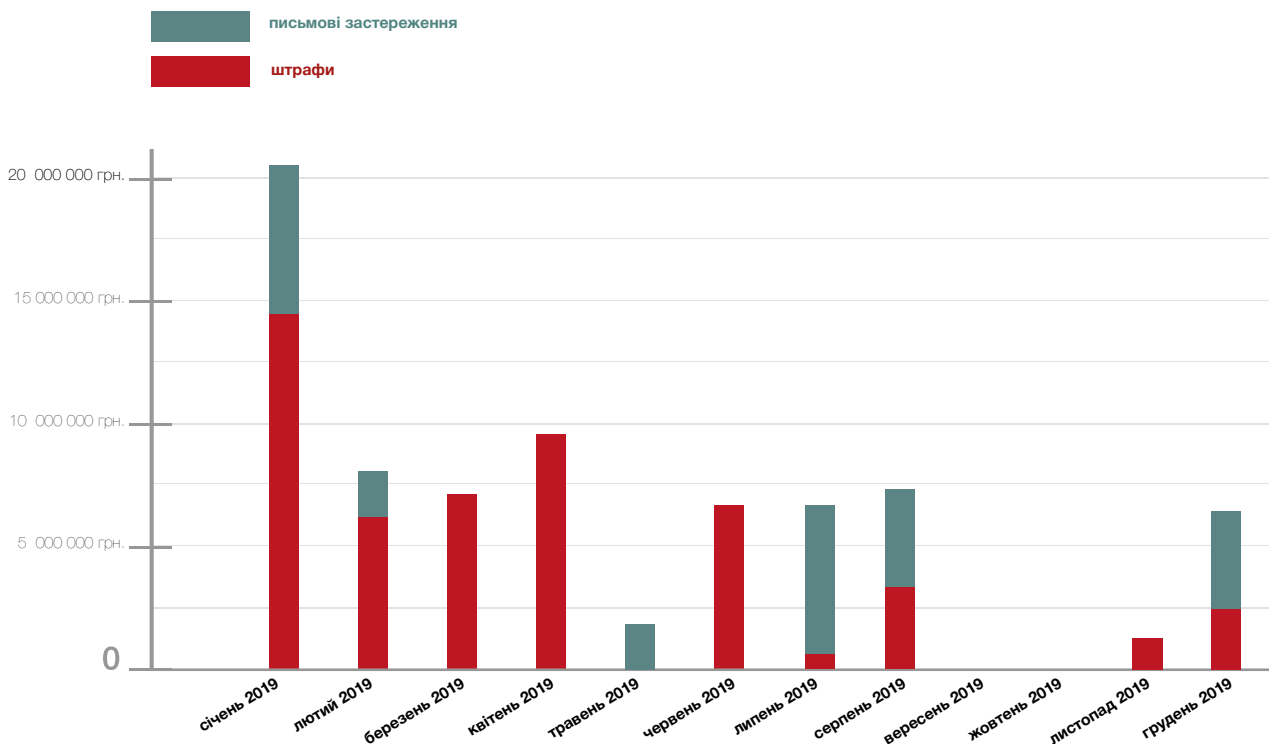
In February 2019 banking regulator [decided on application](#) of influence measure in the form of imposition of a fine in the amount of 6 200 000 UAH to the specified bank

2 600 000

**JSC “BANK ALLIANCE”**

In August 2019 banking regulator [decided on application](#) of influence measure in the form of imposition of a fine in the amount of UAH 2 600 000

The dynamics of application of NBU influence measures in the context of calendar months of 2019 is shown on the chart:



