



The NBU has received the Central Banking's Transparency Award

#CentralBankingAwards #NBU #TrasparentNBU



Annual Report 2018



NBU Strategy

#NBU #Strategy #Actionplan #IndependentNBU



Currency liberalization

#NBU #oncurrency #liberalization



The Law of Ukraine

On Currency and Currency Operations

enacted as of 7 February 2019



for the first time in the history of Ukraine's independence

CentralBanking.com

@CentralBanking_ The @CentralBanking_ Transparency Award 2019 goes to ... @NBUKraine @NBUKraine_eng #CBawards http://ow.ly/HD7a30np6sp



NationalBankUkraine

@NBUKraine_eng Today the #NBU is to receive our first ever international Central Banking Award #CBAward for Transparency. The award ceremony has already started in London. The Governor Yakiv Smolii is there & ready to express gratitude on behalf of central bank's team.

Roman Waschuk

@WaschukCanUA .@NBUKraine awarded top global honours for #transparency by @CentralBanking_ magazine. #Canada has been lead donor in supporting this transformation! Transparency: National Bank of Ukraine - Central Banking



The extent of the .@NBUKraine leap ahead in #transparency? "This has put it well beyond the standards of some central banks in neighbouring countries, including some Eurosystem central banks."

The National Bank of Ukraine is a modern, open, and independent central bank enjoying public trust and integrated into the European community of national central banks



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Low and Stable Inflation

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Creating a Credit Register

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7

A Modern, Open, Independent, and Effective Central Bank

Ensuring Cash Circulation

Research at the NBU

Work with Government Authorities

Cooperation with International Partners

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Managing Human Capital

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Internal Audit



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Key Financials of the National Bank of Ukraine

Converting to IFRS 9

Consolidated Financial Statements Consolidated Management Report for the Year Ended 31 December 2018

NationalBankUkraine

@NBukraine_eng

National Bank of Ukraine releases the #NBU Strategy. "We will continue to devote our efforts in ensuring price and financial stability, and together with the financial sector foster the economic growth," noted the NBU Governor Yakiv Smolii: <https://goo.gl/6Uvxtw>

STRATEGIC GOALS OF THE NATIONAL BANK OF UKRAINE



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From now on you can read speeches of the #NBU Governor and Board members on the BIS website along with other central bankers' speeches: <https://www.bis.org/list/cbspeeches/index.htm> ...

Bank for International Settlements

@BIS_org

CB speech: Smolii (UA): The National Bank of Ukraine's key achievements in 2018 and action plan for 2019 - <https://www.bis.org/review/r190128b.htm> ...

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The #NBU has presented beta version of the new NBU site. Closing of the old version of the site and full transfer to the new site are scheduled at the end of this year. For now, it is only available in Ukrainian. English version will be added soon: <https://goo.gl/yNDZfL>



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The NBU's Key Performance Indicators in 2018

#NBU #achievements #2018



100%

Transparency of the banking system



77

Number of operating banks



9.8%

Inflation



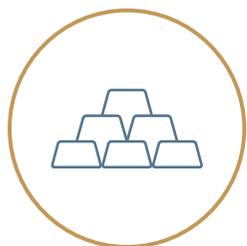
3.3%

Real GDP



10.2%

Ratio of cash outside banks to GDP



20.8

USD billion

International reserves



↑ 10.1%

UAH 540.1 billion

Domestic currency deposits



↑ 7.6%

UAH 614.0 billion

Domestic currency loans



21.7

UAH billion

Banking sector profit



134

UAH billion

Regulatory capital of banks

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The NBU as an Apolitical Institution



The NBU's operational goals have been set by the Constitution of Ukraine, the Law of Ukraine On the National Bank of Ukraine, and the NBU's strategic documents, in particular the Monetary Policy Guidelines for the current year and for the medium term, the Strategy of the NBU, the Action Plan, and others. The NBU is working to deliver its mandate, which is to promote price and financial stability in order to facilitate economic growth.

For the central bank to work effectively regardless of the political cycle, the Law of Ukraine On the National Bank of Ukraine clearly stipulates the NBU's institutional independence and its institutional capacity, which is based on strategic planning, a systematic approach, and collaborative decision-making.

The NBU's institutional capacity is also safeguarded by a system of checks and balances, which ensures the allegiance of the NBU's leadership remains with the public while retaining its independence.

That system is based on the distinction between the management of operations (carried out by the NBU Board) and control (carried out by the NBU Council, whose members are appointed by the Verkhovna Rada of Ukraine and the President of Ukraine). Under Ukraine's Constitution, the NBU Council's main tasks are to develop Monetary Policy Guidelines and oversee the implementation of monetary policy. In addition, the NBU Council oversees the NBU's internal control system.

External audits are another lever of control over the NBU's activities. As an institution that adheres to international standards for central banks, the NBU undergoes external audits regularly. Under Article 70 of the Law of Ukraine On the National Bank of Ukraine, the external audit is conducted with regard to:

- annual financial statements. This audit is conducted by an audit firm with experience auditing central banks (the NBU Council approves the selection of an audit firm and the results of the audit of annual financial statements conducted by the firm)
- reconciling the NBU's administrative expenses to planned expenses. The Accounting Chamber of Ukraine monitors the transfer of funds to Ukraine's state budget.

Publicity and accountability constitute the last element of control over the central bank's activities. Accountability is a basic principle of the NBU's activities and is clearly outlined in the Law of Ukraine On the National Bank of Ukraine. As a government institution, the NBU is accountable to the public. The NBU reports to the president of Ukraine, to parliament, including to parliament's Finance and Banking Committee, and to the NBU Council, and posts all necessary reports on its website.

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Governance

#NBU #faceofNBU



Address by the NBU Governor

In 2018, Ukraine's macrofinancial stability recovered to levels seen prior to the annexation of Crimea and the Donbas conflict. This is a clear sign that the central bank's steady and independent policy and its transparency with stakeholders – financial institutions, businesses, lawmakers, government officials, average Ukrainians, and more – is supportive of macrofinancial stability.

In 2018, Ukraine's economy delivered its most rapid pace of growth in the past seven years. Propelled by the NBU's monetary policy, inflation returned to a downward trend in 2018, decreasing for the first time in five years and dropping to single digits. Despite that remarkable achievement, inflation remained above the NBU's target. The hryvnia strengthened, allowing the NBU to grow international reserves to their highest level in five years.

The financial sector also performed well. The banking system is not only resilient, well-capitalized, and transparent, but also profitable – for the first time in five years. The public's confidence in the reliability of the banking system is on the rise, as are hryvnia-denominated deposits. Banks are finally lending more to households and, at a slower pace, to businesses.

In addition, the working relationship between the NBU and the Verkhovna Rada of Ukraine became very effective in 2018, with significant achievements compared to recent years in the area of financial sector reform.

Most importantly, the Verkhovna Rada adopted the Law of Ukraine On Currency and Currency Operations, which enshrines the free movement of capital. This law kickstarted Ukraine's long-awaited transition from a punitive, convoluted, and obsolete system of currency regulation to a new model based on the free movement of capital that is liberal, transparent, and modern, and one that meets European standards.

Second, after two years, the banking community has finally secured a greater protection of creditor rights after the adoption of the Law of Ukraine On Resumption of Lending, which aims to ease access to loans for households and businesses.

Third, the NBU launched the Credit Register to provide banks with more information about potential borrowers and thus help revitalize lending and reinforce the banking sector's financial resilience.

That would not have been possible if not for the NBU's efforts to maintain and develop a dialogue with stakeholders. We strongly believe that only through openness and accountability can the central bank win the public's trust, fight populism, and preserve its institutional independence. This belief inspires us to explain our actions to the public at every single step: through live streams during meetings, on the NBU's website, and on five social media platforms. The NBU clearly understands the opportunities and challenges Ukraine faces. The NBU commits to be accountable before the people for its actions and its words.

Reflecting all of those efforts in 2018, the Central Banking Awards 2019 honored the NBU's team by awarding the NBU the Transparency Award for significant achievements in transparency and for building a strong dialog with stakeholders in 2018. The award recognizes the NBU's progress in establishing a transparent, modern institution that has earned the support of the international community.

In 2018, in a move that highlights the NBU's commitment to transparency and efficiency in pursuing its mandate, the NBU adopted its first-ever strategy for the medium-term. The strategy identifies clear goals, the actions required to achieve those goals, deadlines, and quantifiable outcomes. As such, the strategy serves as a clear reference for all of the central bank's stakeholders, enabling them to understand the NBU's future policy and preventing any surprises or inconsistencies.



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The strategy is far from just words on paper. In every section of the document, the NBU reports to stakeholders on its achievements over the past year in pursuit of its mandate and strategic goals.

At the same time, the NBU does not dwell on past achievements but continues to lay the groundwork for further reforms of Ukraine's financial system. The NBU is devoting 2019 to developing the Comprehensive Program of Ukrainian Financial Sector Development until 2025, which identifies the NBU's priorities as the architect of Ukraine's financial sector and outlines to the global community Ukraine's ambitions and goals in this area.

Yakiv Smolii

NBU Strategy

Approved and made public in spring 2018, the NBU's medium-term strategy is the first document that outlines the central bank's goals for the coming years. This document serves as a benchmark for the NBU's operations and represents a step forward in the NBU's development as a modern, open, independent, and efficient state institution.

We have a clear-cut strategic vision and program: the strategy identifies seven benchmarks that will guide our development in the next few years. Apart from meeting its statutory mandate of maintaining low and stable inflation and ensuring a stable and efficient banking system, the NBU will be involved in efforts to revive lending and to ensure a smooth transition to the free movement of capital. This will establish the proper conditions for the sustainable development of the banking sector.

The NBU has also set new and ambitious tasks to effectively regulate the entire financial sector and to promote financial inclusion.

Six goals are external and aimed at meeting the needs of financial ecosystem participants. The high institutional capacity of the regulator is an important prerequisite for achieving these goals, and that requirement dictates the seventh (internal) goal: building a modern, open, independent, and efficient central bank.

Throughout 2018, the NBU implemented numerous measures under each of the seven strategic goals. The NBU Board tracks and plans out the performance indicators of the implementation of the strategy together with the strategic planning team. To deliver these goals, the NBU held two strategic sessions for management and numerous strategic sessions for each of the central bank's functions.

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Address by the Chairman of the NBU Council

For the NBU Council, 2018 was marked by decisions that will chart the course of Ukraine's development over the medium term.

Our most important accomplishment within the past year was the development and adoption of the NBU's Monetary Policy Strategy. In this document, the NBU Council laid the groundwork for ensuring a consistent and predictable monetary policy, reducing inflation expectations, and ultimately achieving price and macroeconomic stability in Ukraine.

An important step towards delivering nationwide financial stability was the adoption by the NBU Board of the Strategy for Macroprudential Policy. Throughout 2018, the NBU had pushed for the need to adopt this document to allow the NBU to execute its second most important mandate – the promotion of financial stability.

It is noteworthy that in 2018, the NBU Council began working in its full composition and all its entities worked actively as the Council engaged in constructive dialogue with the NBU Board, Ukraine's parliament and government, and the broader community of experts.

The NBU Council also wishes to recognize the NBU Board's work towards attaining medium term inflation targets. We believe the NBU Board is headed in the right direction from a tactical perspective. From a strategic perspective and as it fulfills its constitutional mandate, the NBU Council will control how the regulator performs its core function as identified by Ukraine's Constitution and other functions under the Law of Ukraine On the National Bank of Ukraine.

Perhaps most importantly, conditions in the banking sector improved in 2018. The banking system is profitable, more resilient, and less prone to shocks and thus has the potential to continue operating uninterrupted – even

if circumstances change. Liquidity in the banking sector has reached a level that ensures the timely fulfillment of all commitments to bank clients and depositors.

Life is constantly throwing new challenges our way, which forces us to rethink how we perceive the economic realities of our day-to-day operations. The NBU Council is ready to meet these challenges in a respectful, professional, and timely manner.

Bohdan Danylyshyn



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Yakiv Smolii

NBU Governor

Governor of the NBU since 15 March 2018.

Acting Governor of the NBU from 11 May 2017 through 15 March 2018.
First Deputy Governor of the NBU from October 2016 through 10 May 2017.

Yakiv Smolii has worked in Ukraine's banking sector for more than 26 years since the sector was established after the country gained independence. In 1991–1994, he worked at the NBU's regional branch in Ternopil oblast. Until 2005, he was deputy chairman of the board at Postal and Pension Bank Aval JSC. From 2005 through 2014, Yakiv Smolii served as director of banking business at Prestige-Group.

He graduated from the Ivan Franko Lviv National University with a major in Applied Mathematics. He holds a PhD in Economics.



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Kateryna Rozhkova

First Deputy Governor of the NBU

First Deputy Governor of the NBU since 15 June 2018.

Kateryna Rozhkova oversees banking supervision, registration and licensing, and financial monitoring of the banking system.

Kateryna Rozhkova has been working in Ukraine's banking system for 21 years. For more than 13 years, she held management positions as deputy chair, board member, and advisor to the chairman of the board at Erste Bank PJSC, deputy chair of the board at Finbank PJSC, and acting chair of the board at Platinum Bank PJSC. In 2009, she chaired the NBU's Off-Site Supervision Department for half a year. Between 10 June 2015 and 18 January 2016, she held the position of director of the Banking Supervision Department at the NBU. Up until June 2018, Kateryna Rozhkova was deputy governor of the NBU.

Kateryna Rozhkova graduated from Kyiv National Economic University with a major in Finance and Credit in Bank Management. She also holds a degree in International Business Management (MBA) from the International Institute of Management (IMI-KYIV).



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Roman Borysenko

Deputy Governor of the NBU

Areas under his management include finance, operations, human resources, and management of property and procurement for the NBU.

Roman Borysenko has worked in Ukraine's banking system for more than 17 years. From 2001 to 2014, he worked at Raiffeisen Bank Aval where he started his career as an economist and reached the position of deputy director and head of human resources.

He graduated from the Ukrainian Academy of Banking of the National Bank of Ukraine in the city of Sumy with a major in Banking.



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Dmytro Sologub

Deputy Governor of the NBU

Dmytro Sologub is responsible for monetary policy, macroprudential policy to ensure financial stability, economic analysis, collection and analysis of statistics and reporting, and research.

In 2002, he started his career as a research associate at the Institute for Economic Research and Policy Consulting (IER). Starting in 2004, he worked as a research economist at the IMF Resident Representative Office in Ukraine. From 2007 through 2015, he was head of analysis and research at Raiffeisen Bank Aval PJSC.

Dmytro Sologub graduated from the Belarus National University with a major in Theoretical Economics. Later, he obtained a Master's in Economics (EERC) at the National University of Kyiv-Mohyla Academy. He is a CFA charterholder.



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Sergii Kholod

Deputy Governor of the NBU

Deputy Governor of the NBU since 23 July 2018. His mandate is the development and regulation of payment and settlement systems, and the management of the cash circulation system.

Sergii Kholod has worked in Ukraine's banking system for 28 years. Sergii Kholod started his career in 1991 as senior electronics engineer in the design and technology of telecommunications department within the IT center at Prombudbank. In 2002 – 2007, he chaired the IT office at Raiffeisenbank Ukraine JSC (renamed to OTP Bank CJSC in 2006). For the next three years, he was the director of IT at Index Bank JSC (Credit Agricole Group). In 2009, Sergii Kholod was appointed operations director, then first deputy chairman of the board and a member of the board of SWEDBANK PJSC. In 2013, he was deputy chairman of the board at TASCOMBANK JSC. In 2013–2014, he was a member of the board of Brokbiznesbank PJSC. Before joining the NBU, Sergii Kholod spent five years working as deputy chairman of the board and a member of the board at VTB Bank PJSC.

Sergii Kholod has two degrees: in Economics from the Kyiv National Economics University, where he majored in Finance and Credit, and in Engineering from the Kyiv Higher Military Aviation Engineering College, where he majored in Avionics.

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Oleg Churiy

Deputy Governor of the NBU

He oversees open market operations, currency regulation, and operations of the NBU Depository. He began his career in Ukraine's financial sector in 1993 as a specialist in the international settlements office at INKO JSB.

Over the course of his career, Oleg Churiy managed securities transactions at VABank JSC, Spivdruzhnist investment company, and BNP-Dresdner Bank Ukraine JSCB. From 1999 through 2007, he was chief dealer of treasury and head of treasury at Bank Austria Creditanstalt Ukraine JSC (in 2002, the bank changed its name to Hypovereinsbank Ukraine JSC). In the following three years, he served first as deputy head and then as head of the investment business department at UkrSibbank JSCIB. Between 2010 and 2014, Oleg Churiy was in charge of fixed income market operations at VTB Bank PJSC.

He holds a degree in Economics from the Higher School of Banking at the International Center for Market Relations and Entrepreneurship, majoring in Finance and Credit. Oleg Churiy is a CFA charterholder.

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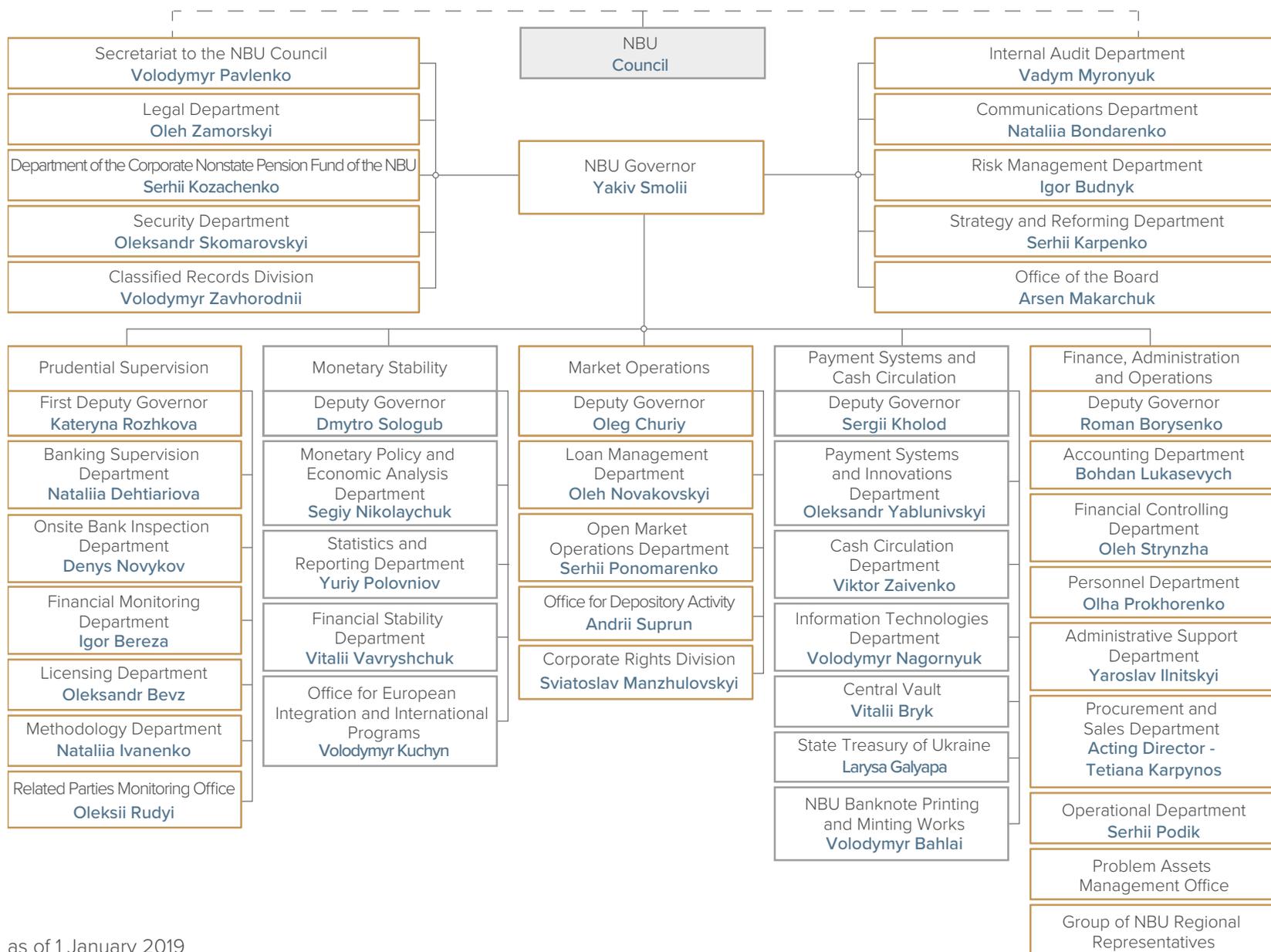
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as of 1 January 2019

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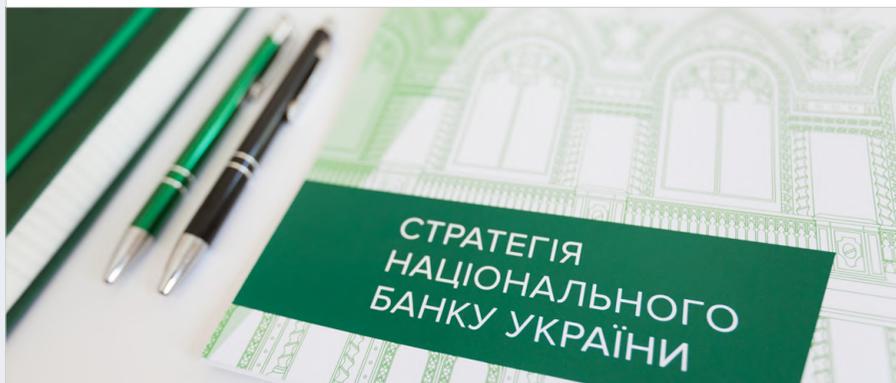
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Implementation of the Comprehensive Program for the Development of Ukraine's Financial Sector until 2020



To build an effective financial market with well-developed infrastructure and financial instruments that allow all segments to develop, the NBU has for the fourth consecutive year worked purposefully to implement the Comprehensive Program for the Development of Ukraine's Financial Sector until 2020.

The Comprehensive Program is being implemented through actions in three main areas:

- A. Ensuring the stability and dynamic development of the financial sector
- B. Building up the institutional capacity of financial market regulators
- C. Protecting the rights of financial sector consumers and investors.

The Comprehensive Program is an evolving document; it adapts to changes, meets new challenges arising from the financial ecosystem, and is revised regularly. To that end, in 2018 the document was revised for the second time by the following financial regulators: the NBU, the National Securities and Stock Market Commission, the National Commission for the State Regulation of Financial Services Markets, and the Deposit Guarantee Fund.

The revised Comprehensive Program has elevated those measures that needed greater attention and effort from regulators and market participants.

That includes the implementation of the BEPS (base erosion and profit shifting) action plan, the improvement of procedures for the licensing of banks and nonbank financial institutions, the development of the FinTech market, and the improvement of the financial awareness of Ukraine's population.

At the same time, the NBU believes the following projects of the Comprehensive Program will require significant efforts from all stakeholders in 2019, including legislative amendments:

- the "Split" project of the National Commission for the State Regulation of Financial Services Markets
- protection of financial consumers' rights
- financial inclusion.

In addition, the NBU is focused on delivering the objectives of the projects that have passed important development milestones: the liberalization of currency regulation, the development of the cashless economy, corporate governance at state-owned banks, and improved protection of creditor rights.

An external project office, made up of 12 project managers and analysts and created with the support of the European Bank for Reconstruction and Development, has joined the team of project managers from financial regulators to jointly implement the Comprehensive Program. These individuals are focused on implementing interdepartmental projects. In addition, international donors are providing technical assistance for 37 of 42 total projects.

Overall, the reform of the financial sector is on track to meet deadlines as required.

Two-thirds of all projects are currently working on the development, adoption, and implementation of legislation, which is the final stage before implementation. The NBU has successfully implemented 22% of its projects and is analyzing the anticipated outcomes and operations under the new legislation. Meanwhile, only 16% of projects are scheduled to be implemented after 2020, i.e. beyond the timeframe of the Comprehensive Program. These long-term projects include the implementation of risk-based supervision over payment systems, the transition to the new financial messaging standard ISO 20022 and the account number standard



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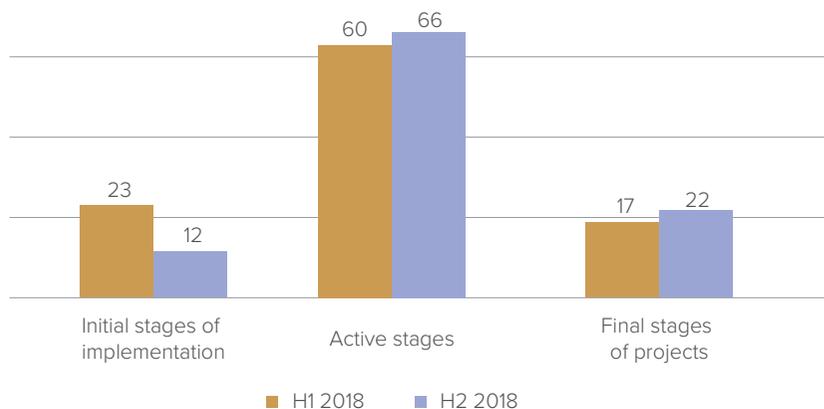
ISO 13616 (IBAN), the development of new infrastructure, and the regulation of the financial market.

The implementation in 2019 of 41% of the measures under the Comprehensive Program will depend on how quickly parliament adopts the draft laws that form the basis of the reforms.

Comprehensive Program 2020 implementation progress as of 31 December 2018



Comprehensive Program 2020 implementation progress, %



Progress in legislative implementation of financial sector reform in 2018

Financial sector regulation



Adopted and submitted to President for signing
Draft law 8060 dated 26 February 2018 bankruptcy code



Registered, consideration postponed
Draft law 0179 dated 23 March 2018 implementation of FATCA requirements and accession to CRS



Registered
dated 15 March 2018 On stimulating investment



Approved by Committee for second reading
Draft law 2413a dated 20 July 2015 consolidation of financial services market regulation



Registered
Draft law 9417 dated 19 December 2018 prevention of money laundering



Registered
Draft law 8055 dated 22 February 2018 financial ombudsman service

Capital markets



Signed, effective 24 November 2018
Draft law 2418-VIII (6141) attracting foreign investment



Registered and approved by Committee
Draft law 9034 dated 3 September 2018 development of banks' financial instruments



Registered and approved by Commit
Draft law 6303-D dated 4 July 2018 protecting investor rights in capital markets



Registered and approved by Committee
Draft law 9035 dated 3 September 2018 attracting investments, and new financial instruments



Registered and approved by Committee
Draft law 8007 dated 6 February 2018 on assignment of ratings



Registered
Draft law 9375 dated 6 December 2018 capital markets development

The Verkhovna Rada has adopted 7 Laws on financial sector reform that are aimed at improving corporate governance mechanisms in state banks, strengthening the protection of creditors' rights, improving the efficiency of bankruptcy procedures, and attracting investment, which will help reduce the risks in the banking system, restore lending, reduce the cost of credit, and ease doing business in Ukraine



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Banking sector

Signed, effective 4 May 2018
Draft law 2277-VIII (7114-D) NBU credit register

Signed, effective 7 February 2019
Draft law 2473-VIII (8152) on Currency

Signed, takes effect on 4 February 2019
Draft law 2478-VIII (6027-D) resumption of lending

Signed, effective 10 November 2018
Draft law 2491-VIII (8331-D) improving financial sector operation

Registered and approved by Committee
Draft law 9067 dated 7 September 2018 improving banking supervision

Nonbanking sector

Adopted, effective 1 January 2019
Draft law 2628 dated 23 November 2018 Amending the Tax Code

Registered and approved by Committee
Draft law 8415 dated 25 May 2018 regulation of financial service markets

Registered and approved by Committee
Draft law 9078 dated 13 September 2018 credit unions

Registered
Draft law 9224 of 19 Oct. 2018 Amendments to private pension provision (level III)

Registered
Draft law 9132 dated 28 Sept 2018 gov. supervision in technogenic safety

Financial sector regulation underwent substantial changes in 2018

N°	Projects of Comprehensive Program until 2020
A.2	FX restrictions for banks and businesses were eased
A.7/1	A package of draft laws to implement the BEPS action plan was prepared
A.7, B.12	IFRS UA XBRL taxonomy was developed and signed
A.10	Corporate governance in joint stock companies was improved
A.9	A mobile money service was launched by mobile operators
A.11	Protection of creditor rights was enhanced
A.13	A concept of cryptocurrency regulation was approved
A.14	A concept of tier II of the pension system was approved and a draft law was prepared
A.14/1	A draft law on changes in tier III of the pension system was registered
A.21	A draft concept of harmonization of taxation of financial sector instruments was approved
C.2	Disclosure standards for financial institutions and issuers were raised
A.15	NBU and NSSMC signed a capital market development memorandum
C.1	Financial literacy strategy project, I financial inclusion forum, financial awareness roadshow throughout Ukrainian cities

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In the framework of 2018 priority projects, the following milestones of the banking sector reform were achieved

N°	Projects of Comprehensive Program until 2020
A.4	Transition to Basel III ratios for banks
A.6, B5	Conducting analyses of banks' business models and strategies
A.6, B.5	New risk management standards at banks
A.7	Banks' transition to IFRS 9
A.7, B.12	26 XML and JSON datasets were opened on NBU website
A.9	A project to outsource cash handling in the regions was launched
A.9/1	SEP-3 was put into operation
A.9/2	Rapid development of NPS PROSTIR
A.10	The bank licensing procedure was changed
A.10	School of independent directors was founded
A.10/1	Transparency of banks' supervisory board formation was ensured
A.17	NBU launched the Credit Register
B.4	NBU Strategy
B.4	"Customer Service" for financial institutions
B.7/2	NBU rebranded
B.13/2	BANK ID was introduced
B.13	Banks' information security and cybersecurity issues resolved
B.13/1	Groundwork for transition to Paperless was laid
C.4	NBU function building concept and roadmap
C.4	Draft consumer rights protection regulations were prepared

In the framework of 2018 priority projects, the following milestones of the nonbanking sector reform were achieved

N°	Projects of Comprehensive Program until 2020
A.6	Improvement of registration and reporting procedures
A.6	Risk-based inspections
A.6/1	Improvement of supervision of nonbanking financial groups (NFGs)
A.6/1	Improvement of listing requirements, conduct of stock market audit
A.10	corporate governance for capital market participants
A.10	Requirements for professional activity in the stock market and risk management were improved
A.10	Procedure for public offering of securities, provision of information services in the stock market
A.14	Draft law on nongovernment pensions was prepared (new edition)
A.18	Accumulation of additional funds at Motor (Transport) Insurance Bureau of Ukraine
A.18	MTIBU partial insurance payments mechanism*
A.18	Changes in makeup of nonlife insurance reserves
A.18	Insurer solvency requirements were tightened
A.19	Concept of capital market infrastructure reform
A.19	Institution of nominees
A.19	Depository activity requirements were updated
B.4	Concept of NSSMC operating model, committee sectoral model
B.4/2	White book New Regulation of NFGs
B.4/2	Draft roadmap for transfer of NCFS functions
B.8	Concept of transformation of law enforcement system of NSSMC
B.10	Interaction between NCFS, ministry of the interior, and law enforcement regarding mandatory insurance of civil liability of land vehicle owners
B.13	Electronic services accessibility
B.13	Stock market software requirements
B.13	System of electronic interactions with authorities
C.2	Securities market disclosure standards were tightened
C.4	Draft law on a system to guarantee life insurance payments was prepared

* A procedure is now in place for insurers to accumulate funds to pay insurance compensation on behalf of insurers that lost MTIBU membership prior to being declared bankrupt

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1 Low and Stable Inflation

#inflation #prices #hryvnia #exchangerate

Monetary Policy and Macroeconomic Developments



Monetary Policy Objectives

The priority objective of the NBU's monetary policy is to deliver price stability. Other objectives include promoting financial stability and ensuring sustainable economic growth.