## Major breaches of banks that have caused application of NBU influence measures

- 1) failure of the bank to perform **due diligence of financial transactions using risk-oriented approach**;
- 2) improper performance of **duty to develop, implement and constantly taking into account the legislation** - to update internal financial monitoring documents;
- 3) improper fulfilment of the obligation **to examine bank customers**;
- 4) **non-implementation of measures that would allow to receive comprehensive information about clients** and their ability to conduct financial activities, essentials of financial transactions, in particular, through implementation of in-depth client verification, demand of additional explanations, documents and information about financial transactions and further use of funds;
- 5) **failure to detect financial transactions of clients**, economic feasibility (meaning) of which is absent or transactions that may otherwise damage the bank by carrying out (involvement in carrying out) of risky activities;
- 6) the bank's **failure to fulfill its obligation to provide risk management in its activities** and reassess clients' risks;
- 7) **failure to fulfill an obligation to detect fact of belonging of clients to politically exposed persons (PEP)** as well as to their close persons or persons connected with national public figures during carrying out of identification, verification according to internal documents on issues of financial monitoring;
- 8) **failure to take sufficient action on client examination and analysis** of their financial transactions to prevent, limit, and/or reduce to an acceptable financial risk level of financial transactions to legalize criminal income/terrorist financing made by institutions and legal entities - clients;
- 9) **non-termination of a financial transaction** participant of which is a person included in the list of persons involved in terrorist acts activities or to which international sanctions are applied;
- 10) the bank's **failure to fulfill its obligation to refuse providing services to clients** in cases provided by the legislation of financial monitoring issues (continuing providing services to those clients concerning whom it was accepted decision to terminate a business relationship establishing unacceptably high risk);
- 11) carrying out **risky activities in financial monitoring sphere** by the bank;
- 12) **violation of the order of registration of financial transactions** which according to legislation are subject to financial monitoring;
- 13) **failure to submit or late submission of information** in cases provided by law to the specially authorized body;
- 14) **failure to provide the NBU with complete and reliable information** in the reports in form, order and terms defined by regulatory act of the NBU;
- 15) **violation of an order of submission of information, materials**, documents (copies and/or extracts from them), explanations (including written) by the bank to request from the National Bank;
- 16) **presence of persons who have substantial participation** but have not received approval of the National Bank in the ownership structure of the bank;
- 17) **failure of the bank to find out information from clients** questionnaires and from state bodies of fiscal service that income of physical persons are clearly not enough to hold relevant financial repayment transactions of loan commitments with participation of non-bank financial institutions because part of the physical persons are unemployed or hold positions that do not provide revenue sufficient for repayment of received credits;
- 18) **failure to identify signs of fictitiousness** of clients (!):
  - insignificant authorized capital compared to the amount of funds that they transfer to other entities' accounts;
  - one person is both owner and at the same time director of the enterprise;
  - the absence of other employees of the entity management other than the director;
  - the period of activity of legal entity does not exceed one year from the date of its state registration;
  - the registration address is the place of registration of a large number of legal entities;
  - the presence of identical IP- addresses of legal persons bank clients and their counterparties;
  - changes in the client's constituent documents, associated with changing its registration address, main activities, composition of participants and executives before opening an account or in the process of bank service.

## The main schemes identified by the NBU and caused implementation of influence measures against banks in 2019

### Problem operations with sovereign bonds

Financial transactions with securities, in particular sovereign bonds conducted by professional participants of the stock market (brokers) on their own behalf, at the expense and at the order of legal entities and individuals, the nature of which may testify the legalization (laundering) of proceeds of crime. Carrying out regular/cyclical buying and selling operations of sovereign bonds with an aim to obtaining by individuals (one side of the transaction) investment profits, and by legal entities (the other side of the transaction) - investment loss.

At the same time, the artificial profit from the sale of sovereign bonds by clients was actually obtained without paying for the purchase of these sovereign bonds (funds for the settlement of the purchase of sovereign bonds by the clients of the broker were not transferred, but retained from calculating of the further sale of these sovereign bonds). Sovereign bonds were acquired by Clients from legal entities at a price lower their fair value and the sale of sovereign bonds to legal entities was carried out at a price that is close to or higher than their fair value.

Therefore, legal entities as the result of such actions received a permanent loss while Clients received constant artificial profit (almost 98% of the profit was subsequently received by the Clients in cash at Bank cash register) as a result from further sales of sovereign bonds.

**According to the results of the NBU's analysis of transactions with sovereign bonds concluded on the stock market it was established that 74 individuals (including 12 public persons) received a profit about 800 million UAH, the damage was received by 18 legal entities (including 6 non-residents) for total amount of about 919 million UAH.**

### Securities at the Over-The-Counter market

Receipt by the bank clients from other legal entities mainly as payment for assignment of right of demand or as a settlement for securities (off the stock exchange) in cashless form not upholding the principle of "delivery of securities against payment" at a sale price that was significantly higher (up to 36 times) the par value of these securities.

### Related parties transactions

Failure to analyze the clients (clients group) of the bank taking into account the signs of their affiliation including joint ultimate beneficial owners (controllers) and/or directors. Consequently, denial to deliver service to one client in the group (with considerable delay) due to scheme transactions, other clients who have performed substantially similar transactions by context and form, continued to be serviced at the bank and the decision to refuse them bank servicing was made later or not approved at all.

### Fictitious collection

Conducting financial transactions to transfer clients' funds by the bank in accordance with collection of funds service contracts. Subsequently, these funds were delivered by means of collection from other banking institutions in cash to financial institutions and were used, in particular, for cash loans to individuals and payments to individuals for agricultural products. Nature and consequences of such financial transactions give reason to believe in the NBU view that they may be related in particular to legalization of criminal proceeds, conversion (transfer) of non-cash funds into cash.

### Non-banking financial institutions

Failure of the bank to carry out measures to obtain comprehensive information about clients - non-banking financial institutions (location is an address that is a registered office of a large number of legal entities persons; frequent changes in the constitutional documents of financial companies, in particular, related to the change of its executives; change of manager and ultimate beneficial owner before opening bank accounts; in the personell of financial company is one person or several persons; manager and ultimate beneficial owner of the financial company is the same person, etc.).

### **Non-application of risk-oriented approach**

Failure by the bank to mitigate existing risks, including through in-depth review, requesting additional explanations, documents and information regarding financial transactions and further use of cash from customers of the bank.

Failure to find out by the bank of real financial capabilities of clients for conducting financial transactions on significant amounts over a short period of time, failing to conduct a quality analysis of clients' financial transactions with the purpose of identifying financial transactions that do not correspond to a financial status and nature of the activities of these clients or the lack of economic feasibility that has led to an incorrect assessment of the level of client risk.

Continuation of providing services to those clients for whom a decision was made to terminate the business relationship (for clients who are at an unacceptably high risk).

### **Failure of the bank to obtain comprehensive customer information**

1. Conducting of cash transactions by the bank to issue cash to a group of individual clients of the bank the nature of which suggests that they may be related to conversion (transfer) from non-cash into cash. At the same time, real incomes of individuals were not enough to pay off relevant credit obligations. Instead, repayment of loan was made only by two legal entities-clients of the bank for which there were signs of fictitiousness. Credit agreements according to which individuals have been granted loans by a financial company are of the same type, and the fulfillment of obligations are secured by a contract of guarantee or a penalty (in case the borrower breaks the loan repayment period, the borrower pays a penalty of 0% of the loan amount for each day of delay).

2. The banks ignore the fact that the volume of transactions for the quarter on the accounts of clients is 350-1800 times exceeds the amount of cash flow from the main business activity declared by clients in their questionnaires completed during the establishment of a business relationship with the bank.

3. Conducting transactions of the clients despite the availability of information in public sources that clients and their counterparties who transferred funds to clients' accounts appear in criminal cases proceedings, in particular, as participants of activities related to the provision of tax minimization services obligations; enterprises with fictitious features; participants of illegal activities related to non-cash processing, tax evasion and involved in the legalization of cash which proceeds from crime, in particular, from the realization of a fictitious enterprise.

4. Transfer of non-cash to cash using lost, stolen documents or those that have the characteristics of fake, invalid (null and void): contracts with deceased persons, concluding agency agreements with the use of stolen and lost passports; legal entities – clients who have signs of fictitiousness (registered almost simultaneously, having sole foundation managerial staff, authorized capital is not fully formed, did not file tax and financial statements etc.), whereas the accrued funds are transferred to other entities within a short period of time to other entities with a different purpose of payment which in most cases indicates payment for goods without actual delivery/transfer of goods.

### **2019 year was the year of prevention and counteraction to legalization (laundering) of the proceeds of crimes, terrorist financing and financing of proliferation of mass destruction weapons.**

**During the audits the NBU thoroughly analyzed both financial operations of clients with securities, timeliness of risks reduction measures and the compliance of the bank's procedures client reviews, in particular, through in-depth audits, requesting additional explanations, documents and information regarding financial transactions, financial state and essence of client activities with the purpose of establishing illegal transactions or transactions with an absence of economic feasibility.**



### 3. Influence measures and non-banking financial institutions in 2019

In accordance with the requirements of [the Currency Supervision Regulation](#) the National Bank carries out currency supervision in Ukraine in order to establish the conformity of the conducted currency transactions with currency legislation of Ukraine taking into account the risk-oriented approach.