The NBU uses inflation targeting to achieve its primary objective. In inflation targeting, a central bank announces its inflation targets and undertakes to meet them in the medium-term.

The NBU de facto adopted inflation targeting in August 2015 when it announced its medium-term inflation target of 5% and the trajectory for gradually approaching the target over the course of 2016–2018.¹ The CPI target for December 2018 was set at 6% ± 2 pp. From December 2019 onwards, the target is 5% ± 1 pp.

The inflation targets set in August 2015 and the principles for conducting monetary policy based on inflation targeting have remained unchanged and have been reinforced every year in the NBU's monetary policy guide guidelines.

In 2018, the NBU Council approved the central bank's monetary policy strategy, in which it enshrined the objectives and the principles for the conduct of monetary policy. A consistent monetary policy based on inflation targeting will help stabilize the inflation expectations of households and businesses and will encourage long-term savings and investment in the economy.

In 2018, inflation dropped to 9.8% yoy, the lowest figure in the last five years. The return of inflation to single digits is primarily the result of the central bank's tight monetary policy.

The deviation of inflation in 2018 from the target range was driven by factors beyond the scope of monetary policy, like increases in administered prices, growth in production costs due to higher wages, and growth in global oil prices.

The NBU has made a conscious choice to meet the medium-term inflation target over a longer period. Although an even tighter monetary policy could have brought inflation back to the target in 2018, that course of action would have generated additional losses of economic growth.

The flexibility of inflation targeting allowed the NBU to considerably slow inflation, while preventing an unjustified slowdown of economic growth.

Inflation will continue to decelerate gradually. The NBU expects inflation will drop to 6.3% by the end of 2019, enter the target range in early 2020, and reach the 5% target in late 2020. Low and stable inflation will lay the groundwork for the sustainable growth of the Ukrainian economy.

¹ December 2016 – 12%± 3 pp, December 2017 – 8%± 2 pp, December 2018 – 6%± 2 pp



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CPI and inflation targets, % yoy



Source: SSSU, NBU.

Monetary Policy Decisions and Their Macroeconomic Reasoning

The NBU pursued a tight monetary policy in 2018 to counteract the impact of inflationary factors and bring inflation back to its target. The central bank raised the key policy rate four times in 2018 by a total 3.5 pp to 18.0% per annum.

In deciding to raise the key policy rate, the NBU took into consideration persistent inflationary pressures and the probability that inflation risks would materialize. The NBU deliberately took a lengthier path to bringing inflation back to the target to minimize the slowdown of economic growth.

In Q1 2018, seeing no signs that inflationary pressures were abating, the NBU continued the monetary policy tightening cycle it began in autumn 2017 by raising the key policy rate by 150 bp in January and another 100 bp in March to 17% per annum.

The key policy rate was raised in response to significant inflation risks. These included the growing vulnerability of the Ukrainian economy due to the delayed arrival of a regular IMF tranche, increased inflation expectations by economic agents, and sizeable growth in consumer demand.

The tight monetary policy played an important role in strengthening the hryvnia exchange rate against the currencies of Ukraine's main trading partners, and not only helped reduce imported inflation, but also provided the foundations for an improvement in inflation expectations.

High interest rates on hryvnia-denominated instruments also whipped up investors' interest in the Ukrainian market, amid the more turbulent financial markets of developing economies. The NBU did not change the key policy rate in Q2 because of these factors.

However, in July, new inflationary pressures started to appear on the forecast horizon. This was the result of delays in the arrival of IMF financing, persistently high consumer demand fueled by growth in real wages and migrant transfers, deteriorating inflation expectations and terms of external trade on the back of escalating global trade conflicts, and the waning interest of investors in emerging markets.

Under these conditions, a tighter monetary policy was a key factor in helping to curb inflation. With that in mind, the NBU raised the key policy rate two times in Q3 by 50 bp in July and September to 18% per annum.

Q4 saw a moderate drop in inflation as the central bank had been delivering a tight monetary policy since October 2017. In addition, inflationary risks arising from global market conditions abated noticeably.

Ukraine's tight fiscal policy in H2 helped reduce pressures related to consumer demand, while favorable FX market conditions helped strengthen the hryvnia exchange rate. Meanwhile, a new stand-by arrangement with the IMF significantly decreased risks to macrofinancial stability.

Based on diminishing risks of inflation on the one hand and persisting considerable underlying inflationary pressures on the other hand, in Q4 2018 the NBU twice decided to maintain the key policy rate at 18% per annum.

Publishing Summaries of Discussions by the Monetary Policy Committee

The NBU has made another step towards enhancing the transparency and predictability of monetary policy by following the example of leading central banks that target inflation and starting to publish summaries of



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Monetary Transmission Mechanism



Achieving the Operational Goal of managing the Interbank Loan Rate

The NBU implements its interest rate policy by regulating the demand and supply of money through changes in interest rates on its operations to influence money market interest rates and the profitability of financial operations.

By changing the key policy rate, the NBU influences short-term interest rates on the interbank money market, which causes changes in interest rates on other financial assets (especially government securities) and in bank loan and deposit rates. These rates have a direct impact on the consumption and investment volumes of both households and businesses, and, therefore, on inflation.

The operational objective of the NBU's monetary policy is to maintain hryvnia interbank loan rates close to the key policy rate and within the range of interest rates on the central bank's standing facilities (overnight loans and certificates of deposit). For the purposes of interest rate policy, an indicator for the level of hryvnia interbank interest rates will be the Ukrainian Index of Interbank Rates (UIIR) for hryvnia overnight loans and deposits.

In 2018, the UIIR responded to key policy rate increases, as expected, and was within the range of interest rates on standing facilities.

NBU's interest rates and UIIR, % per annum



That said, UIIR movements within that range were mainly caused by liquidity in the banking system. With a large surplus of liquidity, the UIIR tended to stay close to the lower bound of the interest rate range throughout most of the year. In H2, as the surplus of liquidity diminished, it came very close to the key policy rate.

Monetary Operations Amid a Liquidity Surplus

In 2018, the banking system retained its liquidity surplus, mainly thanks to the NBU's purchases of foreign currency.

Under these circumstances, the main monetary operations were the placement of NBU certificates of deposit with 14 days' maturity. With the Finance Ministry's return to the short-term government debt market and the appearance of alternative indicators for the cost of three-month hryvnia funding, in February 2018 the NBU stopped placing certificates of deposit with three-month maturity.

Despite a structural surplus of liquidity, the narrowing of liquidity in some periods, and the segmentation of the interbank credit market, demand from some banks for refinancing loans increased. However, the volume of these operations was insignificant.

² Band's cap – interest rates on NBU's loans overnight, band's floor – NBU's CoD overnight.



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Some indicators of banking system liquidity, UAH million

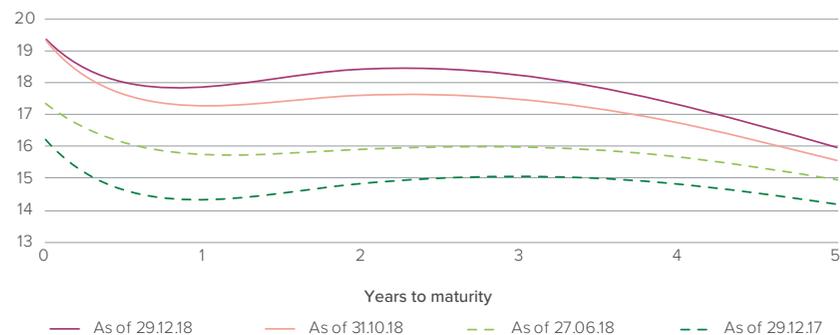
Date	Correspondent accounts	Refinancing	including:			Certificates of deposit	including:	
			loans O/N	Tender loans			Certificates of deposit O/N	tenders
				total	of which: net of insolvent banks and banks under liquidation			
01.01.2017	40,503	67,894	0	1,555	1,555	68,042	20,655	47,387
01.01.2018	37,488	61,673	0	7,374	7,125	67,020	37,319	29,701
01.01.2019	35,648	54,802	1	4,200	4,200	61,944	30,126	31,818

Transmission into Domestic Government Bond Rates and Bank Rates

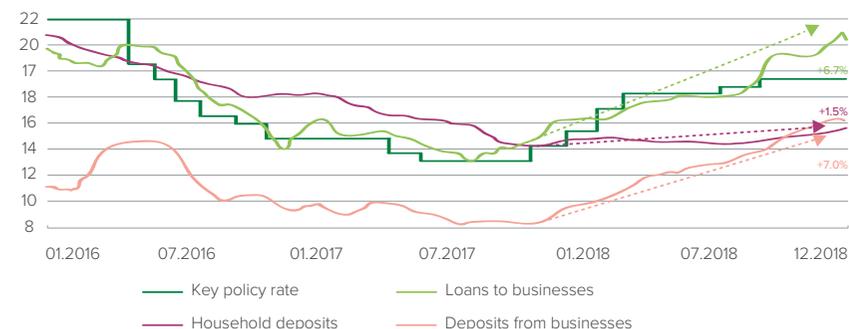
The key policy rate hikes in 2018 pushed up yields for domestic government bonds across all maturities. The yields of hryvnia instruments with shorter maturities were affected the most, mainly due to the Ukrainian government's significant borrowing in certain periods and the financing of fiscal needs. Throughout most of the year, yield curves were inverted, reflecting expectations of a drop in rates against lower inflation. In 2018, real yields on hryvnia-denominated instruments remained some of the highest among developing economies, supporting more favorable FX market conditions than in Ukraine's main trading partners.

Over that period, the transmission mechanism also pushed up bank rates on hryvnia loans and deposits. Rates on hryvnia loans were also driven up by persistently high demand for hryvnia loans from households and businesses, while rates on deposits from non-financial corporations were also buoyed by competition for corporate clients among banks. The more minor impact of the key policy rate on household deposit rates resulted from the significant liquidity surplus in the banking system, as well as from the buoyant growth in hryvnia household deposits.

Zero coupon yield curves for the hryvnia domestic government bond,³ % per annum



Key policy rate and rates on new hryvnia loans and term deposits (monthly moving average),⁴ % per annum



Reductions in Domestic Government Bonds the NBU Holds on its Balance Sheet

In 2018, the NBU continued to reduce its balance sheet holdings of domestic government bonds. The central bank did that to meet its commitment of avoiding any form of fiscal dominance, including providing no direct or indirect support to budgetary spending.

³ Spot rates with continuous interest compounding, based on Nelson-Siegel parametric model

⁴ 20-day moving average Arrows show rate increases after 26 October 2017 (start of a cycle of NBU's monetary policy tightening).



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This commitment stems from the principle of the NBU's institutional, financial, and operational independence, which was outlined in the Monetary Policy Guidelines for 2018 and the Medium-Term and supported by the monetary policy strategy approved by the NBU Board in July 2018.

In fulfilling this commitment, the NBU Board⁵ set a limit on the amount of domestic government bonds the central bank can hold on its balance sheet. That restriction meant the NBU would not purchase any new domestic government bonds. With no new purchases, the central bank gradually let bonds roll off its balance sheet as they matured. As of 1 January 2019, the NBU had UAH 348.1 billion in domestic government bonds on its balance sheet, in-line with the required limit.



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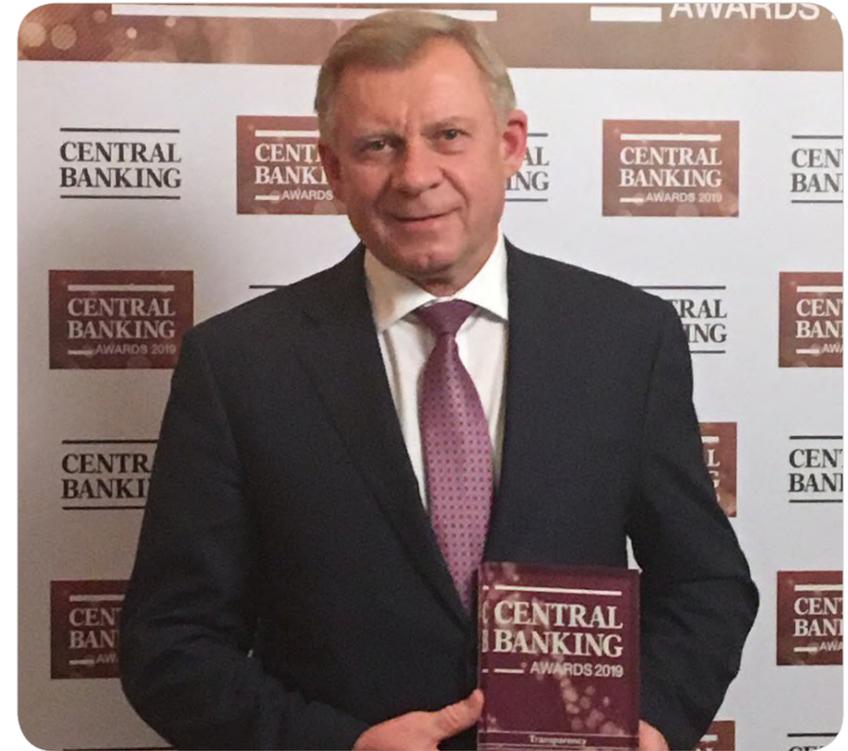


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"We will continue the good work. We are open to accepting and to sharing leading practices in the central banking community," affirmed Governor Smolii when receiving Central Banking Transparency Award



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⁵ NBU Board Decision No. 467-D dated 19 July 2018.



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Floating Exchange Rate and FX Interventions



Aim of the NBU's FX Interventions

The NBU is committed to a floating exchange rate, which means it does not aim to achieve a certain level with its monetary policy or attain a specific range for the hryvnia exchange rate. The hryvnia's trajectory against foreign currencies is driven by market factors that determine demand for foreign currency and its supply on the domestic market.

The NBU conducts FX interventions to fulfill the goals set in the Foreign Exchange Intervention Strategy of the National Bank of Ukraine for 2016 – 2020 – namely to:

- accumulate international reserves
- smooth out fluctuations on the FX market
- support the transmission of the key policy rate as the main monetary policy instrument.

By conducting FX interventions, the NBU does not interfere with fundamental trends, and only smooths excessive exchange rate fluctuations that can be harmful to the economy. This makes it possible to prevent the buildup of external economic and financial imbalances within the framework of FX interventions.

In 2018, the NBU's FX interventions had two goals: to accumulate international reserves and smooth out FX market fluctuations.

New Approach to Interventions

To improve the competitiveness and transparency of the hryvnia exchange rate mechanism, in 2018 the NBU changed its approach to prioritize FX interventions. The central bank now prioritizes those interventions where the NBU accepts the price offered by other FX market participants, rather than offering its own price. These include FX auctions and requests for quotation.

These changes are aimed at minimizing the impact of the central bank's FX interventions on the market exchange rate. At the same time, the choice of the intervention form is determined by conditions on the interbank FX market. This flexible approach allows the NBU to use other forms of FX interventions if necessary, particularly the single-rate intervention.

The new approach to interventions was adopted by amending the Foreign Exchange Intervention Strategy of the National Bank of Ukraine for 2016–2020 (hereinafter referred to as the Strategy), which details the NBU's interbank FX market policy from September 2016 onwards.

To foster transparency of the monetary policy in terms of FX interventions, in 2018 the NBU began making quarterly announcements of the approximate daily amount of interventions to purchase foreign currency to replenish Ukraine's international reserves. Starting in Q2 2018, the daily foreign currency purchase amount was set at USD 10 million.

The announced amount of intervention for replenishing international reserves was minimal relative to the total amount of interbank market transactions. This means the NBU's FX purchases did not have a major impact on the exchange rate. Moreover, depending on the market conditions, FX purchase interventions may have been smaller or may have not taken place at all.

The prioritization of certain forms of FX interventions and setting their quantitative indicators are important elements of the floating exchange rate regime. Those measures shift the NBU's goal on the FX market from attaining a certain FX rate to accumulating international reserves, smoothing excessive exchange rate fluctuations, and supporting the transmission of the key policy rate.



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Matching

In Q2 2018, the NBU transitioned to FX interventions using matching – the new dealing functionality in trading information systems (Bloomberg, Refinitiv, etc.), which allows the central bank and other market players to make instant deals to buy or sell foreign currency by choosing the best from among anonymous quotes.

The anonymity of the matching functionality is the main advantage for FX transactions. In addition, traders see all quotations online but receive counterparty information only once a deal is concluded. This reduces the influence of the NBU's activities on the FX rate, as participants do not see the preliminary announcement of FX interventions and are thus not able to adjust quotations. Moreover, the new functionality minimizes subjectivity risk in the interventions – it is impossible to choose a specific counterparty when quotations are anonymous.

A second advantage of the new functionality is the ability to have an unlimited number of participants. The technical limitations of past platforms only allowed the 20 best-rated banks to take part in interventions in the form of a request for quotation. Matching enables all banks to connect simultaneously and to deal faster with better FX rate parameters. Thus, the new functionality has increased competitiveness on the interbank FX market and supported the transparency and accuracy of the hryvnia FX rate mechanism.

NBU Activity on the FX Market

The NBU has been using FX interventions to increase international reserves for the third consecutive year. In 2018, the NBU had net foreign currency purchases of almost USD 1.4 billion. Almost three-quarters of the USD 2 billion growth in Ukraine's international reserves in 2018 came from the NBU's transactions on the interbank FX market.

During the year, the NBU remained committed to its Foreign Exchange Intervention Strategy for 2016–2020 and did not seek to maintain the exchange rate at a specific level. At the same time, the NBU intervened on the FX market to sell foreign currency to smooth out stronger exchange rate fluctuations in January–February, July–August, and in late November due to seasonal factors.

In 2018, the total volume of interbank FX market trades grew 38% to

USD 117 billion (without the NBU's involvement), compared to just USD 5 billion in NBU interventions to purchase and sell foreign currency. Thus, the NBU's FX interventions had little impact on the exchange rate.

The FX market is improving its ability to balance itself, which makes it less reliant on the NBU's actions to neutralize supply-and-demand mismatches and prevent market glitches.

Accumulation of International Reserves

The FX market remained largely stable throughout most of 2018, which allowed the NBU to continue growing international reserves. Reserves reached a five-year high in 2018 and marked the fourth consecutive year of growth.

A favorable external price environment for Ukrainian goods exports and greater interest from international investors in developing markets helped ensure a high supply of foreign currency in H1.

H2 2018 saw a surplus of foreign currency in the interbank market, primarily owing to export proceeds driven by a record harvest of grains and other agricultural products.

In addition, net sales of foreign currency by households impacted the supply of foreign currency from banks. As of the year-end, the amount of foreign currency sold by households exceeded the amount purchased by USD 1.5 billion.

The combination of these factors allowed the NBU to purchase foreign currency to replenish international reserves without influencing the trajectory of the hryvnia exchange rate, which appreciated 1.4% in 2018.

The positive balance of NBU interventions along with proceeds from international financial institutions and placements of foreign-currency government securities enabled international reserves to grow 10.6% to USD 20.8 billion.

Exchange Rate Levels and Volatility

In 2018, the volatility⁶ of the hryvnia exchange rate declined to a range

⁶ The standard deviation of daily growth in the exchange rate over 20 business days, annualized



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of 2% – 10%. This range is typical for countries that use inflation targeting (2% – 15%).

The FX market was more turbulent in some periods of 2018. For example, in late July and in August, internal factors (expectations of a seasonal depreciation in autumn, postponement of the IMF tranche) and unfavorable developments on foreign markets (turbulent FX markets in developing countries) exerted depreciation pressure on the hryvnia exchange rate. The escalation of the conflict with Russia in the Sea of Azov and the declaration of martial law in some oblasts caused panic buying in late November, which proved to be a temporary effect.

At the same time, the unusual behavior of FX market players in December 2018 was explained by exports of the bumper crop of corn, positive news about the new IMF program, restrained fiscal policy, and the tight approach to monetary policy. Overall, during the year, the tight monetary conditions were one of the main drivers of the hryvnia strengthening by 1.4% against the US dollar and 6.7% and 13.1% against the currency basket of Ukraine's main trading partners in nominal and real terms, respectively.

In 2018, the NBU's transactions on the FX market did not interfere with exchange rate trends, as the rate was determined by supply and demand for foreign currency.

The NBU's presence on the FX market was not the only factor behind the lower exchange rate volatility – this was also driven by the development of the FX market and maturity of the cash FX market, which both helped the exchange rate become more resilient to shocks.

The development of the FX market was driven by the cancelation of many of the most painful FX restrictions and the market gradually getting used to the floating exchange rate regime.

In 2018, the behavior of cash FX market participants became more coherent and reflected standard approaches to market function under a floating exchange rate regime. The amount of foreign currency purchased by households grew markedly at the start of the year when the hryvnia was depreciating most rapidly. Purchases dropped as the hryvnia rebounded.

The prudent response to exchange rate fluctuations by FX market

participants makes it easier for the NBU to fulfill its mandate of delivering price stability, since the public's expectations are less focused on FX rate fluctuations and more on inflation, which is more important for planning and decision-making.



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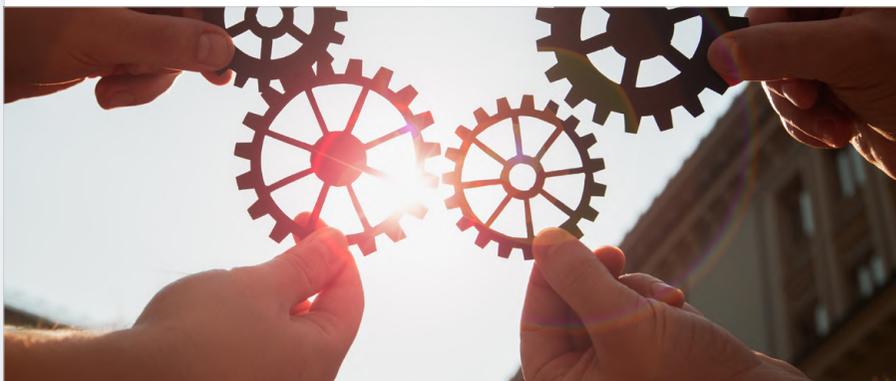
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2 A Stable, Transparent, and Effective Banking System

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Banking Sector Performance



In 2018, almost all key performance indicators in the banking sector performed positively. With the cleaning of the banking system complete, the sector posted net profits that exceeded a record that had stood for more than 10 years, average ROE exceeded 14%, and retail lending continued to grow rapidly. Corporate lending was also on the rise, especially to high-quality borrowers. And although banks still have a substantial amount of nonperforming loans (NPLs) on their balance sheets, they have already reported nearly all of the losses from the decrease in the quality of their loan portfolios. Importantly, the NPL coverage ratio stood at 90%,⁷ an acceptable level by international standards. In 2018, banks primarily relied on the domestic market for funding, which reduced foreign debt to historical lows. At the same time, retail and corporate deposits grew, although they were short-term and volatile. Financial institutions have successfully migrated to the LCR, the new liquidity ratio.

⁷ Including interbank loans; all banks including insolvent institutions; excluding off-balance liabilities.

⁸ The Herfindahl-Hirschman index (HHI) is a measure of banking market concentration. The index is calculated as the sum of the squared market shares of banks. Its value ranges from 0 to 10,000.

Structural Changes in the Banking Sector

In 2018, the number of operating Ukrainian banks shrank by five institutions, which accounted for 1.2% of the sector's net assets as at the start of the year:

- Two of those banks were reorganized into financial companies.
- Two banks merged with other banks, taking advantage of a simplified process for doing so.
- One bank was declared insolvent.

The insolvent bank was a bank with Russian capital that experienced a liquidity shortage and deteriorated financials, and it failed to take measures to prevent an insolvency.

As a result, at the start of 2019, Ukraine had 77 solvent banks.

Distribution of net assets by bank groups, %



Buoyant retail lending boosted state-owned PrivatBank's share in the sector's net assets by 1.3 pp to 20.7% and that of privately owned banks by 0.9 pp to 14.8%. Asset concentration in the sector has remained unchanged over the past two years, with 20 banks accounting for 91% of net assets. However, the Herfindahl-Hirschman index for net assets stood at around 1,000, which reflects a moderate concentration level⁸. That said, state-owned banks continue to dominate the market, accounting for 54.7% of assets and 56.4% of liabilities.



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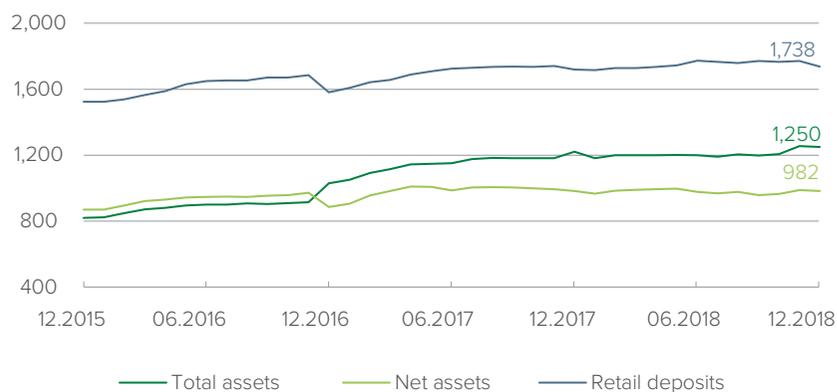
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Sector concentration as defined by the HHI indicator



Assets

The banking sector's net assets increased 1.8% to UAH 1,361 billion in 2018⁹, primarily driven by growth in the loan portfolio. The loan portfolio growth was driven by continued work with NPLs and the transition to IFRS 9 in early 2018. Banks also invested spare liquidity into domestic government bonds and the NBU's certificates of deposit. This boosted the portfolio of NBU-refinanced securities by UAH 54 billion or 13% to UAH 469 billion. At the same time, interbank loans and deposits at the NBU dropped 1.5%

In 2018, net hryvnia loans¹⁰ to corporate customers increased 8.1%, especially in privately owned (+17.6%) and foreign banks (+7.6%). Hryvnia corporate loans at state-owned banks stopped growing (except at PrivatBank), shrinking 1.5% in 2018 after growing 12.7% in 2017. In the meantime, net corporate loans issued in foreign currencies rose 2.6% yoy (US dollar equivalent), registering growth for the first time since the start of the crisis. The main foreign currency borrowers include companies engaged in alternative energy, trade, and agricultural exports.