The National Bank organizes and carries out currency supervision of authorized institutions by conducting on-site and off-site inspections of authorized institutions, their structural subdivisions in accordance with the procedure established by the normative acts of the National Bank which regulate the procedure for conducting on-site, off-site inspections and applying to them measures of influence in this case of detection of violations of currency legislation adequate to these violations.



# 27

influence measures were applied by the NBU to non-bank financial institutions in 2019



# 23

written warnings were applied during 2019 to non-bank financial institutions



# 100 000

fine was imposed for not providing in full documents / properly certified copies of documents providing untrue information at the request of the National Bank



# 3

licenses were revoked: general licenses on currency transactions and licenses to transfer funds in national currency without opening accounts



# 1123

inspections of non-banking currency exchange offices of financial institutions were held by the NBU on compliance of foreign exchange transactions in all regions of Ukraine and in city of Kyiv in 2019

## 4. Appeal against the NBU influence measures and judicial practice

In accordance with [Article 74 of the Law of Ukraine “On Banks and Banking Activity”](#) the decision of the National Bank of Ukraine on the application of an influence measure in the form of a fine is an executive document and shall enter into force on the day of its adoption. In case of failure to implement such a decision it is transmitted by the National Bank of Ukraine to the state enforcement service for enforcement.

***Pursuant to paragraph 4 of Part Three of Article 151 of the Code of Administrative Justice of Ukraine it is not allowed to enforce a claim by suspending the decisions of the National Bank of Ukraine, acts of the National Bank of Ukraine as well as the establishment by the National Bank of Ukraine prohibition or obligation to take certain actions.***

As a result of the analysis of public information contained in the [Unified State Register of Judiciary Decisions](#), the process of appealing by the banks of the influence measures of the NBU in 2019 was carried out in the majority cases as follows:

- 1) taking measures to secure an administrative claim by stopping the recovery on the ground of the relevant decision of the NBU;
  - 2) appeal against the NBU's decision to impose a fine essentially.
- According to information from the Unified State Register of Judiciary Decisions, the status of the appeal of the NBU influence measures by the banks in 2019 looks as follows \*:



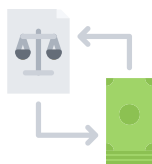
# 33 327 874

of NBU fines were appealed by banks in administrative courts during 2019



# 19 357 516

is the total amount of fines of the NBU which was recognized by the banks in 2019 and has not been appealed in administrative courts



# 25 835 000

administrative courts have suspended the execution of corresponding NBU decisions for such amount



# 5 900 000

of the fine imposed by the NBU was found unlawful by a decision of the administrative court [which came into force in 2019](#)

\* cases remain in litigation process

## **Distinctive judgments of the Supreme Court of 2019 concerning the NBU influence measures**

### [Resolution of the Supreme Court of 02.10.2019 in Case No. 826/9802/17](#)

“... According to Art. 1173 of the Civil Code of Ukraine damage caused to physical or legal person by unlawful decisions, the act or omission of a public authority, a public authority of the Autonomous Republic of Crimea or a local self-government body during carrying out by them of their authority, shall be reimbursed by the state, the Autonomous Republic of Crimea or the local self-government body regardless of the fault of these bodies.

Thus, the failure of the National Bank of Ukraine on non-use of proper measures to protect the legitimate interests of depositors and creditors which has brought to breach of rights of depositors in form of non-refunded funds, for certain the circumstances may be regarded as damage caused to an individual or a legal entity by an unlawful decisions, acts or omissions of a public authority. Aggrieved parties of such failure to act may claim compensation accordingly to Art. 1173 of the Civil Code of Ukraine, however, such a dispute cannot be resolved within the limits of administrative proceedings.”