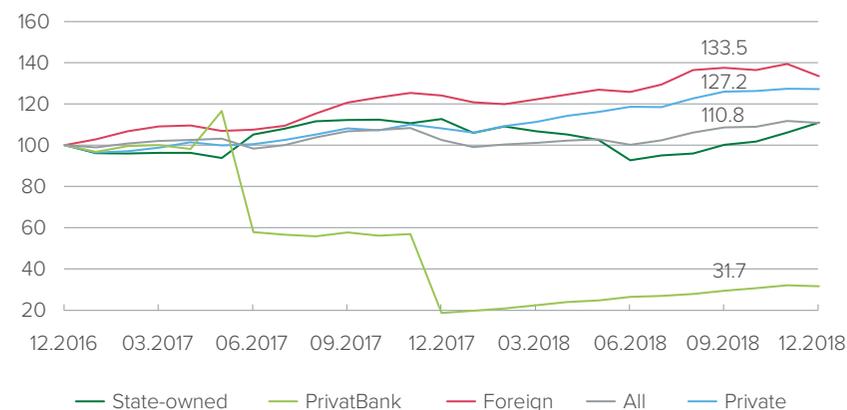
The change in the corporate loan portfolio varied across different borrower groups. Loans to high-quality borrowers with no record of loan default in 2014–2018 continued to grow rapidly: hryvnia loans grew 25% yoy.

⁹ Hereinafter the change is provided for banks solvent as at year-end 2018.

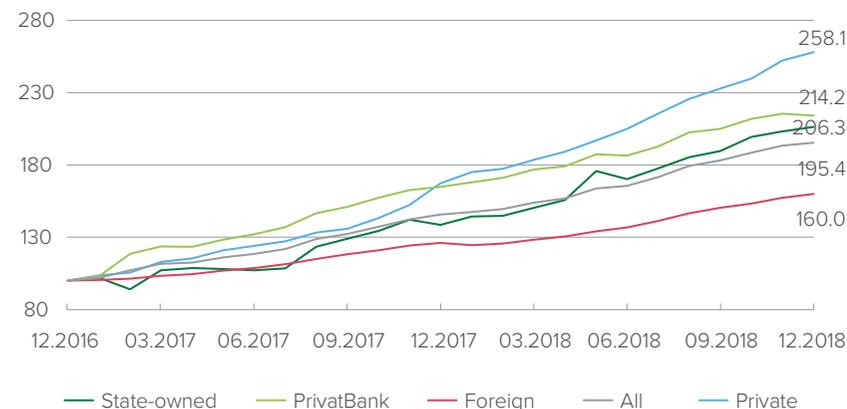
¹⁰ Issued by banks solvent as at 1 January 2019, including accrued interest.

¹¹ According to supervisory statistics for loans issued by banks and their standalone units to residents and nonresidents in Ukraine and abroad, including accrued interest.

Net hryvnia corporate loans, 2016=100% ¹¹



Net retail loans in UAH, 2016=100% ¹¹



The growth of retail lending remained high – 34.1% yoy for hryvnia loans excluding provisions. The highest growth rates were reported in privately owned (54.2% yoy) and state-owned banks (49% yoy). Consumer loans grew fastest, especially in banks that issue this type of loan permanently and consistently. In 2018, mortgage lending grew markedly for the first time since the crisis, at near 6% yoy, although the volume of mortgage loans remains small. At the same time, retail lending remains the most profitable segment for banks, showing active solvent demand: the share of retail loans in total assets increased by 1.5 pp to 8.4%.



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Over the course of 2018, the quality of the loan portfolio improved, with the share of NPLs declining by 1.7 pp to 52.8%.¹² The improvement in loan quality was driven by the growth in retail lending, which reduces the share of NPLs. Currently, state-owned banks and banks with Russian capital account for over 80% of total NPLs and this figure is stable.

Funding

In 2018, banks continued to rely on domestic funding, rather than external sources of financing. Under these conditions, over the first nine months of 2018, the gross external debt of banks decreased 10.7% yoy to USD 5.8 billion, the lowest level since 2005. About half of that debt is in funds raised by state-owned banks through Eurobond issuance. Up to 85% of banks' total liabilities came from the domestic market. In 2018, the share held by retail and corporate deposits in banks' liabilities increased 0.8 pp to 77.9%, driven by a 1.5 pp increase in the share of retail deposits.

The share of corporate loans decreased slightly over the year, but it remains at near 10-year highs. In contrast, the share of NBU loans in the liabilities of financial institutions remained minimal at approximately 1.2%.

In 2018, hryvnia retail deposits grew 14.8% yoy and foreign currency retail loans grew 1.4% yoy (US dollar equivalent). Deposits grew the most in H1, whereas growth was more volatile in H2 owing to changes in the exchange rate and interest rates. As of the year-end, the deposit guarantee system fully covered 98% of all deposit accounts, which meets international IADI standards, and 59% of the total value of deposits.¹³ In 2018, households substantially increased their investment in domestic government bonds – by 4.1 times to UAH 6.1 billion.

Corporate deposits grew, but three-quarters of them remained demand deposits. In 2018, hryvnia corporate deposits were more volatile than in 2017, but they grew 6.8% yoy. The growth was especially strong in December (15.7%). The inflow of corporate funds at the end of the year was primarily driven by substantial government spending. Foreign currency corporate deposits declined 6.2% (US dollar equivalent).

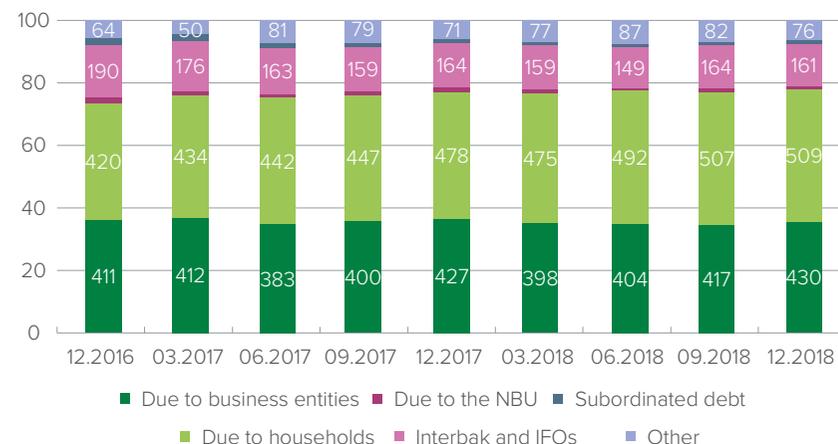
The NBU expects the current funding structure to remain stable in the coming years as Ukrainian banks show little interest in foreign currency lending and as domestic foreign currency funding remains cheaper

¹² At all reporting banks.

¹³ Excluding deposits of less than UAH 10; principle 8 of the Core Principles for Effective Deposit Insurance Systems of the International Association of Deposit Insurers (IADI).

than foreign debt capital. In addition, the growing popularity of cashless payments will push money to flow from retail customer accounts to the accounts of corporates as the former pay for goods and services without withdrawing cash.

Structure of bank liabilities, %



Gross external debt of banks, USD billion



Short maturity is the major weakness of the current funding structure. However, as long as conditions are stable, financial institutions can use short-term funding while issuing long-term loans. That practice does, however, create substantial risk in the event of a shock. To prevent



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short-term funding from causing a liquidity crunch, the NBU introduced the new LCR requirement in December. This motivates banks to keep sufficient amounts of high-quality liquid assets on their balance sheets to cover outflows of customer funds in periods of stress. The NBU plans to introduce the Net Stable Funding Ratio (NSFR) in 2020 to encourage banks to attract longer-term funding.

In 2018, the NBU raised the key policy rate four times – from 14.5% to 18.0% per annum – with the last rate hike occurring in late Q3. Despite the higher key policy rate, interest rates on deposits were practically unchanged in H1 and started rising only in late Q3 as deposit growth slowed and spare liquidity shrank in some banks. Stronger competition for corporate deposits was reflected in higher interest rates on corporate deposits, which grew 5.3 pp yoy to 14.5% per annum.

Profit or Loss and Capital

As at the end of the year, the sector posted a net profit of UAH 21.7 billion, a record in the past 10 years (versus a loss of UAH 20 billion in 2017). This was the first year in which the profit figure was real and not managed by banks not reporting actual loan loss provisions. The number of lossmaking financial institutions decreased to 13 from 18 in 2017. This was driven by a halving of provisions and an increase in net interest income and fee and commission income by more than one-third.

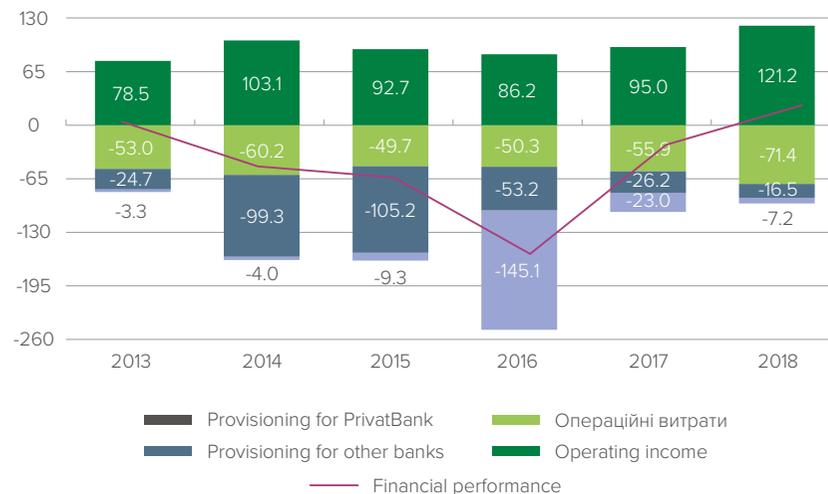
Banks solvent as at the end of 2018 generated UAH 121 billion of operating income, 27.5% more than in 2017. A pickup in consumer lending and stable deposit interest rates in H1 pushed up net interest income by 37.8% in 2018. Net fee and commission income grew 37.6% yoy, primarily in banks that actively work with retail cashless payments. Operating expenses increased 27.6% over the year.

At the same time, pre-provisioning operating profit also grew 25.4% to UAH 50 billion. As at the end of the year, 14 banks reported pre-provisioning operating losses, including two state-owned banks. Overall, state-owned banks generated operating losses owing to the negative results of a revaluation of financial instruments and high operating costs. However, they were able to generate a moderate annual profit by releasing provisions.

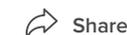
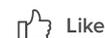
Over the year, the authorized capital of solvent banks grew by UAH 11.1 billion, or 2.4% – primarily on the back of a capital increase in a Russian-

owned bank. Regulatory capital rose by UAH 15.4 billion, or 12.7%, concentrated in foreign-owned banks. Capital adequacy across the sector was generally higher than the minimum requirement.

Profits/losses of solvent banks, UAH billion



Regulatory capital and the regulatory capital adequacy ratio





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Transition to Risk-Based Supervision and the Annual Assessment of Resilience

In 2018, the NBU continued to implement a risk-based approach to banking supervision by following the guidelines of the European Banking Authority on common procedures and methodologies for the Supervisory Review and Evaluation Process (SREP) and recommendations of the Basel Committee on Banking Supervision.

To implement the Comprehensive Program of Ukrainian Financial Sector Development until 2020, the NBU's plans to implement EU legislation, and measures to improve banking supervision, the NBU adopted new regulations in 2018 to establish:

- the procedure for assessing banks according to SREP methodology, which includes procedures to assess the viability of a bank's business model, the resilience of its development strategy based on an assessment of liquidity and funding risks, and more.¹⁴
- the procedure for ongoing monitoring of banks' financial standing.¹⁵

These documents set the NBU's approach to off-site banking supervision under a risk-based approach. That approach allows the NBU to:

- segment banks by categories based on their importance to the banking system
- use a proportional approach when determining the scope, frequency,

and application of supervisory measures to banks, including the frequency of inspections, taking into account a bank's share of the banking system, its structure, and the complexity of its operations, as well as the results of off-site banking supervision

- communicate with the top management of a bank during its SREP assessment
- apply early response measures to any shortcomings/negative trends in SREP elements and high-risk activities.

Risk-Based Approach to Banking Supervision

In 2018, the NBU for the first time assessed most Ukrainian banks, including the country's 12 largest, using SREP methodology and assessed the viability of their business models.

The NBU also adopted a new regulation that identified the procedure for off-site banking supervision¹⁶ using the risk-based approach.

Under the new procedure, the NBU will monitor the financial standing of banks and assess banks based on the risks inherent in banking activity and the quality of the management of those risks. The NBU also introduced a new instrument for off-site banking supervision – desk audits (off-site inspections) of banks – and defined the basis for and procedure of their execution.

Desk audits during off-site banking supervision are conducted to identify or confirm the following:

- a bank's compliance or noncompliance with banking laws, regulations, the NBU's requirements, restrictions on banking activity, business ratios, and open FX position limits
- the credibility of a bank's credit risk assessment, accounting and reporting of transactions, and the information submitted on related

¹⁴ Banks' Assessment Procedure During Off-Site Banking Supervision approved by NBU Board Decision No. 59-D dated 30 January 2018 (as amended); Procedure for Banks' Business Model Assessment by the National Bank of Ukraine approved by NBU Board Decision No. 334-D dated 12 June 2018 (as amended); Procedure for the Assessment by the National Bank of Ukraine of Banks' Liquidity and Funding Risks and the Quality of Management of Such Risks at Banks approved by NBU Board Decision No. 568-D dated 16 August 2018 (as amended).

¹⁵ Methodology for Monitoring Financial Standing of Banks approved by NBU Board Decision No. 60-D dated 30 January 2018 (as amended).

¹⁶ Regulation on the Off-Site Banking Supervision Conducted by the National Bank of Ukraine approved by NBU Board Resolution No. 135 dated 6 December 2018.



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parties and related-party transactions

- confirming or rejecting any signs of risky activity that may pose a threat to the interests of the bank's depositors or other creditors.

Implementing new instruments for off-site banking supervision in line with the risk-based approach will contribute to the financial stability of Ukraine's banking system and the protection of the rights of bank creditors and depositors by ensuring effective banking supervision and the implementation of best practices.

Major Outcomes of On-Site Banking Supervision

In 2018, the NBU conducted 46 inspections of 41 banks within its mandate to supervise individual banks and the banking system overall.

Quantitative distribution of inspections

Inspections	Quantity
Scheduled including:	25
to assess the collective suitability and qualification of top managers ¹⁷	10
Unscheduled including:	21
to assess the collective suitability and qualification of top managers ¹¹	10
regarding a bank's related parties	3
regarding the adequacy of credit risk assessment, capital adequacy and capital management; control over the reliability of reporting; compliance of internal lending processes and procedures with banking laws banks' compliance with established limits ¹⁸	8

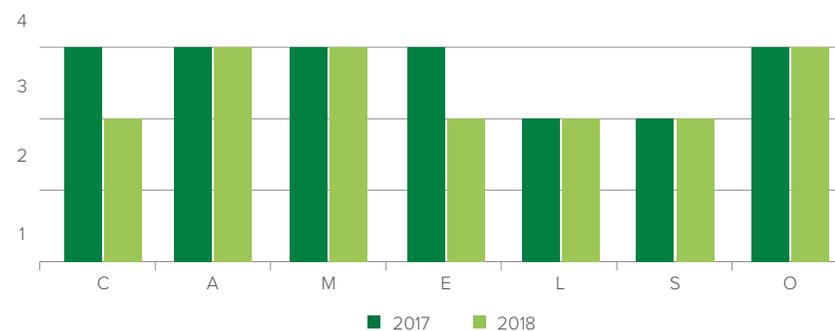
To fulfill Ukraine's obligations under the Memorandum on Economic and Financial Policies signed with the IMF on 2 March 2017 under the Extended Fund Facility, the NBU assessed the collective suitability and qualification of the top managers of Ukraine's 20 largest banks. The NBU made recommendations to banks on improving corporate governance and implementing best international practices and the principles and recommendations of the Basel Committee on Banking Supervision.

During its scheduled inspections, the NBU continued to assess banks under the revised CAMELSO rating system¹⁹. As of the end of 2018, 59 banks obtained composite ratings under this system.

The average composite rating of all banks measured under the CAMELSO rating system improved to "2" in 2018 from "3" in 2017.

Those banks inspected in 2018 received a higher rating than in 2017 on components "C" (Capital) and "E" (Earnings), which raised the average ratings for those components. Other rating components remained largely unchanged.

Average CAMELSO component ratings for banks, 2017–2018



The percentage of lowest ratings by CAMELSO components, 2017 – 2018, % of inspected banks



¹⁷ To fulfill obligations under the IMF program.

¹⁸ Inspections initiated by the Banking Supervision Department.

¹⁹ The Procedure for the Determination and Approval of Banks' Ratings under the CAMELSO Rating System approved by NBU Board Decision No. 393-D dated 4 November 2016 introduced a four-scale rating (1 is the highest rating, 4 is the lowest), added the "O" component, and elaborated the criteria for rating scores in 2018.



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In 2018, banks most often received the lowest ratings for components "M" (Management) and "O" (Operational risk) – 73.7% and 63.2% of inspected banks, respectively. In 2017, the lowest rated components were "A" (Asset quality) and "E" (Earnings) in 2017 at 57.1% and 54.3%, respectively.

The change in the priorities of on-site banking supervision shifted the focus of supervisory actions from assessing compliance with all supervisory requirements and taking mandatory corrective measures in response to any detected violations to assessing risky activities, determining problem areas, and providing constructive and effective recommendations (to avoid repeat violations) based on best practices and professional judgement.

The results of the inspections held in 2018 were taken into consideration when other units of the NBU's prudential block imposed corrective measures on banks.

Based on the inspection results, banks were issued recommendations aimed at adjusting performance indicators:

Key adjustments	UAH million
- to increase regulatory capital	3,258.4
- to increase uncovered credit risk	2,745.8
- to reduce profit/loss	3.9
Total	6,008.1

Entering Information About Banks into the State Register of Banks

Information from the State Register of Banks	Quantity
Registered banks	168
Banks holding a license to provide banking services, including one bank that was declared insolvent and placed under provisional administration	78
Registered branches of Ukrainian banks on the territory of Ukraine	88
Operating branches of Ukrainian banks on the territory of Ukraine	85

Operating representative offices of Ukrainian banks:	5
operating in Ukraine	3
operating abroad	2
Registered outlets of Ukrainian banks on the territory of Ukraine	9,534
Operating outlets of Ukrainian banks on the territory of Ukraine	8,427
Standalone units of Ukrainian banks operating in Ukraine that were closed in 2018:	
representative offices	3
branches	2
outlets	1,371
Standalone units of Ukrainian banks operating in Ukraine that were opened in 2018:	
representative offices	1
branches	-
outlets	335

Approving a Bank Charter

The charter of a legal entity that intends to engage in banking activity (a new bank) and any changes to the charter of an operational bank are subject to NBU approval. In the event of an increase in a bank's authorized capital, the NBU checks the sources of funds contributed by the bank's shareholders. These funds cannot be borrowed from third parties and must be the bank's own funds.

	2016	2017	2018
Document packages submitted:			
Total	126	128	137
for an increase in authorized capital	76	98	42
Changes to charters approved:			
Total	102	100	105
for an increase in authorized capital	59	77	32



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Changes to charters refused:			
Total	2	3	3
for an increase in authorized capital	2	3	3
Document packages returned:	21	20	30

Change in the Amount of Authorized Capital

Authorized capital must be no less than UAH 500 million for new banks and no less than UAH 200 million for operational banks. The NBU has established a schedule for a gradual increase in operational banks' authorized capital up to UAH 500 million.

As of	01.01.2017	01.01.2018	01.01.2019
Number of banks with a banking license	100	84	77
of which:			
banks with less than UAH 200 million in authorized capital	43	1	0
banks with UAH 200–300 million in authorized capital	16	41	33
banks with UAH 301–500 million in authorized capital	11	11	13
banks with more than UAH 500 million in authorized capital	30	31	31

Approval of Candidates for Bank Management Positions

The NBU approves candidates for bank managers (chairperson, deputy chairpersons, and members of the supervisory board; chairperson, deputy chairpersons, and members of the management board; the chief accountant and deputy chief accountants) and the head of internal audit.

To approve bank managers, the NBU verifies compliance with qualification requirements. These include an impeccable business

reputation and professional aptitude, including expertise and professional and managerial experience, especially relative to the bank's business plan and strategy and the functional load and responsibilities of that particular management position.

Approval of bank managers by the NBU in 2018	Кількість
Reviewed documents	
submitted for approval of bank managers:	917
appointment of bank managers	443
reappointment of bank managers	474
Outcomes of the review of submitted documents:	
approved appointments of bank managers	334
confirmation of the suitability of a reappointed manager	465
denied approval or decision of a manager's unsuitability	39
documents returned (to be reworked, based on a bank's request, not reviewed, or for other reasons.)	79

Streamlining Bank Reorganization and Capitalization

In 2018, VS Bank PJSC merged with TAScombank JSC and CB Center PJSC merged with MTB BANK PJSC. The two mergers took place under a simplified procedure as outlined in the Law of Ukraine On Simplifying Bank Reorganization and Capitalization Procedures (hereinafter referred to as Law No. 1985).

Law No. 1985 will be in effect until 1 August 2020, which leaves 18 months for banks to complete mergers under shortened timeframes (three-four months instead of 18 months).

Two banks successfully made use of the simplified capitalization procedure under Law No. 1985. The timelines for capitalization have been reduced mostly owing to a shorter period for receiving regulatory and corporate approvals, as well as the cancellation of a number of requirements. In addition to the two successful bank mergers, one bank



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was also denied.

Cessation of Banking Activity without Liquidating the Legal Entity

Law No. 1985 also introduced a procedure for revoking a banking license without liquidating the legal entity. Banks showed interest in the procedure in 2018, as it allowed banks that were unable to comply with capitalization requirements and/or with other financial issues to exit the banking market without putting pressure on the Deposit Guarantee Fund (DGF) and to continue operating in the nonbanking financial sector.

In 2018, the NBU approved plans to cease banking activities without liquidating the legal entity for three banks. Two of those (DV BANK PJSC and BM BANK JSC) have completed the process.

Supervision over Bank Owners

The NBU is responsible for supervising owners of qualifying holdings in banks. This oversight is needed to control lending to related parties and ensure that a bank's owners are liable to its creditors, especially to depositors.

All acquisitions of a qualifying holding in a bank (no less than 10% of a bank's shares) are subject to NBU approval.

In 2018, the NBU	Quantity
received applications to become a qualifying holder from	10 applicants
approved applications to become a qualifying holder for	5 applicants
rejected applications to become a qualifying holder for	1 applicant
returned applications to become a qualifying holder to	4 applicants
imposed fines for acquiring a qualifying holding without permission on	2 applicants

The central bank also draws up a list of entities entitled to purchase insolvent banks or their assets. This is referred to as a preliminary assessment.

In 2018, the NBU's list contained nine assuming banks, of which two were added in 2018 and seven were holdovers from past years. Assuming banks can participate in a DGF tender to purchase the assets of insolvent banks.

Moreover, the NBU in 2018 excluded from the list one legal entity that had been qualified as an investor. One other bank had its status prolonged.

Supervision over Ownership Transparency

The NBU monitors the transparency of bank ownership structures. The ownership structure reflects the links between a bank and its owners. As of early 2014, 78 Ukrainian banks, or nearly half of all banks in Ukraine, had nontransparent ownership structures. Now, the NBU has information about the owners of every bank. In 2018, the NBU publicized 133 information bulletins about banks' ownership structures.

The central bank is constantly monitoring banks to ensure they have transparent ownership structures. If the NBU suspects an entity may be a nominee shareholder, it reviews that entity's financials and property.

If a bank has a nontransparent ownership structure, the NBU has the right to impose penalties on that bank. The strictest penalty is the removal of the bank from the market, which bans the bank from offering banking services.

Supervision over Banking Groups

In 2018, the NBU	Number of banking groups
recognized	4
approved changes in ownership structure	8
derecognized	2

In 2018, the NBU recognized four banking groups: CIB JSC (GML BANKING GROUP), BANK ¾ JSC, Ukreximbank JSC, and UNEX BANK JSC. In 2018, the NBU also approved changes to the ownership structures of eight banking groups and derecognized two groups.

As of 31 December 2017, 28 banking groups were operating in Ukraine. As of 31 December 2018, 30 groups were present.



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Throughout 2018, the NBU continued to develop new ways of identifying members of banking groups and identification principles. In doing so, the regulator relied on its experience of supervising banking groups.

Granting General Licenses for Currency Transactions

In 2018, the NBU issued 13 new general licenses for currency transactions to banks following the expansion of the list of allowed currency transactions (three licenses) and changes in banks' names or the type of joint-stock company (ten licenses).

The NBU stripped five banks of currency transaction licenses owing to:

- reorganization of two banks
- one bank ceased banking activities without liquidating the legal entity
- revocation of the one bank's banking license
- a breach of currency legislation by one bank.

In 2018, the NBU issued	Number of banks
new general licenses for currency transactions:	13
in connection with the expansion of the list of permitted currency transactions	3
following changes in a bank's name/type of joint-stock company	10

Findings of Related Party Monitoring

In 2018, the NBU continued to exercise control over banks and their execution of the action plans that were drawn up based on the results of diagnostic tests in 2015–2016. As of 1 January 2019, 14 banks have complied with their action plans.

Owing to their fulfillment of action plans, another six banks received an extension on the term of their action plans from three to five years. Those banks also made use of their right to change the schedule for bringing the maximum amount of credit risk under related-party transactions to the level required by the NBU, due to changes in the

schedules for achieving the minimum level of authorized and regulatory capital. The NBU expects that all banks will comply with the requirement by 2021.

As part of the NBU's transition to a risk-based supervisory approach, banks' risks of related-party transactions were assessed and taken into consideration during the assessment of business models and corporate governance as separate components of the overall SREP score.

In 2018, the NBU started to analyze banks' funding transactions with related parties in line with the recommendations of the International Monetary Fund. The move aims to:

- comprehensively monitor bank exposures to counterparties and the funding received from those counterparties
- assess the effectiveness and adequacy of a bank's internal regulations, policies, procedures, and control systems as needed to ensure the integrity and completeness of the process of identifying related parties and control over related-party transactions
- assess a bank's dependence on funding received from related parties when examining its business model and assessing liquidity risks.

In order to improve the effectiveness of related-party monitoring and control over related-party transactions, the NBU Board adopted Resolution No. 125 dated 26 November 2018, which:

- improved and elaborated the procedures and obligations for a bank to submit documents to refute an entity identified by the NBU as a related party; also revised the timing for reporting a related party in a bank's reports
- allowed commercial banks to establish their own procedure for identifying related parties
- improved the mechanism to approve decisions on identifying related parties by transferring the functions of the Commission for the Identification of Banks' Related Parties and Monitoring Banks' Transactions with Related Parties to the Committee on Banking Supervision and Regulation and Oversight of Payment Systems.

The NBU has identified the development of banking supervision technologies as a priority task for 2019. The focus is intended to be on



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identifying and monitoring related parties by the NBU and encouraging banks to use best practices in creating their systems for related-party monitoring.

Supervisory Findings on Financial Monitoring and Compliance with Currency Legislation by Banks and Nonbank Financial Institutions

To ensure the proper supervision of compliance by banks and nonbank institutions with legislation on the prevention and counteraction of the legalization (laundering) of proceeds from crime, terrorism financing, and financing the proliferation of weapons of mass destruction, and taking into account the risk assessment in this area, in 2018 the NBU performed 26 scheduled and 3 unscheduled on-site inspections of banks, 7 scheduled inspections of nonbank financial institutions, 66 off-site inspections of banks, and 7 off-site inspections of nonbank financial institutions.

Findings of Financial Monitoring of Banks and Nonbank Financial Institutions

INDICATOR	NUMBER OF INSPECTIONS
NUMBER OF INSPECTIONS OF BANKS/ NONBANK INSTITUTIONS:	95 / 14
scheduled on-site inspections	26 / 7
unscheduled on-site inspections	3 / 0
off-site inspections	66 / 7
NUMBER OF BANKS/NONBANK INSTITUTIONS WITH VIOLATIONS:	41
banks	34
nonbank financial institutions	7

In addition, in 2018, the NBU conducted 26 scheduled and 3 unscheduled on-site inspections of banks and 2 scheduled inspections of nonbank financial institutions to check their compliance with Ukraine's currency legislation.

In 2018, the NBU conducted 1,141 inspections of compliance with Ukraine's currency legislation, including inspections of nonbank financial institutions, 33 off-site inspections of banks, 5 off-site inspections of

nonbank financial institutions, and 1,103 inspections of cash desks at nonbank financial institutions and their structural units.

Cooperation with Law Enforcement Bodies Based on the Results of Financial Monitoring and Supervision over Compliance with Currency Legislation

In 2018, the NBU submitted information²⁰ to the Security Service of Ukraine regarding 42 banks and 8 nonbank financial institutions, specifically:

- Based on the results of financial monitoring, the NBU sent 39 communications to law enforcement bodies to report on suspicious financial transactions by bank customers totaling over UAH 67.5 billion, USD 68.1 million, and EUR 11.8 million.
- Based on the results of currency supervision and in order to implement the state policy on combating organized crime, the NBU sent 17²¹ communications to report large-scale financial transactions by bank customers for a total amount of more than UAH 839.6 million, USD 738.4 million, EUR 8.8 million, and RUB 57.2 million.

Also, in 2018, the NBU sent seven notifications on suspicious financial transactions to Ukraine's National Anti-Corruption Bureau.

The communications to law enforcement bodies were largely related to financial transactions by bank customers that might relate them to capital withdrawal, legalization of criminal proceeds, conversion of cashless funds into cash, fictitious entrepreneurship, tax evasion, and other infractions.