### [Resolution of the Supreme Court of 13.12.2019 in Case No. 826/7889/16](#)

***“... It is not enough fact alone to declare failure to act as unlawful in case of untimely performance of mandatory actions, and specific reasons are also important, the conditions and circumstances under which the actions subject to mandatory execution under law, have not actually been or have been carried out with breach of timeframes.***

***What really matter are legal content, significance, duration and limits of failure to act, the actual reasons for termination, as well as the harm of inaction for the rights and interests of the individual.***

***On this basis, the panel of judges agrees with the conclusion of the courts of previous instance on that the National Bank of Ukraine in accordance with the laws of Ukraine “On the National Bank Of Ukraine “,”On Banks and Banking Activity”and Regulation No 346 endowed with exclusive authority to determine independently the adequacy of the measure of influence applied to discovered violations, because it is the National Bank of Ukraine as a subject of government authority is vested with the right and has objective capacity to directly evaluate performance of the bank.***

### [Resolution of the Supreme Court of 18.12.2019 in Case No. 520/1636/19](#)

“... the courts have correctly stated that paragraph 14 of clause 3.3 of Chapter 3 of Section I of the Regulation No 346, to which reference is made the defendant in the contested decision refers to the signs of risky activity in the sphere of financial monitoring, and not risky activity in general, and foresees bank involvement (provision of bank services) in conducting financial transactions, the nature or consequences of which give reason to consider that they can be connected with the withdrawal of capital, the legalization of criminal income, conversion (transfer) of non-cash funds into cash, realization of fictitious entrepreneurship, tax avoidance, etc. (particularly cash withdrawals funds, transfer of funds abroad, purchase and sale of securities, use of accounts improperly, etc.).

Having analyzed Regulation No 346 in part of signs of risky activity, the courts of preliminary instances came to the correct conclusion **that “risky activity” and “risky activity in the sphere of financial monitoring” are not identical, defined and characterized by different signs, and according to Regulation No 346, if any, have different consequences for banks”.**






## 5. Trends and Expectations

### 2019 trends

Last year became a year with a risk-oriented approach based on the overall SREP (Supervisory Review and Evaluation Process) estimation, inspections of currency legislation compliance and legislation on prevention and counteracting the legalization (laundering) of income obtained by criminal means as well NBU's unprecedented transparency in publicity of the decisions taken on the influence measures applied.







New NBU principles during banking supervision (since posting of annual plan of bank inspections for 2019 on its official website and completing the requirements of the [Directive \(EU\) 2015/849 of 20 May 2015](#) concerning publication of information on the influence measures applied somewhat changed the domestic regulatory landscape.

#### Moreover, the trends were as follows:

-  implementation of common approaches to supervising banks and non-banking financial institutions (NBFi)
-  increasing of the transparency of communications with the NBU during the application of influence measures (preliminary results of inspections and holding meetings)
-  liberalization of the Order of organization and conducting of inspections on issues of prevention and counteraction to legalization (laundering) of the proceeds in a criminal way
-  introduction of new practices of providing public and official clarifications reasons for applying the influence measure
-  excessive use of Part 1 of Article 7 of the Law of Ukraine "On Access to Court Decisions" and prohibition of public release of texts of court decisions relating to appeal of the NBU influence measures

### 2020 expectations

Taking into account published [Financial Sector Development Strategies of Ukraine by 2025](#), as well as the NBU Action Program for 2020, we expect the following:

-  with the entry into force of [The Law on "Split"](#), non-bank financial institutions will be at the center of the special NBU attention in 2020
-  if 2019 was the year of NBU inspections on prevention and counteracting to legalization (laundering) of the proceeds of crime way, 2020 will be the year of inspections of [internal system control and compliance](#)
-  implementation of requirements on protection of financial services consumer rights will introduce new standards of market behavior both for banks and new challenges for non-banking financial institutions
-  further enhancing NBU attention to the level of corporate management in banks and non-banking financial institutions
-  formation of judicial practice of higher instances in relation to the united principles of banking supervision of the NBU
-  introduction of the mechanism of information check about the final beneficial owners of participants of the financial market to counteract corruption, money laundering, fraud, tax evasion and other crimes

## CONTACTS

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For any queries that require a personal response, we usually reply within 24 hours.

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This post does not necessarily address every important issue and does not cover every aspect of the topic to which this publication is devoted.

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