Moreover, based on the Cooperation and Information Sharing Agreement between the State Financial Monitoring Service of Ukraine and the NBU, the NBU provided the authorized body with information obtained in the course of financial monitoring which may point to suspicions of legalization (laundering) of proceeds from crime, terrorism financing, and financing the proliferation of weapons of mass destruction.

²⁰ Pursuant to Article 18 of the Law of Ukraine *On the Procedural and Legal Framework for Combating Organized Crime*.

²¹ Includes 11 communications with information on the results of financial monitoring and currency supervision, which are part of those mentioned above sent by the NBU to the Security Service of Ukraine based on the results of financial monitoring.



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Imposing Corrective Measures Based on the Findings of Financial Monitoring and Currency Supervision

Based on identified violations, the NBU imposed corrective measures/sanctions (appropriate to the violations or the level of threat to creditors and depositors of a bank), including in the form of fines and written warnings.

Corrective measures/sanctions for breaches of financial monitoring legislation in 2018

Indicator	Quantity ²²
Written warnings	22
Fines imposed on banks	14 decisions totaling UAH 152,072,978.26
Fines imposed on nonbank financial institutions	4 decisions totaling UAH 34,000.00
Written requests for banks to remedy (and prevent in the future) breaches of Ukrainian legislation	28
Written requests for nonbank financial institutions to remedy (and prevent in future) breaches of the Ukrainian legislation	5
Decisions on noncompliance with Ukrainian legislation by top managers of banks	5 decisions regarding top managers of 3 banks

Application of corrective measures/sanctions for violations of Ukraine's currency legislation in 2018

Indicator	Quantity ²²
Written warnings	7
Resolutions on holding banks or nonbank financial institutions accountable (including the national postal service) for breaching currency legislation	72 totaling UAH 840,432.12

Written requests for banks to remedy (and prevent in the future) any breaches of Ukraine's currency legislation and NBU regulations	12
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In 2018, the NBU also carried out explanatory work with entities subject to initial financial monitoring – banks, nonbank financial institutions, legal entities, and individuals with regard to current legislation, especially NBU regulations and legislation on the application of individual special economic and other restrictive measures (sanctions).

In 2018, the NBU exercised control over the timeliness and completeness of information/documents submitted by banks on transactions of authorized banks to bring domestic and foreign currencies and investment metals in and out of Ukraine, compliance with the requirements of individual licenses for using foreign currency as a means of payment in Ukraine, and compliance with the requirements of individual licenses for placing currency assets on accounts outside Ukraine.

The NBU voluntarily sent communications to the State Fiscal Service and law enforcement bodies. Other currency supervision measures were also applied.

The NBU closely cooperates with entities subject to initial financial monitoring and self-regulatory organizations, particularly the Independent Association of Ukrainian Banks and the Forum for Leading International Financial Institutions. In 2018, financial monitoring issues were discussed at common meetings, workshops, roundtables, and conferences.

Annual Assessment of Resilience

Starting in 2018, the NBU introduced the annual assessment of the resilience of banks and the banking system. The regulation on assessing the resilience of banks and the banking system was approved by NBU Board Resolution No. 141 dated 22 December 2017.

The assessment of resilience includes the asset quality review (AQR) for all banks and stress testing for the largest banks.

²² Legal proceedings were initiated regarding some of the decisions.



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The resilience assessment revealed that Ukraine's banking sector is sufficiently capitalized, but that it should increase its safety margin to enhance its resilience to possible crises.

The asset quality review revealed that 4 of 56 banks were in need of a capital increase as of the reporting date (early 2018). Two of those were already sufficiently capitalized before the test was completed. Two more banks needed an increase in capital and had taken the necessary measures as of the end of 2018.

Stress testing encompassed the 24 largest banks by risk-weighted assets and retail deposits, which together accounted for more than 94% of banking sector assets. Stress testing is designed to identify the possible consequences for banks during a crisis instead of attempting to forecast possible developments in the sector. To that end, the NBU models potential bank losses in a hypothetical crisis and calculates the capital the banks would need to cover those losses. The central bank develops two stress-testing scenarios: a baseline and an adverse scenario. The adverse scenario takes into account the largest risks. This scenario is built to primarily trigger credit risk, interest rate risk, and FX risk. The scenario assumes a drop in real GDP, a depreciation of the hryvnia, higher inflation, and a consequent increase in interest rates. The model is run on a three-year forecast horizon to capture all the stages of a crisis, from its inception to the start of economic recovery. The baseline scenario is used as a comparison base for the stress-testing results and is not a forecast.

According to the 2018 stress tests, the common equity adequacy under the baseline scenario would increase by almost 13 pp on average over the forecast period. Eight financial institutions would need capital to meet the minimum capital adequacy requirement in the first year of the forecast under the baseline scenario (UAH 6.1 billion total capital need). One of these banks was recognized as insolvent in November 2018, but most of the banks were able to generate sufficient profit in the forecast period, and their capital has grown.

Under the adverse scenario, capital needs are considerably higher. The common equity adequacy ratio of banks is expected to fall by about 9 pp in the event of a crisis. Thirteen financial institutions would require a capital increase of UAH 42.1 billion. Excluding VTB Bank, the total hypothetical capital needs amounted to UAH 34.7 billion. This amount

includes a significant share of capital needs at two state-owned banks, but after the steps taken by banks and verified by the NBU, the capital needs dropped to UAH 19.7 billion as of the end of 2018.

The NBU will continue assessing bank asset quality and conducting stress testing annually. In 2019, the adverse scenario will have harsher assumptions to determine how vulnerable banks are to risks. These will include a rapid growth in the share of nonperforming consumer loans, unchanged loan rates, and higher loss given default.



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Harmonizing Bank Regulation with Basel and EU Directives



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In 2018, the planned adaptation of the domestic banking system to European banking standards was carried out based on the Core Principles for Effective Banking Supervision of the Basel Committee on Banking Supervision.

The NBU worked to implement the measures that form the core of the Comprehensive Program of Ukrainian Financial Sector Development until 2020, the Action Plan on Enhancing Banking Supervision, and the NBU's plans on the implementation of EU laws in line with the EU-Ukraine Association Agreement. This was done in conjunction with the IMF, World Bank, European Commission, and other IFIs.

To harmonize bank regulation with the provisions of Directive 2013/36/EU, Directive 2014/56/EU, EU Regulation 575/2013, and the recommendations of the Basel Committee on Banking Supervision, and to improve the efficiency and sustainability of the Ukrainian banking system, a number of regulations were adopted in 2018 in terms of the introduction/improvement of:

- the Liquidity Coverage Ratio (LCR)
- a new equity instrument that has conversion/write-off terms
- the annual resilience assessment of banks and the banking system
- a risk-based approach to the licensing of banks

- minimum requirements for setting up risk management systems in banks and banking groups
- recommendations on corporate governance in banks
- the NBU Credit Register
- a procedure for auditing banks.

To maintain financial stability and increase the banking system's resilience to possible liquidity shocks, NBU Board Resolution No. 13 dated 15 February 2018 introduced a new liquidity ratio – the liquidity coverage ratio (LCR). The LCR sets a minimum liquidity level required to cover the estimated net cash outflow within 30 days in the event of a stress scenario.

On 27 December 2018, the NBU introduced a new equity instrument with conversion/write-off terms that opens new possibilities to boost the Ukrainian banking system's capitalization. It is the first step towards the new capital requirements that are to be introduced in 2020. The instrument's key characteristic is a loss absorption mechanism that enables banks to convert or write-off the instrument at the expense of equity investors and at no cost to creditors or the state. A bank will be able to convert or write-off the instrument if an event condition is triggered: if a bank's capital adequacy ratio (net of the instrument) falls below 6.25% (NBU Board Resolution No. 148 dated 22 December 2018).

In addition, NBU Board Resolution No. 139 dated 18 December 2018 introduced the following:

- updated requirements for banks to identify groups of related counterparties bearing common economic risk when calculating credit risk ratios. Under the updated requirements, banks must identify the counterparties that are related either through control or through economic dependency. Banks must therefore thoroughly study their counterparties, including their ownership structures, business environment, financial statements, etc.
- requirements that a bank's regulatory capital must cover the excess of the actual value of the total debt of the bank's related parties over the required maximum.

Also, given the significant changes in the accounting of banks' transactions with financial instruments after the transition to IFRS 9:



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Financial Instruments, the NBU updated supervisory reporting indicators and improved the assessment of risks related to financial instruments when calculating capital ratios, credit risk, and liquidity (NBU Board Resolution No. 33 dated 30 March 2018, NBU Board Decision No. 234-D dated 27 April 2018).

To improve the regulatory framework for bank licensing and to bring ratios in line with the requirements of European legislation, a new regulation on the licensing of banks was adopted (NBU Board Resolution No. 149 dated 22 December 2018). The document's primary objective is to enable a transition from a formal to a risk-oriented approach in issues of bank licensing and to provide regulators with tools for substantive analysis when implementing approval procedures. Below are the new aspects of the bank licensing regulatory framework:

- assessment of the financial status of legal entities and the property status of individuals (in particular, detailed criteria for assessing the financial/property status of individuals were identified; business plan requirements were established; and stricter requirements were introduced for the sources of individuals' own funds that are allocated for the capitalization of a bank and the acquisition/increase of a qualifying holding in the bank)
- assessment of the business reputation of legal entities and individuals (specifically, signs of a flawed business reputation were categorized; the NBU was granted the right to decide whether an entity has a flawed business reputation given a lack of signs as identified by Regulation No. 149 when other factors are revealed that constitute evidence of the entity's flawed business reputation (systematic violation of Ukrainian legislation, breach of standards of business ethics, etc.); the whitewashing procedure was extended so that it can be applied to entities with almost all signs of a flawed business reputation, etc.)
- approval of the acquisition or increase in a qualifying holding in a bank (in particular, specifics of approval procedures were determined for various types of acquisitions/increases of qualifying holdings (intragroup restructuring, acquisition/increase of a qualifying holding under power of attorney and as a result of a management agreement); banks were forbidden to manage their own shares and shares/holdings of entities in the banks' ownership chains)
- bank executives (in particular, additional compliance requirements for

bank executives were introduced (no conflict of interest, allocating sufficient time to the discharge of executive duties); additional requirements for independent directors were imposed (they must not be shareholders or owners of a qualifying holding in the bank); from now on, the independent director and members of the board who are responsible for risk management (CRO) and compliance (CCO) will undergo mandatory tests and interviews)

- opening of standalone units of banks and launching new lines of business (in particular, most formal requirements were replaced with an economic feasibility requirement for opening a standalone unit or launching a line of business, and a requirement that the new unit or line of business comply with the bank's strategy and business plan)
- safeguarding the rights of persons with reduced mobility.

Taking into account the principles and recommendations of the Basel Committee on Banking Supervision regarding corporate governance and risk management in banks and banking groups, the NBU has developed a regulation on the organization of a risk management system in Ukrainian banks and banking groups (NBU Board Resolution No. 64 dated 11 June 2018). That regulation sets the goals and principles of managing risks that arise from all activities of a bank at every organizational level and identifies the minimum requirements for establishing a comprehensive, adequate, and effective risk management system in a bank or a banking group.

The regulation also stipulates the following:

- the imposition of requirements for the selection of structural units when building the risk management system under three levels of protection
- strengthening of responsibilities and accountability of bank boards regarding risk management
- improving the culture of risk management
- strengthening the requirements for the authority, competence, and independence of risk management units and compliance monitoring
- determination of risk appetite within the permissible level of risk and continuous risk control.

In order to increase corporate governance in Ukraine's banking sector while taking into account proposed and adopted legislative changes



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(the Law of Ukraine No. 2210 On Amendments to Certain Legal Acts of Ukraine on Facilitating Business and Attracting Investments by Issuers of Securities), the NBU has approved the guidelines on corporate governance standards in Ukrainian banks (NBU Board decision No. 814–D dated 3 December 2018). The document contains recommendations on corporate governance issues, especially in terms of:

- the responsibility, functions, composition, rules of procedure, and collective suitability of a bank's board
- the formation, composition, authority, and rules of procedure of the bank's board committees
- the role of the bank in ensuring the effective functioning of its internal control system
- the introduction of an effective remuneration policy that will encourage employees to act in the interest of the bank and avoid excessive risks
- disclosure of information about the bank's corporate governance.

As part of its continued effort to increase the banking system's transparency, in April 2018 the NBU for the first time published on its website information about bank executives, as well as the executives and owners of qualifying holdings in banks that were liquidated by initiative of parties other than their owners.

On 5 and 6 December 2018, the NBU hosted the first School of Independent Directors, aimed at raising awareness among representatives of banks and members of their governing bodies (primarily independent members of supervisory boards) of the principles of corporate governance, its role in the activities of banks, the basic principles of the functioning of supervisory boards and the activities of their independent members, as well as raising awareness of relevant issues in banking regulation.

In late 2018, the NBU unveiled the Bank Inspection Plan for 2019. The NBU will prepare these types of schedules regularly. Throughout 2018, the inspections of banks were conducted in accordance with the amended Regulation No. 276, approved by NBU Board Resolution No. 145 dated 28 December 2017. The inspections took into account the provisions of Directive 2013/36/EU of the European Parliament and European Council dated 26 June 2013 on access to the activity of credit

institutions and the prudential supervision of credit institutions and investment firms, as well as the Main Principles of Effective Banking Supervision and the recommendations of the Basel Committee. Pursuant to those guiding principles, the rights and duties of the inspectors and executives of a bank under inspection were clarified and streamlined, the guidelines for conducting inspections were improved, and the approaches to discussions of the preliminary results of the inspections with the management of a bank at meetings of the Committee on Banking Supervision with the possible involvement of the bank's management were improved. The NBU also decided that Bank Inspection Plans were to be drawn up based on a risk-oriented approach and approved by a committee of the NBU.

In 2018, the definition of the CAMELSO rating assessment was improved in the context of harmonization with the approaches used for supervisory assessment of banks during offsite banking supervision (SREP). The description of ratings was refined and an F rating was introduced, which indicates immediate risk to the viability of a bank and grounds for recognizing the bank as distressed/insolvent.

The NBU continued to adapt standardized inspection approaches and procedures (including checklists and questionnaires) to banks' lines of business, taking into account the introduction of the risk-oriented approach during the inspections and the increasing focus of the inspections on the problematic areas of banking activity that pose the greatest risks to depositors and creditors.

Based on the results of the inspections, the NBU improved the approach to assessing the collective suitability of a bank's board and the qualifications of its top managers as part of inspections that will be carried out together with international experts. The approaches used in assessing the 20 largest banks lay the groundwork for an assessment of the rest of Ukraine's banks.

To implement the Law of Ukraine On Audit of Financial Reporting and Audit Activity and the new edition of the International Standards on Auditing (ISA), the NBU Board approved Resolutions No. 89 and 90 on 2 August 2018.

- Resolution No. 89 stipulates:
- the procedure for a bank to inform the NBU of the audit firm selected



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for external auditing

- the NBU procedure for reviewing a bank's information and approving a decision to reject/suspend the audit firm (the Supervisory Committee is responsible for that decision)
- grounds for rejection/suspension by the NBU of an audit firm chosen by a bank.
- Resolution No. 90 stipulates:
- that banks conduct a competitive selection of audit firms
- that the selected audit firm rotate auditors involved in the audit
- that the audit firm include in the audit report information that meets the ISA and the requirements of the NBU regarding specific issues in a bank's activities.



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AML/CFT. Financial monitoring in Ukraine' – project launched in order to increase the understanding of what the financial monitoring in the banking system of Ukraine is: <https://finmon.bank.gov.ua/finmon/en.html>

#AML/CFT

Financial monitoring in Ukraine

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Information Security and Cyber Defense in Banks



The Law of Ukraine On the Basic Principles of Cybersecurity in Ukraine (hereinafter – the Law), which came into force in 2018,²³ identifies the NBU as one of the main parts of the country's cybersecurity system.

In 2018, the NBU worked as part of the National Coordination Center for Cybersecurity under the National Security and Defense Council of Ukraine. Working within our authority, the NBU ensured the implementation of the 2018 Action Plan to implement Ukraine's Cybersecurity Strategy. The plan was approved by Ordinance No. 481-D of the Cabinet of Ministers of Ukraine dated 11 July 2018.

In addition, in 2018, the first stage of the NBU's Center for Cyber Defense was completed. As part of that first stage, the Cybersecurity Incidents Response Team (CSIRT-NBU) was created within the banking system of Ukraine as a key unit within the Center for Cyber Defense.

Furthermore, in 2018, NBU Board Resolution No. 95 On Approval of the Regulation on Measures to Ensure Information Security in the Banking

Cyber Defense in the EU

By 9 May 2018, EU Member States were to have implemented Directive (EU) NIS 2016/1148 of the European Parliament and of the European Council dated 6 July 2016 concerning measures for a high common level of security for network and information systems across the EU

System of Ukraine dated 28 September 2017 came into force. The regulation governs the issues of ensuring information security and cyber defense of Ukraine's banking system by identifying the procedures and requirements for implementing information security measures.

To monitor compliance with the requirements of this regulation during inspections of Ukrainian banks, the NBU conducted inspections of the newly created information security systems and systems of proper enforcement of information security measures in accordance with the approved methodology.

To meet the objectives identified by the Law, in 2018, we developed requirements for information security and cyber defense in fund transfers. The relevant Draft Resolution of the NBU Board On Approval of Regulations on Cyber Defense and Information Security in Payment and Settlement Systems has been reviewed publicly.

This document provides for the identification of requirements for entities of the payment market regarding the establishment of information security

Security of Personally Identifiable Information in the EU

By 25 May 2018, EU Member States are to have implemented Directive GDPR 2016/679/EU of the European Parliament and European Council on data protection and confidentiality for all entities within the EU and the European Economic Area.

and cybersecurity systems, as well as the procedure for detecting cyberattacks that reduce the reliability of payment systems and settlement systems.

An important factor in ensuring an adequate level of cyber defense of the Ukrainian banking system is the possibility of exchanging information between banking institutions of Ukraine, other members of Ukraine's national cybersecurity system, and domestic and international institutions in the area of cyber defense.

²³ 9 May 2018.



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To build a unified and trusted information environment for effective interaction and communication between entities within Ukraine's banking system, the NBU established the information and analytical system of the NBU's Center for Cyber Defense. It contains an analytical repository for malware and CRITS cyberattacks (based on the Collaborative Research Into Threats solution) and the MISP Cybersecurity Indicators system (based on the Malware Information Sharing Platform solution). Their application will significantly increase banks' awareness of cyber threats and allow banks to defend their information systems against actual cyber threats.

To expand cooperation with foreign and international organizations in response to cyber incidents, the NBU has approved the next stage of the development of the Center for Cyber Defense (NBU Board Decision No. 742-D dated 2 August 2018).

The NBU is working to secure accreditation for CSIRT-NBU from FIRST (the international Security Response Team Forum), seeking to participate in the FS-ISAC Information Exchange and Analysis Services, and exchange information with other teams that deal with computer security incidents at EU banks.

The NBU Center for Cyber Defense also exchanges information and works with the State Center of Cyber Defense at Ukraine's State Service of Special Communication and Information Protection (CERT-UA) and the Security Service of Ukraine's Situation Center for Cybersecurity.

In February 2018, the NBU Center for Cyber Defense launched a flash briefing for Ukrainian banking institutions to inform them of cybersecurity incidents and attempted cyberattacks. Since launch, banks have received more than 150 flash briefings containing cyber threat indicators and countermeasures.

In total in 2018, the NBU's information security systems that monitor online activity (CSIRT-NBU) detected approximately one million cyber incidents and attempted cyberattacks. The NBU studied approximately 4,000 samples of malicious software to identify and establish cyberthreat indicators.



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National Bank of Ukraine together with banking community started preparations for introducing NSFR. The test period of the new liquidity index calculation will start next year. The process of developing an appropriate method of NSFR calculation will last until the end of Q3 2019





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Introducing Macroprudential Policy



Promoting financial stability is the NBU's next most important function (after maintaining price stability) under the Law of Ukraine On the National Bank of Ukraine. To execute that function effectively, the NBU has developed a macroprudential policy that aims to prevent systemic risks from accumulating in the financial sector and to improve the sector's resilience to crises.

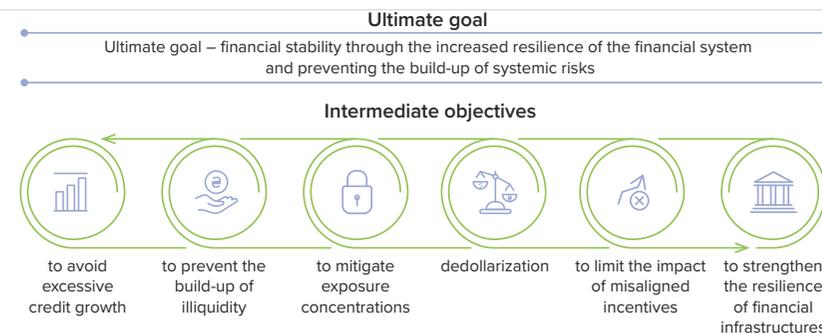
This policy is outlined in the macroprudential policy strategy (the "strategy") announced in late 2018. In-line with European practices, the document determines what and how the NBU should deliver financial stability to facilitate sustainable economic growth.

Macroprudential policy appeared in response to the three deep financial crises that have occurred over the two last decades that resulted in significant and long-lasting losses for the Ukrainian economy. At the time, Ukraine had faced fundamental problems including an absence of effective banking regulation at the macro level and preemptive measures that could prevent a build-up of systemic risks and safeguard financial stability. The banking sector was not prepared to handle those crises and the NBU was forced to intervene in the midst of the crisis.

Since then, the NBU has done a great deal of work to keep any potential crises from catching the banking sector off guard. The central bank is adopting risk-based supervision and has launched macroprudential tools for the financial system overall. The goal of macroprudential policy is to ensure financial stability by increasing the resilience of the financial system

and by preventing the accumulation of systemic risks. This objective will be met by achieving interim goals. Based on recommendations from the European Systemic Risk Board and the nature of Ukraine's financial system, the strategy has six interim goals.

Goals of the Macroprudential Policy Strategy



By addressing these risks, macroprudential policy helps boost the resilience of the economy and the financial system.

However, there are two important aspects in relation to macroprudential regulation. These aspects are also outlined in the strategy.

First, the resilience of individual financial market participants (e.g. banks) does not necessarily ensure the resilience of the entire financial sector. Thus, some of the NBU's tools may rein in a more active expansion by banks into some sectors, while promoting the resilience of the financial sector as a whole.

However, macroprudential policy also has side effects. This may include restrictions on access to credit for households and businesses. This could reduce economic growth, which is a cost of the resilience to financial crises. Therefore, an effective macroprudential policy should always seek a balance between enhancing the resilience of the financial system and decelerating economic growth.

Although macroeconomic policy may limit the activities of certain banks, overall it benefits the banking system by delivering a stable system overall, since crisis-related economic losses tend to outweigh the costs related to macroprudential restrictions.



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Second, macroprudential policy is fundamentally proactive in nature. The NBU will act pre-emptively to prevent crises or minimize the impact of a crisis on the domestic economy. This means that macroprudential tools may be used when risks to the financial system appear insignificant or are not obvious.

The strategy details the sequence of steps that must be taken to achieve the interim goals of macroprudential policy.

The first step is identifying systemic risks to financial stability. The NBU currently sees seven risks:

- short maturities of bank deposits
- high dollarization in the banking sector
- significant share of state capital in the banking sector
- spike in consumer lending
- migration of assets and transactions to the nonbank financial sector
- high concentration of credit risk
- large proportion of nonperforming loans.

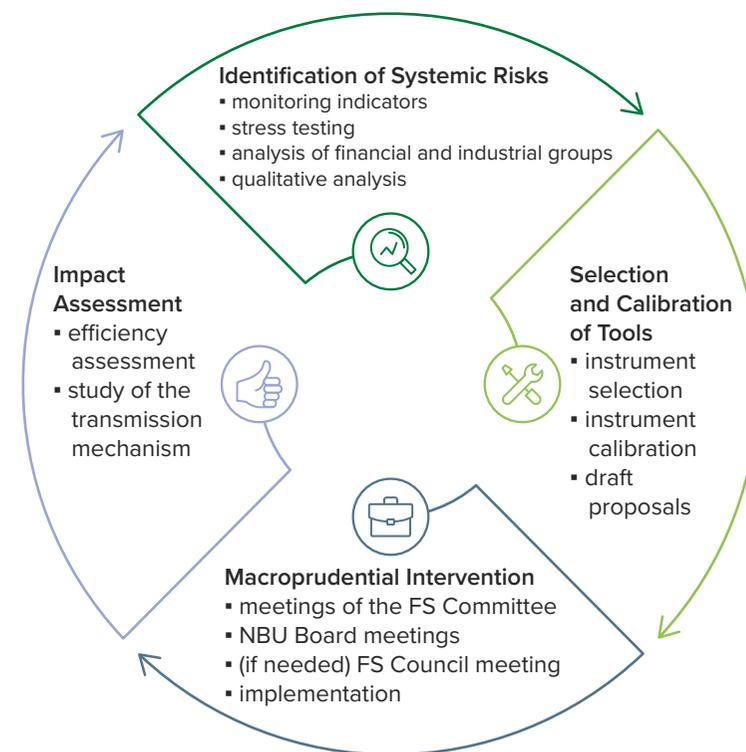
Once risks are identified, the NBU chooses appropriate macroprudential instruments and calibrates them to the scale and potential contagion area of the risk and the conditions of and prospects for financial sector development. In the end, the central bank assesses the impact of these tools and decides whether it should continue to deploy them.

The strategy has a list of instruments that have either been introduced or will be introduced in the future. These include capital instruments (such as the countercyclical capital buffer, the capital buffer for systemically important banks, and the leverage ratio), liquidity instruments (such as the liquidity coverage ratio and the net stable funding ratio), and other instruments (such as the loan-to-value ratio and higher disclosure requirements). The strategy describes the potential effect of each instrument and says what systemic risks the instrument targets. The list is not exhaustive and can be expanded, if required.

The NBU is currently working to introduce macroprudential tools. In 2018, the central bank introduced the liquidity coverage ratio and regular stress testing for assessing the resilience of banks, which is an important instrument for identifying risks. The document also pays special attention

to the coordination of macroprudential policy both within the NBU and with other authorities, which is an important requirement for effective macroprudential regulation.

How the NBU meets the goals of the Macroprudential Policy Strategy



Ensuring financial stability is a task that goes beyond the scope of banking regulation. After all, the financial system is made up of banks as well as other financial institutions.

In the absence of similar requirements for other financial institutions, the effective regulation of the banking sector creates room for regulatory arbitrage, which makes banking regulation less effective. Thus, the impact of macroprudential policy will be maximized if there is a well-coordinated policy in place that enables the comprehensive regulation of all segments of the financial market.



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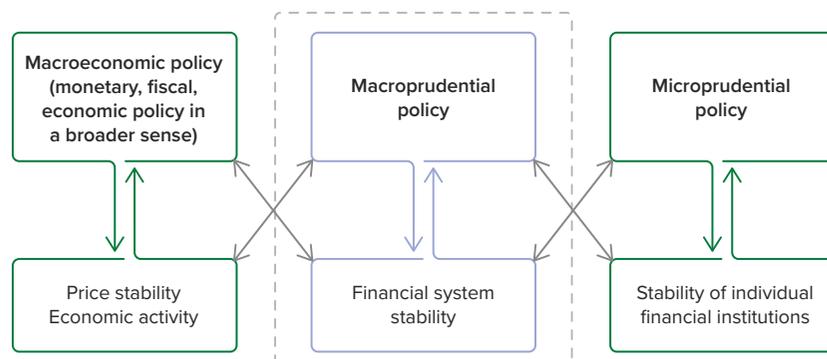
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The strategy also determines how macroprudential policy should interact with monetary and microprudential policies (Figure 3). All these policies should support and complement one another. More specifically, low and stable inflation (which results from a successful monetary policy) promotes financial stability, while a stable financial system (achieved through an effective macroprudential policy) decreases price volatility, enabling effective monetary operations.

That said, sometimes conflicts of interest can arise between policies. For example, an accommodative monetary policy may be appropriate under certain macroeconomic conditions, but it could trigger side effects, like an increase in debt and a less prudent perception of risks by lenders in a low interest rate environment. Therefore, the NBU must coordinate its monetary and macroprudential policy decisions.

How different types of economic policy interact

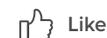


Macroprudential policy pays special attention to communications with market participants. Over the past several years, the NBU has been regularly informing the public of the risks on which it will focus. These are communicated in financial stability reports and other publications on the NBU's website.

Verbal warnings about risks comprise a mandatory stage of macroprudential policy. The NBU limits its intervention to warnings when stricter macroprudential measures are premature, inappropriate, or impossible to take. If warnings about risks are insufficient, the NBU will

select macroprudential tools to be deployed based on an analysis of pros and cons.

The NBU informs market participants of all regulatory changes, to not shock them with new requirements and to allow them enough time to adjust.



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#NBU has developed and presented Macroprudential Policy Strategy, which lays the groundwork for the introduction of a systemic macroprudential policy in Ukraine: <https://bit.ly/2EjNcBd>





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Protection of Creditors' Rights

Creating a Credit Register

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3 Resumption of Lending

#credits #banks #finstab

Protection of Creditors' Rights



Last year, investors and creditors finally saw an improvement in the protection of their rights. This was accomplished by adopting the Law of Ukraine *On Amending Some Ukrainian Laws that Relate to the Resumption of Lending*, signed by President of Ukraine Petro Poroshenko.

For a long time, significant legal risks remained one of the main obstacles to the resumption of lending, primarily corporate lending. Developed with the support of the NBU, the law has eliminated most of the legislative loopholes that had been used by borrowers to avoid repaying debt or to dodge responsibility for a failure to repay.

The law has decreased risks for creditors by:

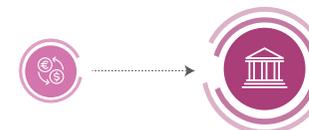
- safeguarding and protecting the rights of mortgage holders
- updating and improving some surety-related legislation
- enabling banks to obtain information about borrowers when the information is relevant to their credit relations with the borrower
- forbidding the sale of mortgaged property without the prior consent of the lending bank

- making it harder for heirs who receive the property of a borrower to avoid discharging the borrower's loan debts
- improving alternative dispute resolution instruments.

improving alternative dispute resolution instruments. Thanks to the law, banks have greater confidence in the legal protection of their rights and thus can ease requirements for potential borrowers. This will spur lending growth, reduce the cost of credit, and ease access to bank products for businesses and households. However, this is not enough to ensure the effective protection of creditors' rights and to make loans readily accessible. For this reason, the NBU is calling for the establishment of a full-fledged private bailiff service that will improve the procedure for selling seized property, as well as addressing other legislation gaps that prevent creditors and investors from exercising their rights in full.

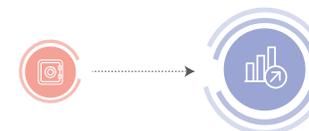
Draft Law No. 6027-d *On Amendments to Some Legal Acts of Ukraine on the Resumption of Lending*

will reduce risks for banking institutions' lending transactions



Outcome: Banks will readily grant loans to clients.

will make bank loans more accessible to business entities and individuals.



Outcome: The economy will receive a boost.

Will eliminate legal loopholes used to refuse paying debts or avoid responsibility for failure to pay



Outcome: The law will facilitate further development of market relations and elimination of "schemes".

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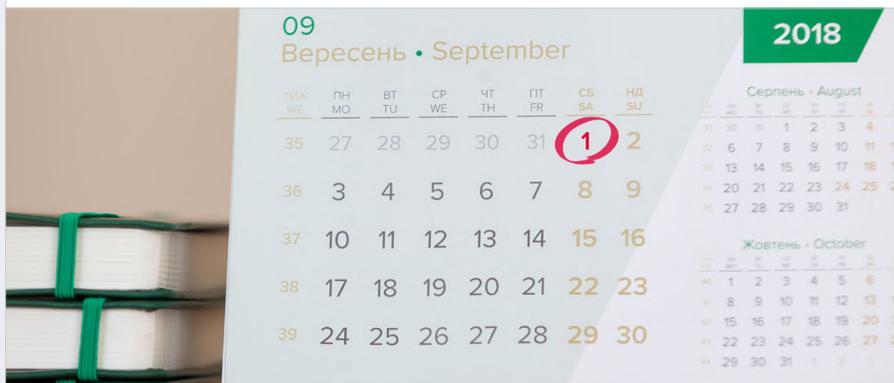
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Creating a Credit Register



To comply with the Law of Ukraine *On Amending Some Ukrainian Laws that Govern the Creation of the Credit Register*, which was drawn up with the support of the NBU, the central bank approved a regulation related to the credit register (NBU Board Resolution No. 50, dated 4 May 2018). This regulation sets rules for:

- banks and the Deposit Guarantee Fund to provide information about insolvent or liquidated banks to the credit register and to remove information from the register
- banks, private individuals, and businesses to obtain information from the register
- maintaining a register of requests to the credit register from banks, private individuals, and businesses.

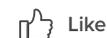
Starting from 1 September 2018, banks have been required to provide information to the NBU's credit register (the "credit register") and have been allowed to obtain information about borrowers that owe more than 100 times the minimum wage to one bank. Borrowers whose data has been included in the credit register can also request and receive information about themselves and request changes in the event of a disagreement. Banks must update information in the credit register on the first day of every month.

As of 1 January 2019, all banks have provided information to the credit register as required by the Law of Ukraine *On Amending Some Ukrainian Laws on Creating and Keeping the NBU's Credit Register and Improving Credit Risk Management*.

The NBU is constantly monitoring how banks comply with the existing laws that govern the operation of the credit register and checking whether the provided data is up to date.

The register currently contains information about more than 80,000 borrowers, including 53,200 private individuals and 27,200 businesses. When sending information about private individual borrowers to the credit register, banks must comply with Ukrainian law, especially the Law of Ukraine *On the Protection of Personal Data*.

The credit register allows banks to measure credit risk more effectively, contributes to the resumption of lending, and provides access to bank loans for reliable and honest borrowers.



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4 Effective Regulation of the Financial Sector

#split #WhitePaper

The Future of Nonbank Financial Sector Regulation



The draft White Paper

The Future of Regulating the Nonbank Financial Sector

The functions of the National Commission for the State Regulation of Financial Services Markets were delegated to other bodies last year. As a potential regulator of a larger part of the nonbank financial market, the NBU has initiated a discussion with market participants over the future of nonbank financial market regulation. The NBU has presented its vision in a draft white paper titled *The Future of Regulating the Nonbank Financial Sector*.

The liquidation of the National Commission for the State Regulation of Financial Services Markets and delegation of responsibility over the markets it regulates between the NBU and the National Securities and Stock Market Commission (NSSMC) has been one of the most actively discussed topics in Ukraine's financial market in recent years. The Draft Law of Ukraine *On Amendments to Certain Laws of Ukraine on the Consolidation of the State Regulation of Financial Market Functions* (draft law No. 2413-a), known as the split draft law, was registered in 2015.

It aims to introduce a partially consolidated (integrated) model of financial sector regulation, which implies that two regulators – the NBU

and the NSSMC – will regulate the entire financial sector. The adoption of the split law is also a structural milestone of the Memorandum of Economic and Financial Policies under the new program of cooperation with the International Monetary Fund in 2019–2020.

As of today, the document has been approved only in the first reading. Nevertheless, the NBU has taken a proactive approach and is preparing to regulate the nonbank financial sector in the future by engaging in discussions with the financial community. In cooperation with consultants from USAID and the World Bank, the central bank has developed a white paper titled *The Future of Regulating the Nonbank Financial Sector* (referred to below as the White Paper), which it presented to nonbank financial sector participants and offered for public discussion in October 2018.

The document outlines the regulator's approach to:

- segmenting the nonbank financial market
- licensing
- prudential supervision
- reporting and inspections
- corporate governance
- market behavior and the protection of consumer rights by nonbank financial institutions.

The new regulation is intended to cover insurance companies, credit unions, pawnshops, leasing and factoring companies, and other financial companies that lend, provide guarantees, and engage in other similar activity. Moreover, the NBU continues to regulate and supervise nonbank financial institutions that deal with hryvnia and foreign-currency money transfers and trade in cash currency assets (carry out foreign exchange activities). The norms and requirements set out in the draft of the White Paper are not a unilateral initiative; the NBU developed the document in close cooperation with market participants.

The nonbank financial market has historically been less regulated than the banking sector in Ukraine. This has resulted in low transparency, which deters potential investors and reduces consumer trust.



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The proposed regulation model has two main goals:

- To identify more development opportunities for each segment of the nonbank financial market
- To inspire fair market behavior and the effective and systematic protection of the rights of financial services consumers.

The draft of the White Paper considers the high segmentation and heterogeneity of players in these markets in terms of their size and the types of products and services they offer. It provides the most flexible approach to the licensing of nonbank financial institutions and to reporting and supervision.

The proposed regulation also proposes a risk-oriented approach, similar to the one the NBU has been successfully implementing in the banking sector for the past three years. The new approach will help companies proactively identify and avoid problems, as opposed to requiring a reaction once a company has become insolvent. In addition, the NBU emphasizes the importance of the introduction of corporate governance standards that will improve corporate performance and the protection of consumer rights.

Under the proposed approach to regulation, market participants would be required to:

- disclose ultimate beneficiary owners
- comply with financial monitoring legislation
- comply with capital adequacy requirements.

Moreover, the new regulation would introduce corporate governance standards to improve the quality of services provided by nonbank financial institutions and reinforce the protection of consumer rights.

The NBU has taken the following steps to allow market participants, experts, and other stakeholders to become familiar with the main components of the proposed model for nonbank financial market regulation and to collect feedback:

- October 2018 – published the draft of the White Paper on the NBU's official website with a call for comments open until 22 November 2018.

- October 2018 – presented the White Paper to representatives of associations that represent the nonbank financial market (over 70 participants).
- November 2018 – held detailed discussions over the future regulation with representatives of insurance companies, credit unions, leasing, factoring, and other companies.
- November 2018 – participated in the *Nonbank Financial Markets Regulation: International Experience* international conference organized by the Independent Association of Ukrainian Banks and the Ukrainian Insurance Federation.

The central bank expects that the new framework for nonbank financial market regulation and the draft laws and proposed regulations will now be more widely discussed by financial institutions, experts, and other stakeholders.

Without a doubt, the regulator, market participants, and political forces will need to work together to deliver a successful reform. The NBU is open to discussions and cooperation with representatives of all nonbank financial institutions and all other stakeholders.



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Licensing Nonbank Financial Institutions



In 2018, the NBU continued to improve the conditions for nonbank financial institutions to conduct hryvnia money transfers without opening an account, conducting currency transactions, and providing banks with cash collection services. The central bank also worked to improve transparency and competition on those markets.

To continue to transition to the new liberalized currency regulation system and allow postal service operators to access financial services markets, starting on 2 February 2019 the NBU allowed postal operators to obtain licenses to conduct hryvnia money transfers without opening an account and to perform currency transactions.

Moreover, the NBU improved the procedure to issue general licenses to nonbank financial institutions for currency transactions. Those changes were geared towards implementing the Law of Ukraine *On Currency and Currency Operations* and at optimizing regulations and loosening licensing requirements. Now, currency transaction licenses will be granted for an indefinite term as opposed to a maximum three years previously. In addition, the NBU:

- halved the minimum equity requirement for nonbank financial institutions (NBFI) from UAH 10 million to UAH 5 million, provided the NBFI has no more than 50 structural units each subsequent increase in the number of structural units by 50 units will require an increase in minimum equity by UAH 5 million instead of UAH 10 million

- canceled the requirement that, when a license is issued, the premises of at least five units of a NBFI must comply with the NBU's requirements for conducting FX transactions and ensuring the security of NBFI premises.

The NBU also improved the procedure for issuing licenses for banks to provide cash collection services and expanded the list of cash-in-transit (CIT) companies. Now, in addition to cash collection services, CIT companies will be able to process and store cash (once they receive NBU approval).

At the same time, the Regulation *On the Procedure of Licensing Legal Entities for Rendering Cash Collection Services to Banks* set stricter requirements for financial standing, ownership structure, business reputation of top managers, and owners of qualifying holdings of CIT companies. To obtain a license to provide banks with cash collection services, a legal entity must have the amount of funds required in a business plan for its first year of operations, but no less than UAH 2 million for cash collection services and UAH 3 million for processing and storing cash. Furthermore, legal entities must meet requirements for the transparency of their ownership structure. In particular, their ownership structures must not be reciprocal and must not include any trust structures. The NBU will issue licenses to CIT companies by making an entry in the electronic register of licenses. Information on the existence and status of a license will be available on the NBU's website.

In 2018, the NBU launched a service to search for information on licenses issued to nonbank institutions, which allows users to search for the following licenses:

- for conducting money transfers in hryvnia without opening an account
- for providing cash collection services to banks
- for conducting currency transactions.

In 2018, the NBU also took measures to bring the ownership structures of NBFIs with NBU licenses in compliance with transparency requirements.



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Registration of Payment Systems, their Participants, and Payment Infrastructure Service Providers

As of the end of 2018, 42 payment systems operated in Ukraine. Of those, 11 were established by nonresidents and 31 systems by residents (9 intrabank money transfer systems, 8 established by banks, and 14 established by nonbank institutions). There were also 23 payment infrastructure service providers.

In 2018, the NBU registered:

two new payment systems:

- international card payment system UnionPay International (belonging to UnionPay International Co., Ltd), the world's largest payment system in terms of the number of issued cards and the fourth largest international card payment system in Ukraine with a nonresident payment system operator
- international payment system GLOBUS (payment system operator CB GLOBUS PJSC).

seven new payment infrastructure service providers:

- PLATEZHI ONLAIN LLC
- XPAY GROUP LLC
- EASY SOFT LLC
- HOTLINE LLC
- PAYCELL LLC
- FINANSOVA LINIIA LLC
- FINTECH PROCESSING LLC.

Licensing for Conducting Money Transfers in Hryvnia without Opening an Account

As of 1 January 2019, 62 nonbank institutions held licenses to make money transfers in hryvnia without opening accounts.

In 2018, the NBU issued four new licenses to the following nonbank institutions:

- UKRPOSHTA JSC
- FC AVERS N°1 PJSC
- PAYCELL LLC
- FC PROFINEF.

Granting Licenses to Nonbank Financial Institutions to Conduct Currency Transactions

In 2018, nine nonbank financial institutions obtained general licenses for performing currency transactions

- FC A FINANS LLC
- POST FINANS LLC
- FC AVERS N°1 PJSC
- FC PROFFINANS LLC
- STANDART-REIESTR LLC
- CAPITAL TIMES LLC
- FC SOKRAT LLC
- AMC CITI ASSET MANAGEMENT LLC
- AMC INVEST CONSULTING LLC.

In 2018, two nonbank financial institutions obtained licenses for performing currency transactions (FC A FINANS LLC, FC AVERS N°1 PJSC) and five nonbank financial institutions received licenses for performing securities transactions:

- FC PROFFINANS LLC
- CAPITAL TIMES LLC
- FC SOKRAT LLC
- AMC CITI ASSET MANAGEMENT LLC
- AMC INVEST CONSULTING LLC).

Another two nonbank financial institutions were granted new general licenses following the increase in the number of permitted currency transactions.

The NBU revoked general licenses for conducting currency transactions from nine nonbank financial institutions in 2018 for the following reasons:



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- at the request of a company's owners – 3
- license for providing financial services withdrawn – 3
- no currency transactions performed within 180 days – 2
- company ownership structure recognized as nontransparent – 1.

Licensing CIT Companies

In 2018, the NBU issued four licenses to legal entities for cash collection services to banks: DIAMANT SECURITY LLC, Panorama Prykarpattia LLC, CASH AND SECURITY LLC, Komservis-Bezpeka PE.

Overall, as of the end of 2018, nine legal entities had the right to provide banks with cash collection services:

- CIT SECURITY LLC
- Ukrainskyi Servis Inkasatsii LLC
- Persha Inkasatorska Kompaniia LLC
- O-Mega LLC
- Ahenstvo Kompleksnoi Bezpeky – Okhoronna Firma LLC
- DIAMANT SECURITY LLC
- Panorama Prykarpattia LLC
- Komservis-Bezpeka PE
- CASH AND SECURITY LLC.



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The #NBU has won the Central Banking Award, recognising the progress made in increasing our transparency. It is an honour to receive such recognition from the international community and a pleasure to see such support for the future of central banking in Ukraine!
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Well done to @NBUKraine_eng for winning this year's 'Transparency' award. #cbawards

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Regulating Payment Systems



In 2018, the NBU took the following steps in continuing to implement the Comprehensive Program for the DEvelopment of Ukraine's Financial Sector until 2020 and the NBU Strategy regarding development of cashless payments:

- authorized banks to open accounts using data received from other banks (existing accounts) through the NBU's BankID System
- authorized banks to delegate to agents the process of identifying and verifying retail bank customers as stipulated by the NBU's regulation on financial monitoring
- lifted restrictions on settlements between resident and nonresident individuals for the purchase and sale of real estate
- cancelled the requirement for self-employed individuals to submit to banks a copy of their registration with the Pension Fund of Ukraine
- allowed individuals to credit funds to current accounts that stem from the repayment of inherited certificates of deposit and accrued interest
- defined the methods and deadlines for introducing the international bank account number (IBAN) that will simplify payer and payee identification mechanisms and prevent errors in filling out payer/ payee account details, streamline payment processing, and ensure a standardized approach to generating bank account numbers for cross-border and domestic payments
- improved the procedure for issuing and revoking licenses to nonbank

financial institutions for domestic currency transfers without opening accounts

- updated the procedure for the provisioning of and resumption of SEP operations
- streamlined the procedure for conducting bank payments in extraordinary situations when banks cannot operate SEP under normal conditions
- revised the procedure for conducting transactions under guarantees in domestic and foreign currencies
- harmonized the procedure for conducting transactions under letters of credit in domestic and foreign currencies
- eliminated the requirement for business entities to affix a seal on payment documents as a way of certifying the signatures of authorized individuals.



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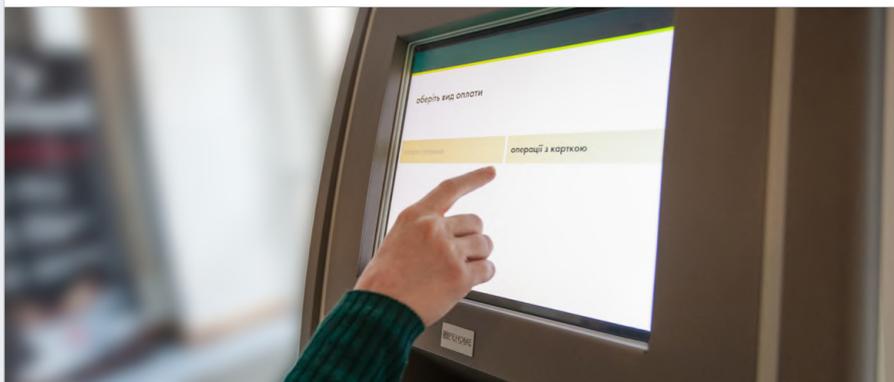
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Oversight of Payment Systems



The stable operation of the financial system and the national economy overall depend on the effective functioning of payment systems. Increasing the reliability of payment infrastructure is one of the key goals of oversight in ensuring financial stability.

As per the Law of Ukraine *On Payment Systems and Money Transfer in Ukraine*, the NBU conducts oversight of payment and settlement systems that operate in Ukraine.

The oversight function aims to ensure the stable and effective operation of the payment systems that are an integral part of Ukraine's financial system. Entities that are subject to the oversight include payment system operators, payment system participants, and payment infrastructure service operators.

In 2018, the NBU conducted on-site and off-site monitoring as part of its oversight mandate. On-site monitoring of overseen entities covered three payment system operators, six payment system participants, and one payment infrastructure service operator.

Inspections identified serious violations, including the following:

- services provided in violation of rules approved by the NBU
- noncompliance with the protection of consumer rights regarding fund transfers
- failure to ensure business continuity and information security

- failure to recognize all transactions on fund transfers in reporting systems
- misrepresentation of financial statements
- noncompliance with ratios and restrictions as required by law and under the rules approved by the NBU.

Based on the results of the inspections, the NBU required entities to rectify any violations and to communicate in written form about the corrective measures taken, as required in Article 41 of the Law of Ukraine *On Payment Systems and Money Transfer in Ukraine*.

The NBU conducted off-site monitoring of the entities subject to oversight to check for compliance with Ukrainian law, specifically the following:

- operations must be started only after registering with the Register of Payment Systems, Settlement Systems, Participants, and Payment Infrastructure Service Providers
- the money transfer system and its participants must comply with the rules set by the respective payment system operators
- the rights of the users of the money transfer system must be protected, especially in terms of reporting on the system's operation
- must not work with those international payment systems that Ukraine has tagged with special economic sanctions and other restrictive measures in line with the Decision of the National Security and Defense Council of Ukraine *On the Application of Personal Special Economic and Other Restrictive Measures (Sanctions)* dated 16 September 2016.²⁴
- According to the findings of off-site monitoring, the NBU made recommendations to entities on bringing their operations in line with Ukrainian law.

A targeted assessment of the Finansovyi Svit domestic money transfer system (with Ukrainska Platizhna Systema LLC as the payment system operator), with the goal of checking its compliance in terms of operational risk management and business continuity with Ukrainian law and the Principles for Financial Market Infrastructures (PFMI) (Principle 17: Operational risk). The scope of that assessment was identified based

²⁴ Enacted by Decree of the President of Ukraine No. 467/2016 dated 17 October 2016 as amended on 21 June 2018.



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on the NBU's enhanced requirements on the business continuity of payment systems introduced in line with the Regulation *On Payment Systems and Settlement Systems Oversight in Ukraine* approved by NBU Board Resolution No. 755 dated 28 November 2014 (as amended).

Based on the findings of the assessment, the NBU issued recommendations to Ukrainska Platizhna Systema LLC on improving the business continuity of Finansovyi Svit DTS.

The NBU is constantly working to bring Ukrainian laws and payment oversight practices in line with international best practices in payment security and the protection of consumer rights.

Towards that end, the NBU in 2018 strengthened its oversight of payment system operators, participants, and payment infrastructure operators by:

- introducing organizational and technical requirements aimed at ensuring business continuity
- defining the information that must be recorded by an entity following a breach of business continuity and identifying the mechanism for reporting that information to the NBU.

Also in 2018, the NBU continued to convert to a risk-based approach to oversight based on global best practices.

For that purpose, the NBU developed the *Guidelines for Risk Management in Payment Systems Established by Ukrainian Banks and Nonbank Institutions*.

The document contains general information on the risk management system, payment system risks (legal, financial, commercial, systemic, operational, etc.), and respective management mechanisms. The Guidelines are based on the best international practices of central banks and the approaches used by expert missions on the oversight of payment systems from the World Bank and the IMF.

The document is intended to be used by resident payment systems operators to improve the quality of the documents that are submitted to the NBU as required under law. The implementation of the Guidelines will improve risk management in the payment systems.

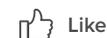
Also, the Comprehensive Program for the Development of Ukraine's Financial Sector until 2020 includes the continued development of the oversight of payment systems in terms of risk management.

With due consideration to international oversight standards and in line with the recommendations²⁵ from the IMF's technical mission to Ukraine in 2018, the NBU Board has approved a decision to expand the oversight function.

Once the legislative framework is amended, the list of entities subject to oversight will expand to include equity market infrastructures that are commonly regarded as systemically important for the national economy. In Ukraine these entities include:

- the central depository (today, the National Depository of Ukraine)
- the central counterparty (at present, part of this function is assigned to Settlement Center PJSC).

Oversight of these entities covers verification of operational compliance with international standards and, as necessary, drafting recommendations to improve performance. Already in 2019, the NBU will conduct a preliminary assessment of the National Depository of Ukraine's operational compliance with the PFMI.



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²⁵ International Monetary Fund Report: Strengthening the Payment Systems Oversight Function (June 2018).



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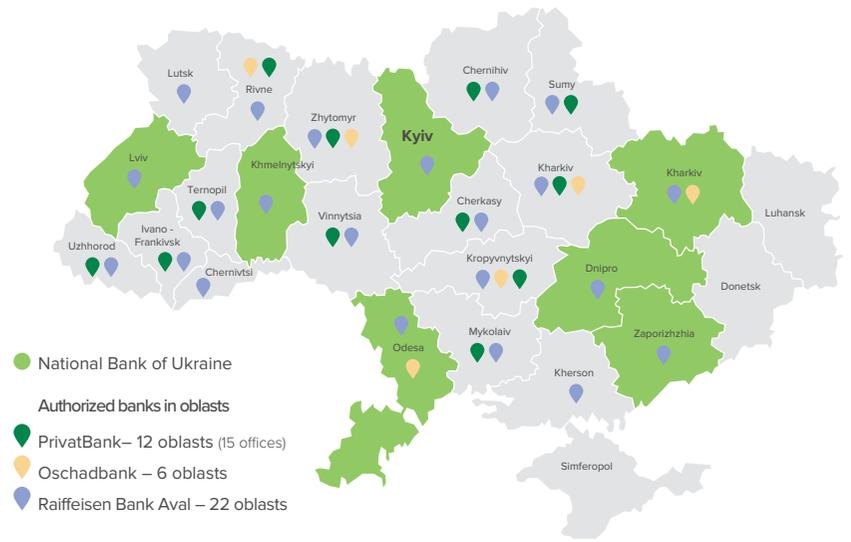
In 2018, the NBU worked to implement its cash circulation policy, which was approved by NBU Board Decision No. 207-D, dated 11 August 2016 (the "policy").

As required by the Law of Ukraine *On the National Bank of Ukraine*, the NBU continued in 2018 to transfer its cash inventories into the custody of authorized banks in all oblasts (including the government-controlled areas of Donetsk and Luhansk oblasts), in proportion to the limits set on the amounts each bank is allowed to store. This activity also included banks in Kyiv and Kyiv oblast under agreements with Oschadbank JSC, PrivatBank PJSC, and Raiffeisen Bank Aval PJSC.

The NBU also streamlined the procedure for transferring its cash inventories into the custody of authorized banks. On 25 July 2018, the NBU Board adopted Decision No. 478-D on transferring its cash inventories to authorized banks.

In 2018, the central bank transferred UAH 42.3 billion in cash to authorized banks, which the banks used to replenish cash desk inventories. At the same time, the NBU withdrew cash worth UAH 5.1 billion from its inventories kept in custody, including UAH 2.95 billion in unfit banknotes.

Cash handling by authorized banks in the oblasts of Ukraine as of December 2018



In 2018, the NBU continued to outsource cash handling to third parties (CIT companies). Cash handling will be conducted according to rules set by the central bank and supervised by the regulator. As of early 2019, six CIT companies provided cash collection services to 60 banks, 265 business entities, and 738 bank branches, and collected cash from 396 ATMs and 63 self-service kiosks. In 2018, the NBU inspected the cash collection activities of and compliance with licensing requirements of five CIT companies.

With a view to handling cash quickly, reliably, and effectively, the central bank in 2018 improved its software for transferring cash inventories to authorized banks, which is part of the central bank's centralized system for automating cash circulation.

The NBU continued to make internal changes and centralize functions by streamlining cash handling in Volyn, Kherson, and Chernivtsi oblasts (NBU Board Decision No. 453-D, dated 19 July 2018).

The central bank also introduced a more flexible cash flow management system designed to enable quick and effective management of the



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value of cash and to promote cashless payments, as outlined in the Comprehensive Program for the Development of Ukraine's Financial Sector until 2020. These changes were made in accordance with NBU Board Decision On Approving Changes to the Action Plan for Implementing Cash Circulation Policy No. 309-D, dated 4 June 2018.

With a view to improving cash handling by Ukrainian banks, and pursuant to the Law of Ukraine *On Currency and Currency Operations*, the NBU amended the Instruction *On Cash Handling by Ukrainian Banks* (NBU Board Resolution No. 103, dated 25 September 2018, as amended).

In order to improve the procedure for issuing licenses to legal entities to provide cash collection services to banks and to expand the list of allowable cash handling services, the NBU amended the Regulation *On Licensing Legal Entities to Provide Cash Collection Services to Banks* (NBU Board Resolution No. 150, dated 22 December 2018).

The central bank also improved its cash issuing and cash handling procedures (NBU Board Decisions No. 3-D dated 9 January 2018, No. 332-D dated 12 June 2018, and No. 864-D dated 2 December 2018).

The central bank has recommended that legal entities (regardless of business organization type or ownership form) and sole proprietors round off bill totals for goods (works, services) from 1 July 2018. The NBU made this decision to improve currency circulation and to decrease the cost of currency circulation, as outlined in Articles 7, 15, 33, 34, 39, 40, and 56 of the Law of Ukraine *On the National Bank of Ukraine* and Articles 598 and 604 of Ukraine's Civil Code (NBU Board Resolution No. 25 *On Streamlining the Circulation of Small Denomination Coins*, dated 15 March 2018).

The central bank also revised the rules for business entities entering cash onto their books and for private individuals making payments of up to UAH 50,000 to business entities. These changes were reflected in NBU Board Resolution No. 54 *On Amendments to Some NBU Regulations*, dated 24 May 2018.

New 1- and 2-hryvnia coins were issued into circulation on 27 April 2018.



On 25 September 2018, the NBU entered the 20-hryvnia banknote into circulation. The note was designed in 2018 and incorporates improved security features.



In 2018, the central bank manufactured numismatic products that mark the 100th anniversary of the Ukrainian revolution of 1917 – 1921, complying with Presidential Decree No. 17, dated 22 January 2016. The central bank produced the following commemorative coins:

- 100 Years Since the Establishment of Ukraine's National Academy of Sciences (silver, nickel silver)
- The Centenary of the Establishment of Ukraine's Academy of Sciences (a set of gold-plated, pad-printed silver coins)
- 100 Years Since the Issuance of the First Ukrainian Postage Stamps
- 100 Years Since the Establishment of Vernadsky Tavrida National University
- 100 Years Since the Creation of the Ukrainian Navy



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The NBU also produced the following souvenir products:

- the 100-hryvnia souvenir banknote (it reproduces the design of the Ukrainian 100 hryvnia banknote that was put into circulation on 17 October 1918)
- Coins of Ukraine of 2018 (a set).

In 2018, the NBU also launched special issues of 10-hryvnia commemorative coins made of non-precious metals (zinc-based alloy). These coins are legal tender in Ukraine and are dedicated to national topics:

- Defenders of Donetsk Airport
- Ukrainian Volunteer Day
- 100 Years since the Creation of the Ukrainian Navy.

The NBU also issued the commemorative coin "I Give my Heart to the Children" to mark the centenary of Vasyl Sukhomlynsky's birth, an event which UNESCO also commemorated.

In terms of technical innovations, the NBU released six-sided silver coins that celebrate the centenary of the Establishment of Ukraine's Academy of Sciences and the elliptical silver medal Mariinsky Palace. These coins were made using pad printing (a type of color printing), as well as gold-plating, cold enamel, and patination techniques.



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National Bank of Ukraine started publishing new statistics on deposits of individuals. It reflects the amount of possible reimbursement by Deposit Guarantee Fund



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5 Free Movement of Capital

#currency #liberalization #BEPsinUA

Development of Capital Market Infrastructure

The Law of Ukraine

On Currency and Currency Operations

enacted as of 7 February 2019



for the first time in the history of Ukraine's independence

In terms of the free movement of capital, in 2018 the Verkhovna Rada of Ukraine adopted the Law of Ukraine *On Currency and Currency Operations*. The law was developed by the National Bank of Ukraine and the European Commission and supported by the relevant Verkhovna Rada committee. That law has allowed parliament to dismantle the repressive and complicated system of currency regulation that has been in place since Ukraine gained independence. The system was made up of dozens of regulations, restrictions, and limits for businesses and individuals, and it banned currency transactions that did not comply with the legislation.

In compliance with the Law, the NBU has developed a liberal and transparent system for currency regulation that represents the opposite approach: everything which is not forbidden is allowed. The new system is made up of eight major regulations issued by the NBU Board and is aimed at gradually deregulating investments, simplifying international operations, and expanding the list of allowed currency transactions. Since the law came into effect on 7 February 2019, nearly 30 currency restrictions that had impeded businesses and discouraged investment inflows have been lifted.

Under the NBU's vision, the lifting of key currency-related restrictions will:

- herald a risk-based approach to supervision that will replace the outdated system of currency control
- the new system will eliminate the need for businesses to deposit hryvnia to purchase foreign currency
- double the settlement requirement for import/export contracts to 365 days
- reduce the requirement to sell foreign currency earnings from 50% to 30%
- allow resident legal entities abroad to freely use their accounts and allow nonresidents to open accounts in Ukraine
- replace individual licenses for currency transactions with a system of electronic limits
- allow individuals to make online purchases of foreign currency.

Before introducing the new currency regulation system, the NBU with IMF experts presented a roadmap to currency liberalization. Ukraine has also declared it will not reverse course on plans to lift all foreign currency restrictions. The country has also committed to adopt laws to streamline the regulation of the nonbank financial market (draft law *On the Split*) and prevent unproductive capital outflows from Ukraine (the draft law developed by the NBU and the Ministry of Finance to combat BEPS).

In 2018, the NBU succeeded in gradually embracing the free movement of capital, which is an obligation for Ukraine under the Association Agreement with the European Union. The transfer from absolute control over all currency transactions to a modern system of risk-based supervision and abolishment of the large number of currency restrictions helps ease business conditions, improves Ukraine's investment climate and spurs the inflow of foreign capital, and promotes sustainable economic growth.

In 2018, the legislation on depository activities was amended, including, most importantly, the procedure for placing domestic government bonds with customers of primary dealers (brokerage agreements), which has granted private investors access to the primary market for government securities.



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In 2018, the NBU continued to establish long-term correspondent relationships with international depository. Talks on opening accounts between the NBU depository and international depository Clearstream have reached their final stage. In particular, the approval of final procedural issues and technical terms, as well as operating conditions for the international depository in Ukraine have been started.

The execution of the agreement is planned for Q1 2019 and that will mark a major step in the process of improving Ukraine's capital market infrastructure. Correspondent relations with the international depository are meant to simplify access for foreign investors to the Ukrainian market and consequently improve the appeal and liquidity of government securities, spur foreign capital inflows, reduce the cost of Ukrainian government borrowings, and ensure financial stability.



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#NBU Explains Reasons for Applying Corrective Measure to MEGABANK JSC: <https://bit.ly/2Hrh9Ri>



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6 Financial Inclusion

#finliteracy #finclusion #cashless #GMW2018

Providing Ukrainian Citizens with Access to Financial Services



Financial inclusion refers to access to financial products and services for all individuals. The process of improving inclusion has intensified in Ukraine recently. Greater innovation in the financial sphere has provided households with new and inexpensive financial services.

As seen globally, financial inclusion is essential to decrease poverty and create opportunities for economic growth. Greater access to digital financial services leads to the development of a new digital economy. Financial inclusion streamlines daily tasks and helps individuals and businesses to plan for the long term and deal with unexpected situations.

Financial inclusion has become a top priority for many governments, as each state must ensure the involvement of all citizens in its financial system.

Based on research by the World Bank Group, as of the end of 2017, 1.7 billion adults (31% of the global population) do not have even a basic bank account.

In Ukraine, 37% of adults do not. Two thirds of them cite a lack of funds

as the main reason for not having a bank account. This indicates that financial services are still not widely available to low-income Ukrainians. Other reasons for a lack of involvement in financial services both in Ukraine and in other countries include access to providers of financial services, red tape, and distrust in financial institutions.

Financial inclusion is the NBU's sixth strategic goal. The NBU is currently developing a holistic national strategy to enhance the financial involvement of Ukrainians. The strategy is aimed at engaging all Ukrainians in the country's financial system.

In addition, the NBU has continued working on a strategy to enhance financial literacy, which will be presented to the public in summer 2019. The strategy is aimed at raising the public's awareness of the secure use of financial services and household budget planning.

Another priority is to improve the protection of the rights of financial services consumers by enhancing financial awareness. Individuals who know their rights and understand a particular financial service can effectively take advantage of the service and better manage their savings.

An important step towards financial inclusion is Ukraine's accession to the International Network on Financial Education (INFE) of the Organisation for Economic Co-operation and Development (OECD).

By joining INFE, Ukraine has finally become part of the international community that is focused on financial education and financial literacy. INFE is a key international platform for the analysis and research of financial literacy. Membership allows Ukraine to conduct research on financial inclusion under INFE's internationally recognized methodology on an equal basis with other countries. This, in turn, allows researchers from other countries to analyze the financial competence of Ukrainians. In 2019, the NBU will conduct a study on the financial literacy of Ukrainians using international methodology.



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The International Network on Financial Education (INFE)

The International Network on Financial Education (INFE) was established within the Organisation for Economic Co-operation and Development in 2018. The INFE promotes international cooperation on financial education between state bodies and other stakeholders all over the world. It serves as a platform for collecting data and news on financial literacy and preparing analytical and benchmarking reports, research, policy tools, and strategies. Over 115 countries are part of the INFE community.

The INFE's areas of focus include:

- national strategies for financial education
- evaluation of financial literacy
- financial education for youth
- protection of the rights of consumers of financial services
- evaluation of financial education programs
- financial education for women.

Ensuring the Rights of Individuals with Reduced Mobility

As required by the NBU, Ukrainian banks will improve inclusiveness by ensuring access to the premises where they provide services to disabled individuals and other individuals with reduced mobility, in accordance with state building standards.

This requirement is part of the new regulation on bank licensing. Compliance with the building standards must be certified. If a premises cannot fully meet the needs of disabled individuals, it must be adapted as best as possible using universal design principles.

Banks are to bring their premises in line with the accessibility requirement in stages:

- in 2019: at least 50% of all premises located in Kyiv, oblast centers, and cities with population of over 300,000, at least 30% of premises in all other areas of Ukraine must comply
- in 2020: all premises in Kyiv, oblast centers, and cities with population of over 300,000, at least 70% of premises in all other

areas of Ukraine must comply

- in 2021: all premises must be compliant.

Financial Inclusion Forum 2018

In June 2018, the NBU and MasterCard Ukraine organized Finclusion UA, Ukraine's first forum on financial inclusion. This was a powerful platform that played host to high-level discussions.

The forum focused on financial inclusion, the roles of the state and businesses in building financial inclusion, and local and global practices of creating a financially inclusive society.

Experts from Azerbaijan, Poland, Singapore, and Sweden, as well as key players from Ukraine's financial market discussed the following:

- how to involve individuals in financial services
- how businesses and the state should work together to promote financial inclusion
- a look at practices that other countries have introduced on the path to creating a financially inclusive society and which practices are feasible in Ukraine
- ways to promote cashless settlements and financial security
- how financial inclusion will influence the future economy.

The forum was attended by 220 individuals from the financial sector, businesses, government, the diplomatic corps, financial and educational associations, and the media.



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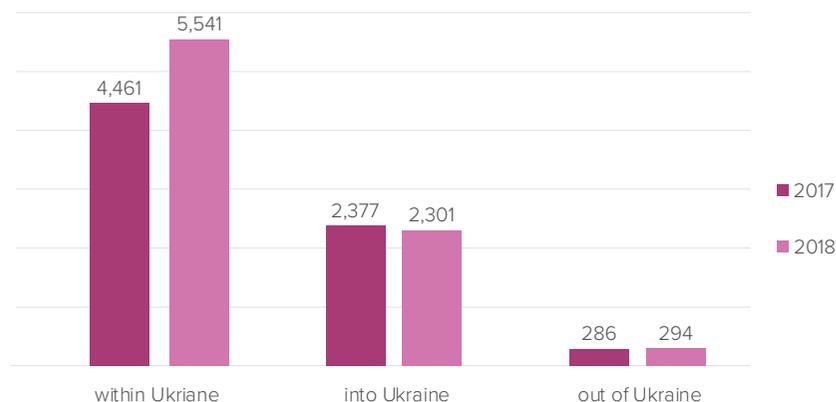


Operation of Money Transfer Systems

In 2018, 35 money transfer systems operated in Ukraine, including 281 established by residents and 7 by nonresidents.

In 2018, the following transactions took place across Ukraine's money transfer systems by residents and nonresidents:

Volumes of transfers via money transfer systems, USD million (equivalent)



- UAH 150.534 billion in domestic transfers (equal to USD 5.541 billion)
- USD 2.301 billion into Ukraine (converted to USD)
- USD 294 million abroad (converted to USD).

Operation of Money Transfer Systems Established by Residents

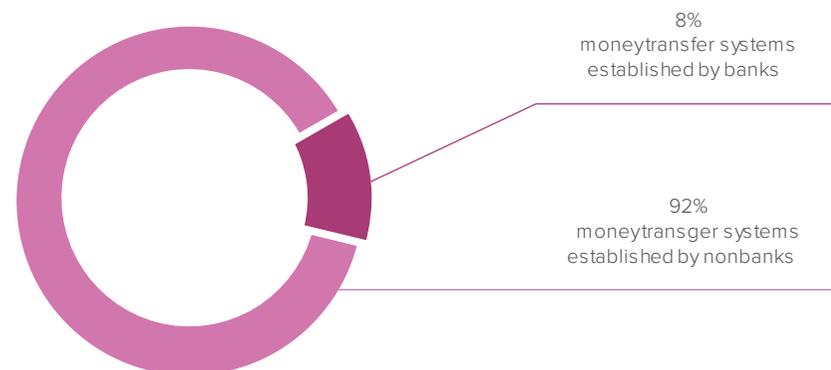
In 2018, 8 money transfer systems established by banks, 12²⁶ systems set up by nonbank institutions, and 8 by interbank transfer systems operated in Ukraine.

The following amounts were transferred via money transfer systems established by banks and resident nonbank institutions in 2018:

- UAH 150.49 billion in domestic transfers (equal to USD 5.539 billion)
- USD 222 million into Ukraine (converted to USD)
- USD 2 million abroad (converted to USD).

In 2018, Poshtovyi Perekaz became the top money transfer system in terms of domestic transfers (equal to USD 1.460 billion).

Payment transfers through money transfer systems within Ukraine in 2018 (volumes)



²⁶ On 22 June 2018, the registration of TYME payment system (FC OMP-2013 LLC) was cancelled.



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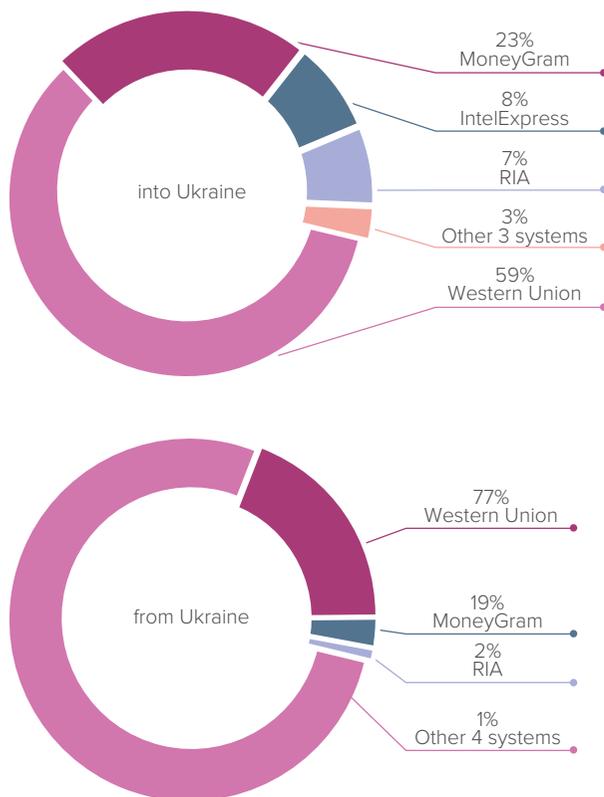
Operation of Money Transfer Systems Established by Nonresidents

In 2018, 7 money transfer systems established by nonresidents operated in Ukraine, including three from the US and one each from Georgia, the UK, Canada, and Azerbaijan.

In 2018, payment systems established by nonresidents executed the following transfers:

- UAH 44 million in domestic transfers (equal to USD 2 million) domestic transfers
- USD 2.079 billion into Ukraine (converted to USD)
- USD 292 million abroad (converted to USD).

Value of cross-border transfers via nonresident systems



Western Union accounts for the greatest share of transfers to Ukraine and abroad in 2018 (59% of cross-border transfers to Ukraine and 77% to foreign destinations).

Ukraine remains a net recipient of cross-border transfers. In 2018, the amount received in Ukraine through international money transfer systems was eight times larger than the amount sent abroad.

The largest transfers to Ukraine came from the US (17%), Israel (13%), and the Russian Federation (9%). In 2018, the largest transfers from Ukraine were to Russia (36%), Georgia (10%), and China (6%).

Opening Accounts for Customers by Banks

As of 1 January 2019, Ukrainian banks provided services to 56.7 million customers, including:

- to 2.3 million businesses, including 1.3 million sole proprietors
- to 54.4 million individuals.

94.3 million accounts were opened by bank customers.

4.9 million accounts were opened for business entities, including:

- 4.7 million current accounts
- 0.2 million deposit accounts.

Over 31% (1.5 million) of business entities' accounts are serviced remotely; customers can track account balances and execute transactions in real time.

89.4 million accounts were opened for individuals, including:

- 71.4 million current accounts
- 18 million deposit accounts.

Over 4.5 million retail accounts are serviced remotely. Payment cards were issued for 59.2 million accounts.

In 2018, the number of accounts opened by business entities grew 14%. Current account openings increased 12% and deposit accounts 25%.

At the end of the reporting year, the NBU approved a decision to introduce the IBAN bank account number in Ukraine (ISO 13616).



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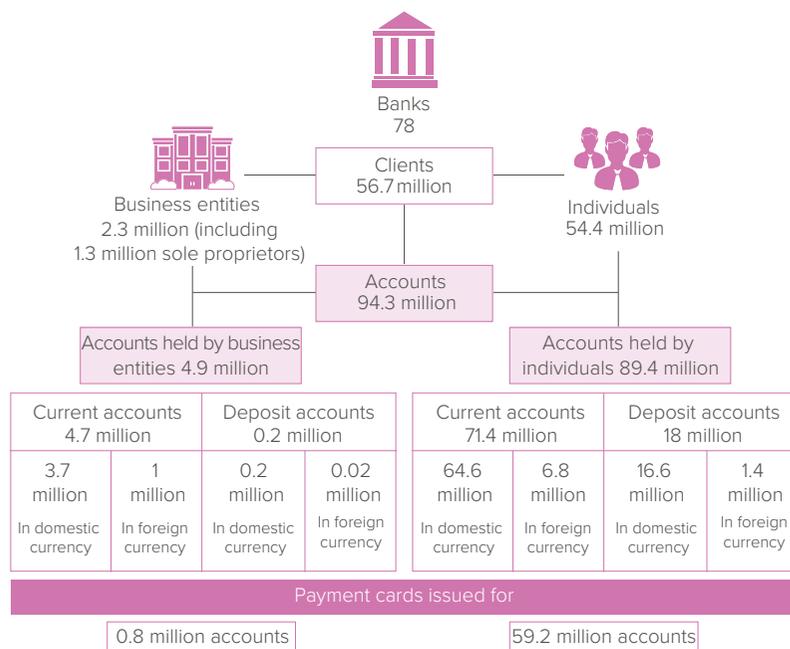
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Banks are expected from 5 August 2019:

- to open new accounts for their customers using the IBAN standard
- to change existing bank accounts over to IBAN, while maintaining the existing numbers for analytical purposes. Under the new approach, a country code and a bank code will be added to existing bank account numbers.

Number of customers and accounts with Ukrainian banks as of 1 January 2019



Using the IBAN number will become mandatory for all Ukrainian banks for money transfers in domestic and foreign currencies, including cross-border transfers. In other words, all transfers will be conducted only using IBAN.

This will allow bank customers to:

- identify the payer and the payee easily and conveniently

- avoid mistakes in bank account details thanks to fewer details in payment documents.

The NBU intends to introduce QR codes for payments between payment market participants. QR codes containing IBAN details will simplify the payment of invoices and the exchange of payment information.

Number of Cashless Payment Card Transactions

In 2018, the NBU continued to improve control and transparency of cash flows and mitigate the consequences of the shadow economy by reducing the share of cash in circulation and increasing cashless transactions.

Share of cashless transactions within the total volume/number of payment card transactions, %



The growth trend in card-based cashless transactions issued by Ukrainian banks was positive in 2018:

- the value of transactions increased to a 45.1% share of all transaction, or 5.8 pp higher than in 2017
- the number of operations rose to a 78.5% share, or 3.7 pp higher than in 2017.

In 2018, holders of payment cards issued by Ukrainian banks made 3.9 billion transactions, up 26.7% from 2017, and the value of those transactions rose 35.4% to nearly UAH 2,876.5 billion.



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Volume of payment card transactions, UAH billion



Number of payment card transactions, million



Of those card transactions, 63.6% of the number and 80.2% of the value were executed in the proprietary network of the issuing banks. Other resident banks executed 34.3% transactions that account for 16.0% of the total value of the transactions. The number of foreign transactions remains the lowest at 2.2% of all transactions (3.8% of transaction value).

In 2018, just 1.7% of all transactions (2.3% of transaction value) were conducted in Ukraine using payment cards issued by nonresident banks.

The value of cashless payment card transactions continues to grow. In 2018, the value of those transactions increased 55.4% to UAH 1,297.4 billion and the number grew by 3.1 billion, or a 33.0% increase yoy.

The cashless payment card transactions can be broken down as follows:

- card-to-card transfers: 35.8% of the total value (a 9.4 pp increase yoy) and 8.8% of the total number

- online transactions: 32.6% of the total value and 38.1% of the total number
- in retail stores: 29.3% of the total value and 51.2% of the total number
- via self-service devices (ATMs, self-service payment kiosks (SSKs) etc.): 2.2% of the total value and 1.9% of the total number.

Also, 2018 saw rapid growth in card-to-card transfers. Their value more than doubled yoy to hold the largest share of cashless transactions (35.8%).

The number active of active payment cards²⁸ increased 6.0% from early 2018 to 36.9 million as of 1 January 2019. There are also 4.0 million contactless cards, up 44.3% from early 2018.

Number of payment cards issued by Ukrainian banks, million pcs



As of 1 January 2019, the number of magnetic stripe cards increased 12% to 30.4 million to account for 82.3% of all active payment cards. Overall, the number of magnetic stripe and chip payment cards decreased 15% to 6.3 million.

Despite the significant number of magnetic stripe cards, smartphone- and gadget-based contactless payment services supporting NFC technology are growing in popularity in Ukraine. Tokenization services enable the use of payment card details, as well as magnetic stripe-only cards for contactless settlements using this technology.

²⁷ Active cards are those with at least one debit operation over the last three months.



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Of all payment cards, MasterCard accounts for 26.0 million (70% of the market), Visa for 10.5 million (28%), PROSTIR NPS for 0.5 million (1%), with 0.004 million others.

In 2018, Ukraine's payment infrastructure also continued to evolve.

The number of trade and service business entities that offer customers the option to make cashless card payments rose by 34,900 (up 20.1% from the start of 2018) to 208,700.²⁸

As of 1 January 2019, Ukraine's POS terminal network grew 18% from the start of 2018 to 297,300. That growth was driven by an increase in commercial POS terminals from 232,100 to 279,000, a 20% increase from the start of 2018. On the other hand, the number of bank ATMs decreased 7% to 18,300.

Innovative services like Apple Pay and Google Pay have helped the development of contactless payment infrastructure in Ukraine. As of 1 January 2019, 79.4% of all POS terminals in Ukraine (207,300) offer contactless payments.

Payment terminals (thousand pcs)



On a per-capita basis, the number of POS terminals increased 18% yoy to 7,100 per million as of 1 January 2019.

At the same time, Ukraine's POS network is still unevenly distributed and is growing too slowly. Western Ukraine and Luhansk and Donetsk

oblasts have the lowest number of payment devices, while the city of Kyiv and Dnipropetrovsk and Kharkiv oblasts have the most.

Since the beginning of 2018, the number ATMs (including deposit ATMs) has hardly changed and stood at 20,000 as of 1 January 2019. The number of self-service kiosks (SSK) decreased 3% last year to 16,600.

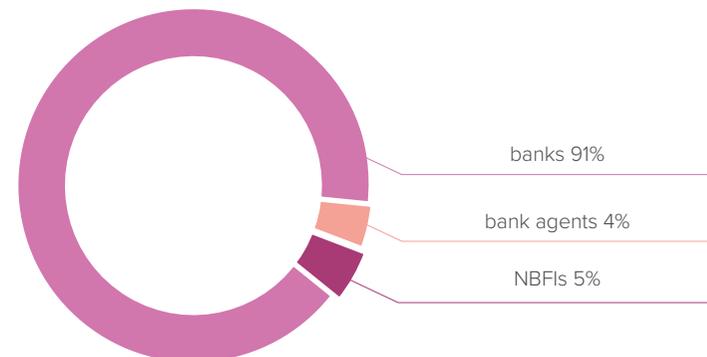
CB PrivatBank PJSC, Oschadbank JSC, and Raiffeisen Bank Aval JSC remain the top banks with respect to the number of payment cards issued and the network reach of their card processing infrastructure.

Accepting Cash Payments for Further Transfer

As of 1 January 2018, the following institutions accepted cash in hryvnias for further transfer:

- via payment devices: 15 – nonbank financial institutions (NBFIs); 7 – bank agents; 31 – banks using their own payment devices

Cash payments accepted via payment devices by value



- cash acceptance points: 20 – NBFIs and 15 – bank agents

²⁸ As of 1 January 2019, the number of POS terminals of commercial and service business entities that are part of the data that Ukrposhta JSC provided to the NBU within the framework of a pilot project for filing reporting statements (starting from Q1 2019, this type of data will be required for filing under Rules No. 120).



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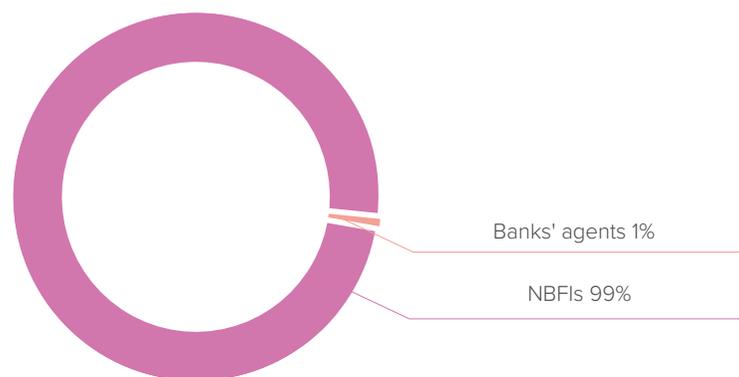
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Cash payments accepted via cash acceptance points by value



In 2018, the service market showed the following trends with regards to cash payment acceptance by payment devices (yoy):

total number of payment devices decreased by 8,500, specifically:

- nonbank financial institutions – by 3,200 as certain nonbank financial institutions stopped accepting cash payments
- bank agents – by 7,200 as bank liquidation reduced the number of agents
- the number of bank payment devices increased by 1,900 units

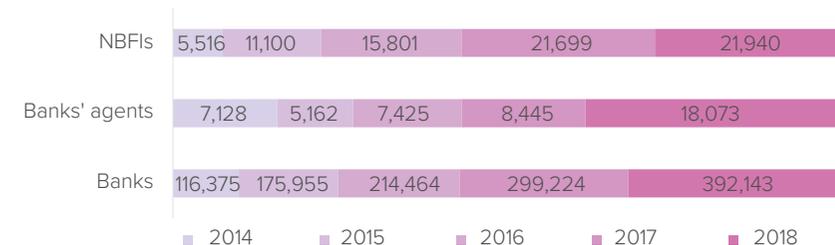
Payment devices, thousand units



cash accepted via payment devices rose by UAH 102,788:

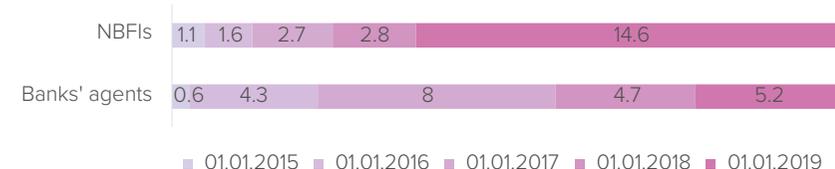
- nonbank financial institutions – by UAH 241 million
- bank agents – by UAH 9,628 million, driven by IBox LLC as the top bank agent
- banks – by UAH 92,919 million, driven by PrivatBank as the top bank.

Cash payments accepted via payment devices, UAH million

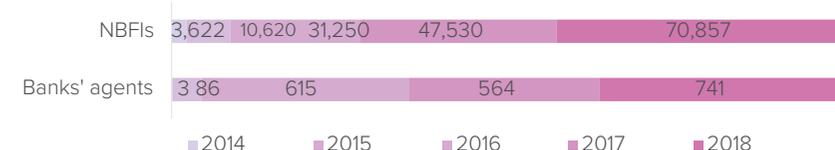


ket accepting cash via cash acceptance points grew both in cash acceptance points and accepted cash payments.

Cash acceptance points, thousand



Cash payments accepted via cash acceptance points, UAH million



In general, 2018 saw rapid growth (76% yoy) in cash payments accepted via cash acceptance points at NBFIs. This growth can be largely attributed to Ukrposhta PJSC, which was granted license No. 64 for



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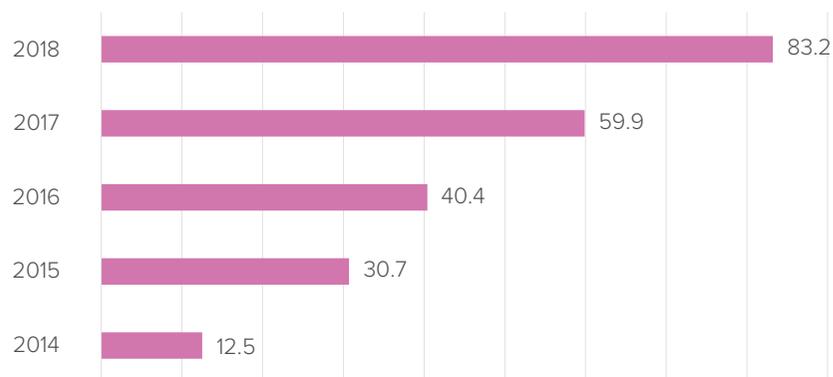


domestic currency transfers without opening accounts dated 17 April 2018 by the NBU and started submitting statistical reporting.

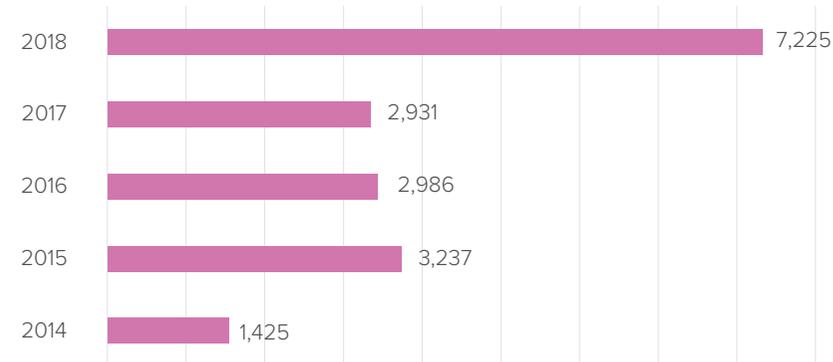
E-money

The e-money market has grown rapidly in Ukraine over 2014-2018.

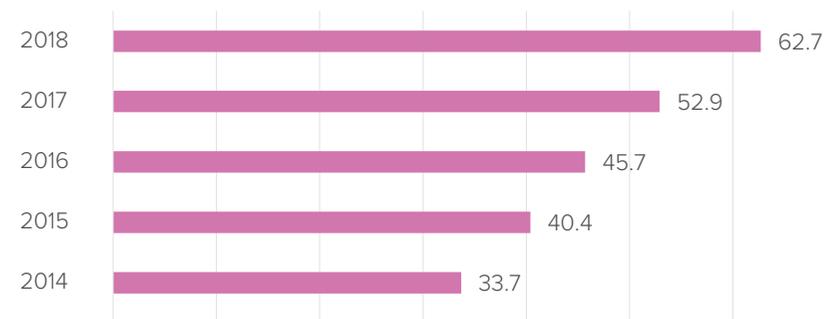
E-money issued, UAH million



Volume of transactions, UAH million



Total number of e-purses, million pcs



In 2018 compared with 2017, banks increased:

- e-money issuance from UAH 59.9 million to UAH 83.2 million (up 40%)
- the value of e-money operations from UAH 2,931 million to UAH 7,225 million (up almost 2.5 times)
- the number of e-wallets from 52.9 million to 62.7 million (up 19%).

In 2018, the following banks issued e-money and conducted e-money transactions:

- FORPOST (ALFA-BANK PJSC)
- Maksi (TASCOMBANK JSC)
- GlobalMoney (CB GLOBUS PJSC)
- XPAY (BANK SICH JSC)
- ELECTRUM (UKRGASBANK JSB)
- ALFA-MONEY (ALFA BANK JSC)
- MasterCard (BANK VOSTOK PJSC, ALFA-BANK PJSC, TASCOMBANK JSC, CB PrivatBank PJSC, FUIB PJSC, OSCHADBANK JSC)
- Visa (CB PrivatBank PJSC, OSCHADBANK JSC, FUIB PJSC, INDUSTRIALBANK JSCB)
- PROSTIR (UKRGASBANK JSB, ALFA-BANK JSC, UNEX BANK JSC, PRAVEX BANK JSC).





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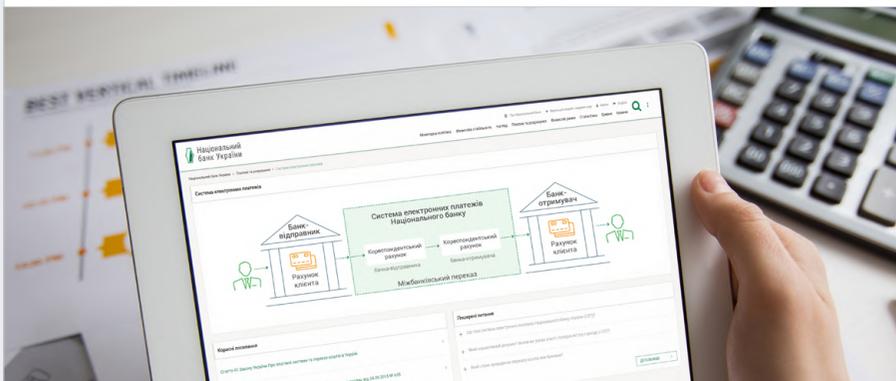
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NBU System of Electronic Payments



In 2018, the NBU ensured the reliability of domestic interbank transfers and created the conditions to meet the needs of interbank market participants.

SEP. Facts and Figures 2018

Currency	UAH
Settlement model	Real-time gross settlement (RTGS) system
Operating mode	file and real-time mode
Importance category	systemically important payment system
SEP capacity	10 million payments per banking day
System corporate participants as of January 2019	79 Ukrainian banks The State Treasury Service of Ukraine The NBU
Number of transactions in 2018	357 million payments
Value of transactions in 2018	UAH 25 trillion
Daily average transactions	1.4 million payments UAH 101 billion
Structure of payments (number)	under UAH 1,000 – 53% UAH 1,000 – UAH 100,000 – 43% over UAH 100,000 – 4%

Structure of payments (value)

under UAH 1,000 – less than 1%
UAH 1,000 – UAH 100,000 – 7%
over UAH 100,000 – 92%

In 2018, the new generation of the SEP (SEP-3) was launched. The system was transferred onto a new platform (commercial server environment application), which improved its speed and reliability.

In 2018, the SEP handled 357.2 million transactions (1.43 million average per day) at a value of more than UAH 25.3 trillion. The daily average ratio of cash circulation was 1.59, maxing out at more than 3.7. Overall in 2018, the number of transactions handled by the SEP grew 7%, their value grew 21%, and the ratio of cash circulation increased 59%.

Future development initiatives for the SEP include aligning its financial messaging with international standards and implementing innovative instruments for cashless transfers. First and foremost, this includes the implementation of ISO 13616 (IBAN) and ISO 20022, which carry new functional options and harmonize the system with European and international payment infrastructures, directives, and standards. In addition, a priority in modernizing the SEP is to implement instant payments, lay the groundwork for 24/7 operations, fully update the NBU's system for cryptographic information security, and expand the functionality and information content of messages.

Last year was notable for the following:

- development of the terms of reference for the new generation of the SEP (code name SEP-3.2)
- development and provision to SEP participants of new formats for information exchange through the SEP
- development of SEP software
- ensuring operation of SEP-3.2 platform for SEP participants.



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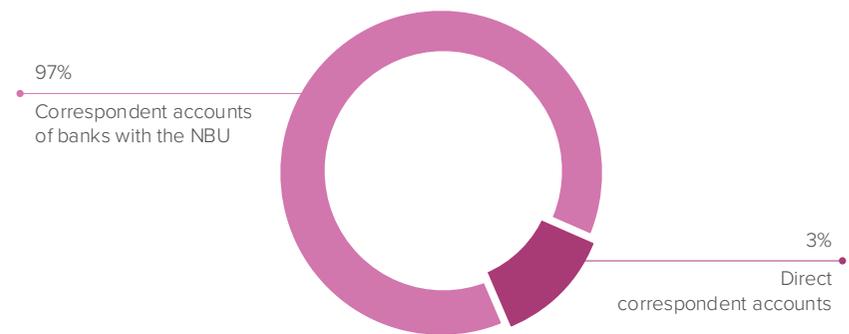
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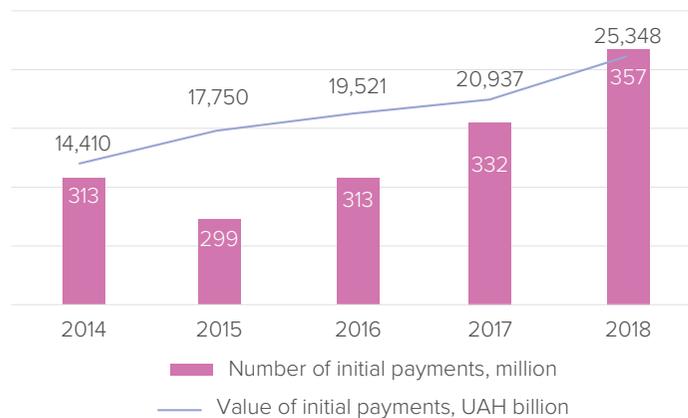
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Interbank hryvnia transfers through direct correspondent accounts and through the SEP, %



Value of payments through the SEP



Daily average ratio of cash circulation in the SEP



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PROSTIR National Payment System



At the beginning of 2018, the NBU approved the Development Strategy for the PROSTIR Ukrainian Payment Area National Payment System (PROSTIR NPS) until 2022. Also in 2018, the NBU achieved the strategy's targets in terms of the expansion of infrastructure for the acceptance of PROSTIR NPS cards and in introducing new products and innovative technology.

Participants, Card Issuance, and Transactions with Payment Cards in PROSTIR NPS

As of 1 January 2019, 50 Ukrainian banks and the national postal service were participants in PROSTIR NPS. Of those, 25 banks were involved in the acquisition and issuance of PROSTIR NPS payment cards.

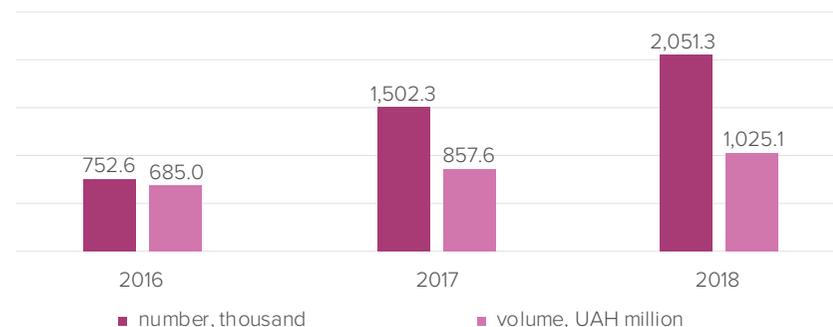
In 2018, PROSTIR NPS finalized new agreements with five banks, the national postal service, and an independent processing center (EASY SOFT LLC). At the same time, five banks ended their participation in PROSTIR NPS as they stopped operating on the Ukrainian market.

As of 1 January 2019, 586,200 PROSTIR cards were in service. Of the total, 459,400 cards were in active use. This represents 78% of all of the system's cards, an 11 pp increase yoy.

In 2018, the value of PROSTIR NPS card transactions increased 31.8% yoy to UAH 21.4 billion. The number of transactions reached nearly 10 million.

Of all PROSTIR NPS card transactions, 79.1% are executed within the proprietary network of issuing banks. The Central Router of PROSTIR NPS processed almost 2.1 million interbank transactions in 2018 (a 37% increase yoy), with the value of those transactions rising 20% to UAH 1,025.1 million.

Interbank transactions via PROSTIR cards



PROSTIR NPS Payment Infrastructure

In 2018, PROSTIR NPS expanded its infrastructure for payment card acceptance. As of 1 January 2019, 95% of all retail POS terminals in Ukraine accept PROSTIR NPS cards. This represents a 10 pp increase over the course of 2018.

As of 1 January 2019, 17,000 ATMs serviced PROSTIR NPS payment



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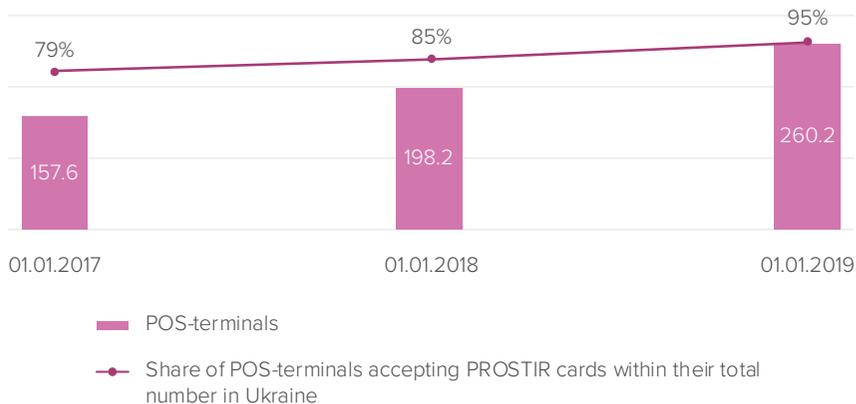
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cards, 85% of all ATMs in Ukraine, a 5 pp increase over 2018.

POS-terminals accepting PROSTIR cards (thousand)



Key achievements by PROSTIR NPS in 2018:

- payment infrastructure accepting PROSTIR NPS cards expanded by 95%
- introduced a service for transacting interbank transfers between PROSTIR cards and international payment system cards
- introduced additional verification for secure online settlements
- expanded the product range with the introduction of PROSTIR Klasychnyi and PROSTIR Vynahoroda products
- signed an agreement between PROSTIR NPS and UnionPay International to issue co-badged PROSTIR–UnionPay cards
- implemented an e-money PROSTIR NPS project with a telecommunications company
- executed multiple initiatives for PROSTIR NPS payment card holders to promote the brand and the system's services.



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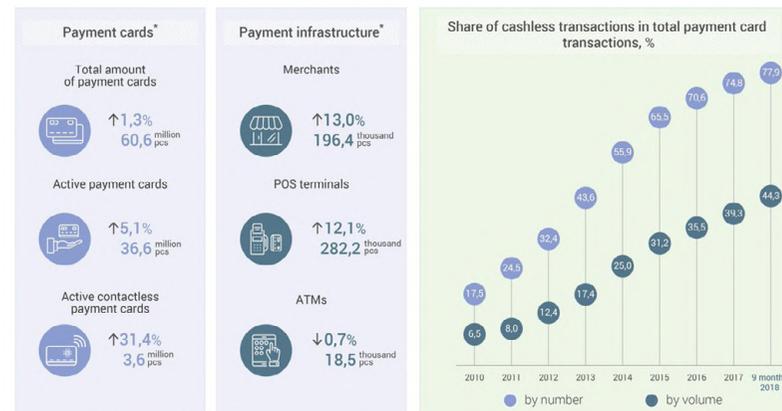
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#NBU: Payment card market growth reflects real demand for cashless operations and innovation technologies.



Payment cards market Q3 2018

Indicators of the payment cards market for nine months of 2018



*as compared to the beginning of 2018. For reference: As of 1 October 2018, 76 banks operating in Ukraine were card payment system members.



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Promoting Innovation in Ukraine



The NBU closely monitors innovation in Ukraine's financial sector as its influence on today's market cannot be overstated. Innovative technologies can dramatically change the traditional ways of financial management.

Fintech is a world trend that is growing rapidly.

The expansion of the fintech sector is driven by the following:

- the rapid development of innovative technologies
- the complex IT systems of traditional financial institutions, which cannot quickly adapt and change
- the emergence of a new generation of bank clients and startups that are making inroads across many areas of the economy.

Ukraine's fintech sector is early in its development stages, and the market is limited and focused mostly on online settlements and payments.

The NBU believes significant attention should be given to developing the financial and banking sectors using innovative and digital solutions.

In 2018, the NBU signed an agreement to work with Lithuania's central bank in the area of financial innovation.

The agreement is aimed at sharing experiences and information on regulatory issues, market development trends, and financial services innovations. It is also geared towards joint innovation projects like digital and mobile payments, blockchain and distributed ledgers, big data, APIs, and others.

The NBU also plans to expand its fintech collaboration with other central banks.

In 2018, the NBU worked on projects aimed at facilitating the development of innovative financial services in Ukraine.

As of 5 November 2018, banks can provide services using the NBU's BankID identification system.

Ukrainians can now remotely access those administrative, banking (including opening accounts), financial, and commercial services that require identification.

Now, retail customers must be at a bank in person only for the initial identification process.

Then, as long as the bank that conducts the initial identification is part of the NBU's BankID system, retail customers can use this system to transfer their personal data to other banks or nonbank institutions that are connected to the NBU's BankID system and which offer services to customers.

To open a bank account remotely, a bank must cross-check the identification data it receives:

- from electronic copies of a customer's documents (provided remotely)
- from an electronic signature (used by an individual to sign the data and an agreement with the bank)
- obtained through the NBU's BankID system.

Two banks connected to the NBU's BankID system throughout 2018, with four banks connected as of the beginning of 2019 (Oschadbank JSC, Credobank JSC, JSB RADABANK JSC, MOTOR BANK JSC). Another ten banks have applied to join and are at different stages of the connection process.



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Nonbank financial institutions will also be able to join the NBU's BankID system and configure their remote service channels.

Mobile network operators have expressed an interest in BankID as they have identification and verification requirements in order to transfer subscriber numbers between operators. That functionality is scheduled to launch in May 2019. In addition, other business areas like microcredit, insurance, and securities have shown an interest in BankID.

The NBU also worked to harmonize Ukrainian laws in the area of payments. The NBU intends to bring international best practices to Ukraine, including those for enhancing the security and efficiency of payments and developing the payment services market.

Another area of focus for the NBU was the implementation of the EU PSD2 Directive in Ukraine, which will facilitate innovation by opening the market to new players and new payment methods. This is a large project that will require the cooperation of all payment market participants. The project will deepen Ukraine's integration with the global economy.

In today's world, banks no longer are the sole providers of payment services to customers. Thus, more attention is being given to the operation and accountability of payment institutions, as well as the protection of the rights of financial services consumers and their financial data.

In 2018, the NBU implemented a pilot project to study opportunities for issuing a blockchain-based digital currency – the e-hryvnia.

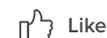
Under this pilot project, a limited volume of e-hryvnia was put into circulation, with e-hryvnia transactions being tested by the members of an initiative group. In addition, the NBU has analyzed international practice, legal implications, and the macroeconomic impact.

In doing so, the NBU obtained insights on the e-hryvnia and valuable practical experience, which has allowed the central bank to understand its capacity and potential to implement similar projects.

The NBU is continuing to study the possible impact of the e-hryvnia on the payment market ecosystem, potential demand for e-hryvnia by individuals and professional market participants, the legal aspects of its

implementation, and more.

With this project, Ukraine is keeping pace with global innovative trends. Innovating and digitalizing financial services is an effective way of enhancing financial inclusion in Ukraine, which is a strategic goal of the NBU for the next two years.



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Enhancing Financial Literacy



The NBU is continuing to work on enhancing the financial literacy of Ukrainians, in particular through regional educational events and participation in a global initiative called Global Money Week.

Jointly with participants from the market, the NBU has continued to run a regional education project called Financial Awareness Days. In April 2018, the project came to Poltava, where over 2,600 guests, including school and university students and teachers, were able to attend:

- lectures by financial markets experts
- financial awareness trainings
- workshops for school and university students
- an exhibition of Ukrainian money and modern commemorative coins by the NBU's Money Museum.

Last year, the NBU visited three more regional centers – Odesa, Sumy, and Zaporizhzhia – to deliver a series of financial lectures for university students.

The NBU also supported an all-Ukrainian tournament for students that had completed an annual course in Financial Literacy. The competition assessed the effectiveness of the course, which had been attended by 20,000 school students. The goal was to identify the most talented students and to involve academics, university students, and postgraduate students to work with them.

The tournament consisted of a regional phase and a two-stage all-Ukrainian phase. The winners were named during the final stage of the all-Ukrainian phase on 3–4 December 2018 in Kyiv.

Global Money Week in Ukraine

In 2018, the NBU participated in Global Money Week for the 6th time. The event brought together the NBU with partners like the USAID Financial Sector Transformation Project, the Ministry of Education and Science of Ukraine, the Banking University, and the Deposit Guarantee Fund.

Participants included volunteers, NGOs, teachers and students of schools, colleges, institutes, and universities, and representatives of financial institutions and companies.

The event took place on 12–18 March 2018 under the slogan "Money Matters" and was made up of a series of learning opportunities and engaging activities for youth, including:

- on 12–16 March 2018, participants from all of Ukraine played Cashflow (a business simulator board game) and took part in financial quizzes, trivia, workshops on family budget planning, round tables, and more. These activities aim to teach youth how to make decisions and learn practical cash flow management skills. Nearly 150,000 school and university students took part.
- on 14–15 March 2018, the NBU's head office hosted debates on the benefits of bank savings and cashless settlements, which allowed the youth of Kyiv to demonstrate their intellectual and speaking skills. Close to 100 students from six higher education establishments in Kyiv took part.
- on 17 March 2018, the NBU hosted a financial simulator game called Life Capital (Ukrainian version of the Cashflow board game) for post-secondary students in Kyiv. The game brought together over 120 youth at 14 gaming tables. Throughout the day, players were able to acquire practical skills for real-life financial decision-making.
- on 18 March 2018, the NBU held its first Doors Open Day for 500 family and friends of NBU employees. This was the last event of Global Money Week. Guides (volunteer employees of the NBU) gave 21 tours of the NBU's head office. The US Ambassador to Ukraine Marie Yovanovitch and other US embassy officials visited the NBU.



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For Global Money Week, the NBU's Money Museum prepared a new program for school and university students, which featured:

- a tour called The 100th Anniversary of the Ukrainian Revolution
- a general tour in the form of an interactive quest
- a series of lectures, including Currency Circulation in Ukraine in the Days of Kyivan Rus, Currency Circulation in Ukraine During the Second World War, and Behavioral Economics: How We Make Financial Decisions.

Almost 1,000 guests visited the NBU's Money Museum during Global Money Week.



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"For last years the National Bank of Ukraine adopted new culture and values. We became more modern, open and transparent. We take responsibility for our words and our actions", affirmed Governor Smolii when receiving Central Banking Transparency Award [#CBAwards](#)



Central Banking Award



Yakiv Smolii
Governor of the National Bank of Ukraine



For last years the National Bank of Ukraine adopted new culture and values. We became more modern, open and transparent. We explain our actions to the public every step of the way. We take responsibility for our words and our actions.

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Money Museum



The NBU's Money Museum is an important part of the central bank's communication strategy.

In 2018, the museum continued to herald the slogan "Open Museum – Open National Bank of Ukraine". Over the year, the museum held 278 tours for 6,103 visitors.

The museum also expanded its programming with 26 interactive quests and 20 lectures, including lectures held outside the museum. The museum introduced a new walking tour called Instytutska: Kyiv's 19th-Century Financial Center.

The current list of tours, quests, and lectures includes:

- A History of Cash Circulation and Commemorative Coins in Ukraine (tour)
- Treasure Hunting (quest)
- Money Protection (quest)
- Behavioral Economics: How We Make Financial Decisions (lecture).

From now on, every tour in the Money Museum will start in the NBU's sophisticated operating room, where guests can learn about the building's history. The tour includes a narrative on the NBU's current role and functions.

In addition to the permanent exhibition, the museum has also organized

two temporary travelling exhibitions:

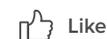
- The first one was seen by 63 tours as part of the April road show Financial Awareness Days in Poltava. The second exhibition was displayed at Ukrfilexpo–2018.
- For this event, the Money Museum created an exhibition called Money Stamps and gave two lectures on shahs (money stamps used in the Ukrainian People's Republic) and the history of cash circulation in Ukraine.

In 2018, the NBU continued to work on establishing an Education and Information Center. The center is scheduled to open in 2022. A new location for the center has been identified and we have started pre-project research and concept development.

The Education and Information Center – new, modern, and open to all – will become a cultural and educational space with the following goals:

- inform the public about the main functions of the regulator
- improve personal financial management practices
- raise the level of trust in the banking system
- increase the use of financial services among individuals.

The Education and Information Center will include a large classic museum dedicated to money and its history (in Ukraine and abroad) and will be technologically modern. The center will be interactive and will have play areas and rooms for events. The project's plan expects 100,000 visitors annually.



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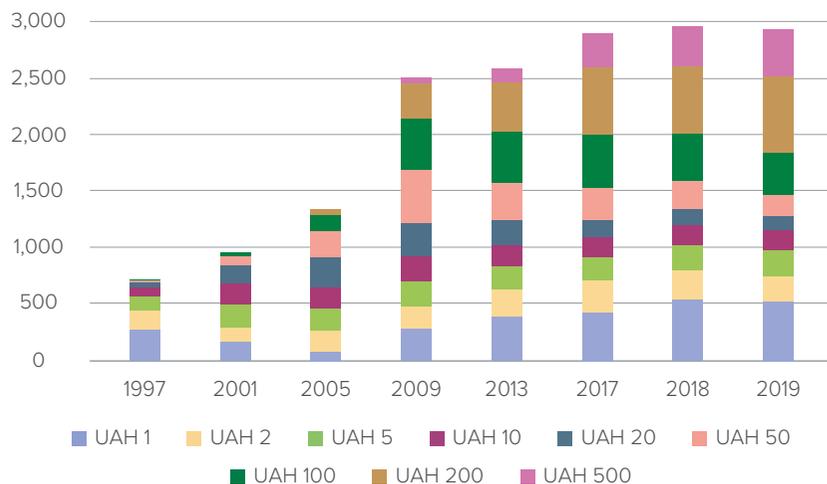
#transparentNBU #NBUstrategy #hryvnia #coins #NBUresearch

Ensuring Cash Circulation



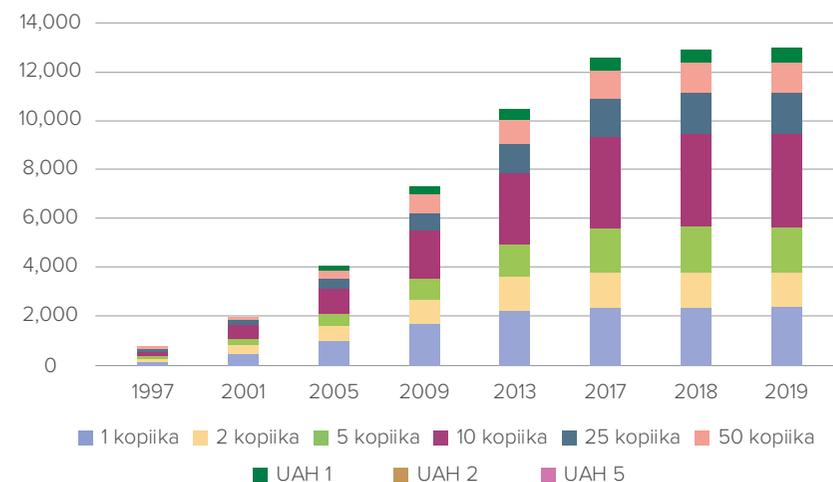
As at 1 January 2019, Ukraine had UAH 400.1 billion in banknotes and coins in circulation, up by UAH 38.6 billion or 10.7% from UAH 361.5 billion at the start of 2018.

Number of banknotes in circulation at the beginning of the year, million



Last year, Ukraine had 2.95 billion banknotes worth UAH 397.8 billion, 13.1 billion small and circulating coins worth UAH 2.3 billion, and 15.8 million commemorative and bullion coins worth UAH 87.7 million in circulation. In 2018, the number of banknotes in circulation decreased by 23.8 million (0.8%). By contrast, the number of coins increased by 118.0 million (0.9%).

Number of coins in circulation at the beginning of the year, million



As at 1 January 2019, there were 69 banknotes and 293 small coins per capita in Ukraine.

Cash Circulation in Ukraine

Cash circulation grew in 2018 in Ukraine.

As at 1 January 2019, banks had UAH 36.5 billion in vault cash, the highest since Ukraine's currency reform began in 1996. In 2018, vault cash increased by UAH 7.5 billion, or 25.8%.

In January–December 2018, cash received by banks increased by UAH 278.3 billion, or 15.4%, to UAH 2,083.1 billion.



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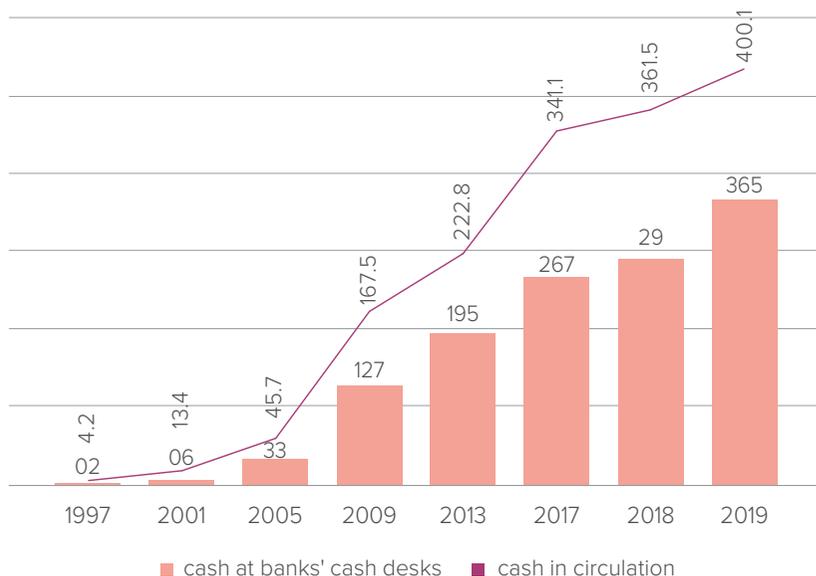
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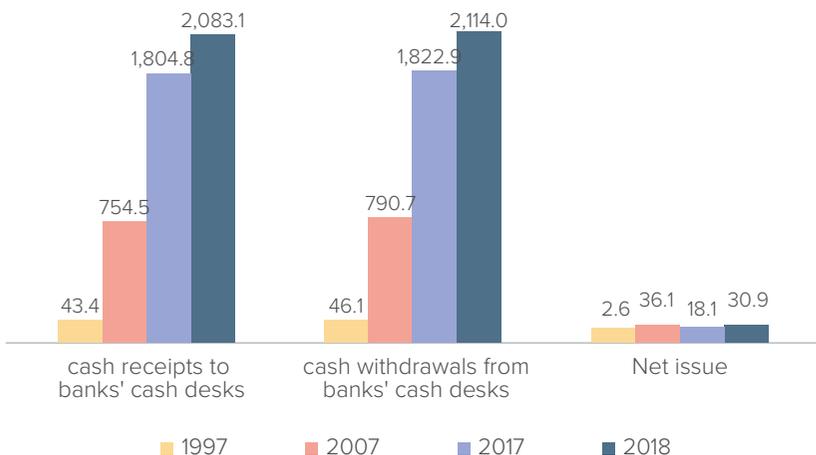
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Cash in Circulation and cash in bank vaults (as of the year start), UAH billion



Cash receipts and disbursements at Ukrainian banks, UAH billion



The following cash receipts increased significantly in year-over-year terms:

- payment card-based receipts increased by UAH 146.3 billion, or 23.3%, to UAH 775.5 billion
- sales revenue receipts increased by UAH 62.4 billion, or 9.3%, to UAH 730.9 billion
- cash receipts from foreign currency sales increased by UAH 42.7 billion, or 65.7%, to UAH 107.6 billion
- cash receipts from all services increased by UAH 12.5 billion, or 8.7%, to UAH 155.7 billion.
- Cash disbursements by tellers grew by UAH 291.1 billion, or 16.0%, to UAH 2,114.1 billion.

The following cash disbursements increased the most in January–December 2018:

- payment card-based disbursements increased by UAH 274.6 billion, or 21.6%, to UAH 1,547.6 billion
- cash disbursements to purchase foreign currency increased by UAH 25.7 billion, or 21.5%, to UAH 144.8 billion
- cash disbursements to provide lodgment to post offices increased by UAH 11.0 billion, or 10.2%, to UAH 118.9 billion
- loan cash disbursements increased by UAH 2.8 billion, or 47.1%, to UAH 8.7 billion.

The balance of currency exchange transactions – the excess of cash disbursements to purchase foreign currency over cash receipts from foreign currency sales – decreased to UAH 37.2 billion in January–December 2018 from UAH 54.2 billion a year earlier.

Last year, the NBU provided banks in the government-controlled areas of Donetsk and Luhansk oblasts with the cash they require through units in Zaporizhzhia, Dnipropetrovsk, and Kharkiv oblasts, primarily to pay pensions, salaries, and social benefits. In 2018, that cash totaled UAH 14,407.3 million, approximately even with the UAH 14,446.5 million



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in 2017.

Cash Processing

In 2018, nearly 1.59 billion banknotes were received for processing by cash circulation units and the Central Vault (including 1.22 billion banknotes from banks), down by 0.13 billion banknotes from 2017.

The reduction in the volume of cash subject to processing was chiefly caused by the decrease in cash receipts from banks and by termination in 2018 of cash services provided to banks by the NBU's cash circulation units in Volyn, Kherson, and Chernivtsi oblasts.

In addition, the NBU processed 1.56 billion banknotes in the reporting year (98.0% of receipts), down from 1.65 billion in 2017. Automated banknote processing systems processed 1.49 billion banknotes (95.5% of banknotes processed in 2018).

Removal of Worn Banknotes From Circulation and Acceptance of Unsorted Banknotes

In 2018, cash circulation units, the Central Vault, and authorized banks removed from circulation 664.3 million worn banknotes worth UAH 46,827.5 million. This represents an 11% decrease compared to 2017 (749.2 million banknotes worth UAH 48,335.5 million).

The number of worn banknotes of UAH 1, UAH 2, UAH 5, UAH 10, UAH 50, UAH 100, and UAH 500 denominations that the NBU removed from circulation declined by 4%–23%. The number of UAH 200 denomination banknotes withdrawn from circulation increased 4%.

NBU Pricing Policy

In 2018, cash circulation units and the Central Vault generated UAH 117.8 million in revenue for cash services to banks, including UAH 246,000 for small coins (priced since 1 August 2018).

In 2018, revenues from cash services to banks decreased 37% (by UAH 186.2 million).

In 2018, the Central Vault generated UAH 27.6 million in revenue from cash services to banks, which represented 24% of all revenue from cash

services to banks.

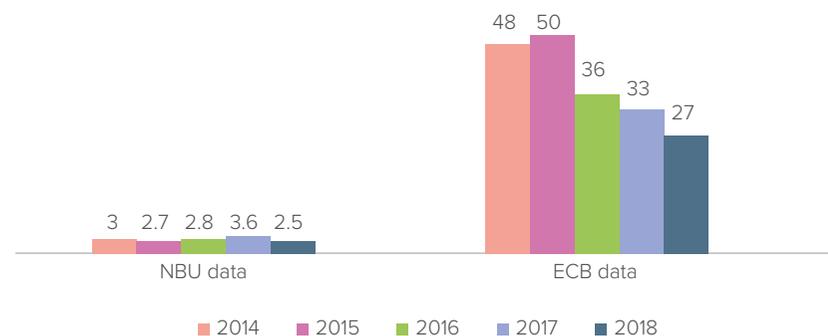
Withdrawal of Counterfeit Money from Circulation

The NBU continually monitors the withdrawal of counterfeit money from circulation. In 2018, there was a relatively minimal amount of counterfeit hryvnia banknotes.

In 2018, the number of counterfeit banknotes withdrawn from circulation decreased and accounted for 0.00025% of banknotes in circulation. This means there were approximately 2.5 counterfeit banknotes per one million authentic banknotes (compared to 3.6 banknotes in 2017).

For comparison, EU member states had nearly 27 counterfeit banknotes per million of authentic banknotes in 2018, according to the ECB.

Counterfeit banknotes per one million of authentic banknotes



Throughout 2018, the NBU removed from circulation almost 7,400 counterfeit hryvnia banknotes worth UAH 2.1 million (compared to 10,500 counterfeit hryvnia banknotes worth UAH 3.6 million in 2017).

The following changes took place in 2018:

the number of counterfeit banknotes decreased, in particular:

- the quantity of UAH 500 and UAH 20 denomination banknotes decreased 50%
- the quantity of UAH 50 denomination banknotes decreased 25%



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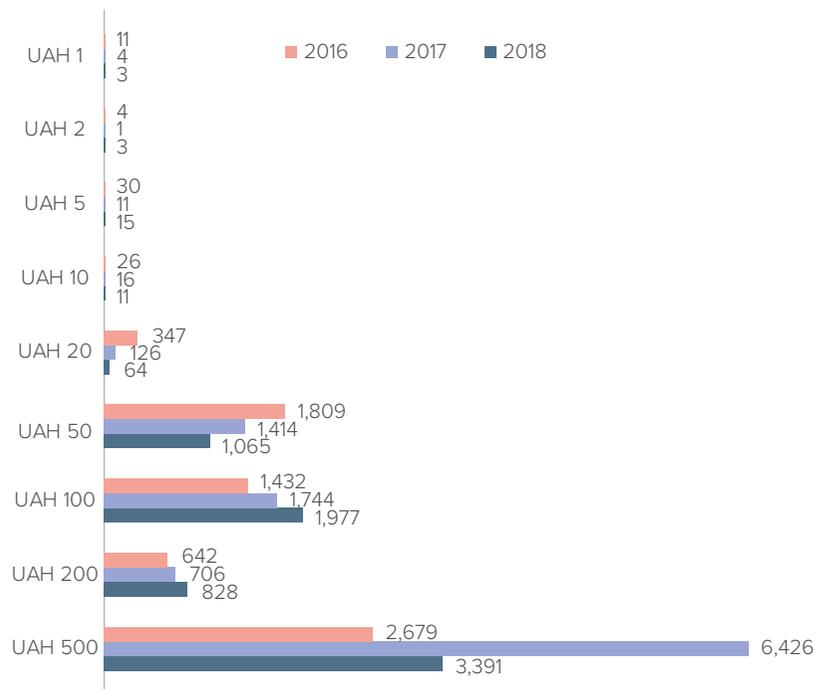
- the number of withdrawn counterfeit UAH 200 denomination banknotes decreased 17%, while that of withdrawn counterfeit UAH 100 denomination banknotes decreased 13%.

Banknotes of the following four denominations accounted for 99% of counterfeit banknotes withdrawn from circulation:

- UAH 500 (46% of the total number of withdrawn counterfeit notes and 80% of their total value)
- UAH 100 (27% and 9%, respectively)
- UAH 50 (15% and 3%, respectively)
- UAH 200 (11% and 8%, respectively).

Counterfeit UAH 1, UAH 2, UAH 5, UAH 10, and UAH 20 banknotes that the NBU withdrew accounted for just 1% of all withdrawn banknotes.

Withdrawn counterfeit hryvnia banknotes by denomination (number of banknotes)

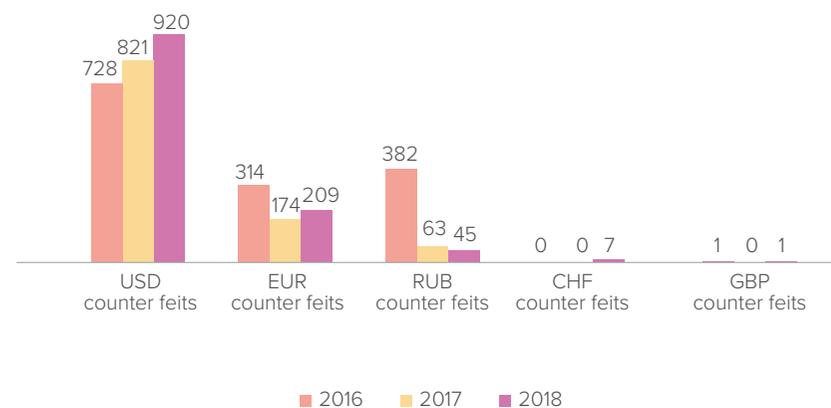


The following is a breakdown, by currency, of counterfeit foreign currency banknotes withdrawn from circulation in 2018:

- US dollars (78% of all counterfeit foreign currency banknotes withdrawn from circulation)
- euros (17%)
- Russian rubles (4%)
- Swiss francs and GB pounds (1%).

Counterfeit USD 100 notes accounted for 97% of all seized counterfeit US dollars; counterfeit EUR 50 and EUR 200 notes accounted for 45% and 36% of all seized counterfeit euros, respectively; counterfeit RUB 5,000 banknotes accounted for 78% of all seized counterfeit Russian rubles.

Withdrawn counterfeit foreign currency banknotes (number of banknotes)





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Issuance and Sale of Commemorative and Bullion Coins in 2018

In 2018 the NBU circulated 3,995,500 pieces of 41 commemorative coins (35 titles), including: 13 silver coins, 25 nonprecious metal coins, and 3 zinc-based bullion coins.

In addition, the NBU issued 83,500 pieces of 5 commemorative medals. In terms of technical innovations, the NBU released six-sided silver coins that celebrate the centenary of the Establishment of Ukraine's Academy of Sciences and the elliptical silver medal Mariinsky Palace.

Also, in 2018, special issues of commemorative coins of non-precious metals were launched. They are a legal tender and are of national importance by their theme: Defenders of Donetsk Airport, Ukrainian Volunteer Day, 100 Years since the Creation of the Ukrainian Navy.

In 2018, the NBU completed the coin series Oblasts of Ukraine by issuing the coins City of Kyiv, City of Sevastopol, and Autonomous Republic of Crimea.

The NBU issued coins to commemorate the following events: the 100th anniversary of Ukraine's Red Cross Society, the achievements of the Ukrainian team at the 2018 Winter Paralympics, and the anniversaries of prominent Ukrainians Liubomyr Huzar, Ivan Nechui-Levytskyi, Valentyn Hlushko, Olha Avilova, Oleksii Kolomiichenko, Oleksandr Shalimov, and Leonid Zhabotynskyi.

The NBU sold the commemorative and bullion coins through its units and banks designated to distribute commemorative coins. In the domestic market, the NBU sold 3.5 million pieces of numismatic products worth UAH 274 million, including:

- nearly 3.1 million commemorative coins worth UAH 139.8 million (including 1,600 gold coins, 65,800 silver coins, 1 million nonprecious metals coins, and almost 2 million zinc-based bullion coins)
- 32,000 bullion coins worth UAH 110.3 million (6,500 gold coins and 25,500 silver coins).

In 2018, the NBU sold almost three times as many coins as in 2017 (when it sold 1.2 million commemorative coins worth UAH 106.2 million).

In addition, last year the number of bullion coins sold by the NBU

doubled (in 2017, the NBU sold about 15,900 bullion coins worth UAH 82.6 million, including 5,200 gold coins and 10,700 silver coins).

Overall in 2018, the NBU generated revenue of UAH 245.6 million from domestic sales of Ukrainian commemorative and bullion coins, souvenirs, and accessory products and paid UAH 23.1 million in taxes to the state budget.

In 2018, the NBU bought only 260 Ukrainian bullion coins from the public (243 gold and 17 silver). This is less than 1% of the total number of bullion coins sold in 2018, which confirms the public's robust demand for these products and characterizes them as an investment.

Auctions were another channel through which the NBU sold commemorative coins. In 2018, the NBU held four auctions to sell commemorative coins titled 25 Years of Ukrainian Independence, selling 63 gold coins worth UAH 9.2 million.

To purchase the commemorative coins and souvenir products, consumers actively used an online preordering system. In 2018, the NBU sold souvenirs and commemorative coins of 111 titles through the online ordering system and received orders for 524,700 coins and souvenirs. Of these, the NBU sold nearly 400,000 coins and souvenirs, meeting 76% of all orders.

An important step in 2018 was the introduction of cashless payments to sell numismatic products at NBU units.

In general, the NBU exceeded its annual target for revenue from the sale of bullion and commemorative coins and souvenirs in the domestic and foreign markets by 32.5%, selling UAH 245.6 million of the products.

In addition, the NBU hosted a traditional annual coin-of-the-year contest in 2018 to identify the best coin of 2017. Wheel of Life, made of silver and with a face value of UAH 10, won the contest. Volodymyr Taran, Oleksandr Kharuk, and Serhii Kharuk designed the coin's drawings, Volodymyr Demianenko engraved the coin, and Vitalii Andriianov completed the computer-aided design.



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In the Unique Concept category, the award was shared by Wheel of Life and 100th Anniversary of the Ukrainian Revolution of 1917–1921 (nickel silver, UAH 5 face value). Volodymyr Taran, Oleksandr Kharuk, and Serhii Kharuk designed the coin. Volodymyr Demianenko and Volodymyr Atamanchuk completed sculpturing works.



The award in the Best Artistic Solution category went to the Kosiv Painting Style coin (silver, UAH 10 face value; nickel silver, UAH 5 face value). Volodymyr Taran, Oleksandr Kharuk, and Serhii Kharuk designed the coin and Volodymyr Atamanchuk completing the sculpturing works.



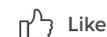
Throughout 2018, the NBU continued to promote Ukrainian numismatic products internationally. Ukraine's commemorative and bullion coins and souvenirs were exhibited at the World Money Fair in Berlin, the

International Convention of the American Numismatic Association in Philadelphia, and international exhibitions in Prague and Vilnius.

NBU's Strategic Initiatives and Plans for Cash Circulation in 2019

The NBU's strategic initiatives and plans for cash circulation in 2019 include:

- optimizing the denominations of banknotes and coins in circulation
- engaging third parties (CIT companies) to participate in cash circulation in Ukraine's regions by licensing legal entities to provide cash collection services to banks
- developing the concept of the operation of a cash control system in Ukraine to ensure the proper quality of cash in circulation, complying with technical equipment requirements, and ensuring security measures by all participants of the cash cycle (Cash Supervision)
- improving the regulatory framework behind restrictions on cash settlements by business entities and individuals
- developing a prudent tariff policy in cash circulation
- creating a competency hub at the NBU that would fight banknote counterfeiting and study and analyze the counterfeit of domestic and foreign currencies
- launching an online store to sell numismatic products.



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Research at the NBU



The NBU has focused research activities on monetary policy, macroprudential regulation, and macroeconomic modelling. These will remain priority research areas until 2021. The NBU is continuing its integration into the global research community by involving recognized scholars and experts in its research and academic events.

In 2018, in the area of monetary policy, our researchers assessed the neutral interest rate most suitable for attaining inflation targets and potential GDP, studied the spillover effects of international shocks on countries in the region, and launched a study of disinflation (slowdown in price growth) in a small open economy.

In the area of financial stability and macroprudential regulation, our researchers focused on the spillover effects of external shocks and the reaction of banks to those shocks, as well as the macroeconomic effects of implementing prudential instruments.

In 2018, the NBU's researchers also worked on developing nowcasting models (real-time analysis and forecasting) and short-term forecasts based on business outlook surveys and online data.

The NBU also intensified its work on the dynamic stochastic general equilibrium model (DSGE model) for Ukraine, kicking that workstream off with a workshop titled Use of DSGE Models in Central Banks. The event brought together NBU experts, representatives from 13 central banks, and foreign scholars, including Guido Ascari (Professor of Economics,

University of Oxford and University of Pavia) and Jaromír Beneš (independent consultant and the developer of the IRIS Toolbox open platform of macroeconomic modelling). Participants of the event shared their experiences in developing and using DSGE models, discussed trends in modelling, and drafted recommendations for the effective practical use of DSGE models.

The NBU's international research programs were a key component of the central bank's efforts to increase cooperation in the area of research. Through its secondment program, the NBU organized an open research seminar on disinflation in a small open economy and published an article on the macroeconomic effects of the implementation of the additional requirement for Ukrainian banks starting from 2020 to form capital buffers during periods of economic growth. The results of the research showed that a gradual implementation of that requirement with a preemptive announcement is effective. This finding matches the NBU's strategy on that front.

In 2018, the findings of research conducted under the Visiting Scholar Program were presented at seminars and conferences at the NBU and abroad, in particular at the Bank of Finland Institute for Economics in Transition (BOFIT) and Swansea University. The results include articles and research findings on the NBU's online price monitoring and how prices correspond to official inflation statistics, the impact of military actions in eastern Ukraine on banking system asset quality, and the relationship between bank branch structure and loan portfolios. Recognized experts including Oleksandr Talavera from University of Birmingham (UK) and Ukrainian scholars Andrii Tsapin, Oleksandr Faryna, and Tetiana Jukhymenko also contributed to the various research papers.

In 2018, the NBU organized two large conferences to foster research potential and attract young researchers. The first (Integration Trends in Europe and the Impact on the Region) was organized jointly with Narodowy Bank Polski and with support from the Warsaw School of Economics, the Banking University, and the Ivan Franko Lviv National University. The second conference (Prospects for the Banking Sector and Monetary Policy), now a regularly held event, was organized with the Kyiv School of Economics. Those researchers who prepared the best reports secured research internship in the NBU's Monetary Policy and Economic Analysis Department.



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This year, the Annual Research Conference organized by the NBU and Narodowy Bank Polski with support from the Kyiv School of Economics and the Government of Canada focused on the interaction between fiscal and monetary policies. The event gathered over 350 participants from 114 international financial, academic, and government institutions. The conference included four research sessions and two discussion sections focused on practical approaches to political decision making. Many globally renowned experts and scholars spoke at the event and participated in its discussions, including Alan Auerbach (professor, University of California, Berkley), Cecilia Skingsley (Deputy Governor, Sveriges Riksbank), Jerzy Osiatyński (member of the Monetary Policy Council, Narodowy Bank Polski), Koba Gvenetadze (Chairman of the Board, National Bank of Georgia), Mojmír Hampl (Vice Governor, Czech National Bank), Jonathan Ostry (Deputy Director, Research Department, IMF), and Jesper Lindé (Head of Research, Sveriges Riksbank). A short summary of the lectures held at the conference was published in the Global Banking & Finance Review. Participants also gave lectures for Ukrainian students on the problems and prospects of tax reform and on inflation targeting.

At the same time as that conference, the Kyiv School of Economics and VoxUkraine organized Ukraine Economy Week. As part of that event, NBU Deputy Governor Dmytro Sologub and representatives from Ukraine's Ministry of Finance participated in a panel discussion titled Modern Trends of Monetary and Fiscal Policies: How to Choose the Right Path for Ukraine. Additionally, a "careers breakfast" was organized for students of top universities where they were able to discuss career opportunities in academics, business, and public administration.

Overall in 2018, the NBU conducted research and worked to improve the macroeconomic models and forecasting tools needed to implement monetary policy and ensure financial stability in Ukraine. And throughout the year, the NBU established several research-focused events that attracted a wide international audience of experts and scholars and launched joint advanced research projects.



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Work with Government Authorities



In 2018, the NBU improved its communication with the Verkhovna Rada of Ukraine, the Cabinet of Ministers of Ukraine, and individual ministries.

The Financial Stability Board, which is the key platform for coordinating the economic reform efforts of financial sector regulators, held four meetings during the year.

The NBU's active involvement and close cooperation with the Verkhovna Rada of Ukraine contributed to the adoption of five important laws that will help further develop Ukraine's financial services market:

- Bankruptcy Code of Ukraine (as of the start of 2019, waiting to be signed into law by the President of Ukraine)
- Law of Ukraine On Amendments to Certain Laws of Ukraine on Establishing and Maintaining the Credit Register of the National Bank of Ukraine and Improving Credit Risk Management of Banks (No. 2277-VIII dated 6 February 2018)
- Law of Ukraine On Currency and Currency Operations (No. 2473-VIII dated 21 June 2018)
- Law of Ukraine On Amendments to Some Legal Acts of Ukraine on the Resumption of Lending (No. 2478-VIII dated 3 July 2018)
- Law of Ukraine On Amendments to Some Legal Acts of Ukraine on Improving the Financial Sector of Ukraine (No. 2491-VIII dated 5 July 2018)

- Law of Ukraine On Amendments to Some Legal Acts of Ukraine on Facilitating the Inflow of Foreign Investment (No. 2418-VIII dated 15 May 2018).

These laws became possible as a direct result of the NBU's effective communication and cooperation with parliament during committee meetings, as well as to the popularity of those laws among the Ukrainian public.

As part of its work with the Verkhovna Rada, the NBU maintained its commitment to improving legislation and ensuring open dialogue by:

- working with the Verkhovna Rada of Ukraine and its committees and members of parliament and their assistants on issues that fall within the regulator's mandate
- providing comments and suggestions for draft laws
- presenting the NBU's viewpoint to parliamentary committees during the process of drafting laws.

In 2018, members of the NBU Board, department directors, and other experts attended 18 meetings of the Verkhovna Rada's Committee on Financial Policy and Banking. That committee held seven meetings with the participation of the NBU governor, nine with deputy governors, and six with department directors.

NBU representatives were invited to committee meetings three times and attended meetings at their own initiative 15 times.

In addition, NBU deputy governors, department directors, and specialists attended meetings of other committees of the Verkhovna Rada:

- Committee on Economic Policy (6 times)
- Committee on the Prevention and Counteraction of Corruption (1 time)
- Committee on Taxation and Customs Policy (2 times)
- Committee on Construction, Urban Development, Housing, and Communal Services (2 times)
- Committee on Social Policy, Employment, and Pensions (1 time)
- Committee on State Building, Regional Policy, and Local Self-Government (1 time)
- Committee on Foreign Affairs (1 time)
- Budget Committee (2 times).



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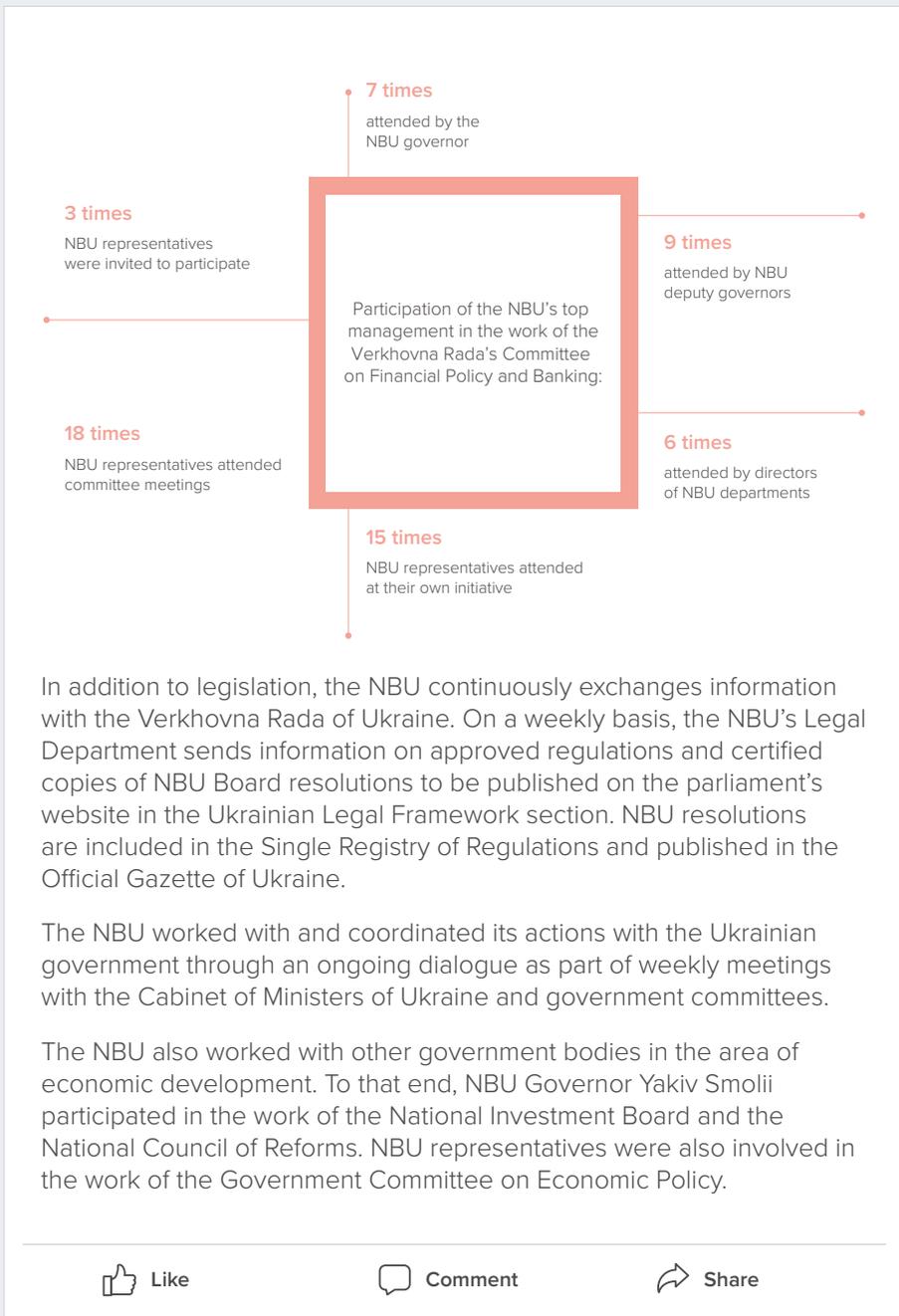
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In addition to legislation, the NBU continuously exchanges information with the Verkhovna Rada of Ukraine. On a weekly basis, the NBU's Legal Department sends information on approved regulations and certified copies of NBU Board resolutions to be published on the parliament's website in the Ukrainian Legal Framework section. NBU resolutions are included in the Single Registry of Regulations and published in the Official Gazette of Ukraine.

The NBU worked with and coordinated its actions with the Ukrainian government through an ongoing dialogue as part of weekly meetings with the Cabinet of Ministers of Ukraine and government committees.

The NBU also worked with other government bodies in the area of economic development. To that end, NBU Governor Yakiv Smolii participated in the work of the National Investment Board and the National Council of Reforms. NBU representatives were also involved in the work of the Government Committee on Economic Policy.



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Cooperation with International Partners



The NBU continued to work to integrate into the global financial system by deepening its cooperation with international partners and supporting global initiatives for banking regulation. In this way, the NBU is showcasing its desire to become a partner, its openness to cooperation, and the development of its multilateral and bilateral relations.

Multilateral Cooperation

While working with the IMF in 2018, the NBU met all requirements of the IMF Extended Fund Facility. The central bank also participated in talks regarding a new Stand-By Arrangement for Ukraine, which provides USD 3.9 billion in financing and which was approved by the IMF Executive Board on 18 December 2018. The first tranche of USD 1.4 billion arrived on 20 December 2018 and was used to replenish international reserves.

The NBU also finalized the USD 750 million Economic Growth and Fiscally Sustainable Services Policy Based Guarantee for Ukraine with the World Bank. Ukraine's Finance Ministry used these guarantees to attract USD 349.3 million in loans in December 2018 and to finance the general fund of the state budget.

The NBU also played a role in securing EUR 1 billion in financing under the fourth EU Macro-Financial Assistance program for Ukraine. Ukraine received the first tranche of USD 500 million in December 2018 and used it to improve the country's balance of payments, support the budget, and replenish international reserves.

Top management of the NBU also represented Ukraine in the management bodies of international financial institutions. In 2018, representatives of the central bank participated in the Annual and Spring Meetings of the International Monetary Fund and World Bank Group, the Annual Meetings of the European Bank for Reconstruction and Development (EBRD), the Black Sea Trade and Development Bank (BSTDB), and the Bank for International Settlements (BIS).

Participation of the NBU in Events by International Organizations

- Spring Meetings of the International Monetary Fund (IMF) and the World Bank Group (WBG)
- Annual Meetings of the IMF and the WBG
- Annual Meetings of the European Bank for Reconstruction and Development
- Annual Meetings of the Bank for International Settlements
- Annual Meetings of the Black Sea Trade and Development Bank
- Regional Meetings of IMF and WB Member States
- Meetings of the Financial Stability Board Regional Consultative Group for Europe
- Meetings of the Basel Consultative Group of the Basel Committee on Banking Supervision
- Meetings of the Advisory Group of the European Fund for Southeast Europe

The NBU also took part in sector-specific task forces and continued to increase its role in global initiatives. In 2018, at the NBU's suggestion, Ukraine became a member of the Financial Stability Board Regional Consultative Group for Europe. The central bank presented its achievements and progress in reforming Ukraine's financial sector at the Vienna Initiative Forum in March and the BCBS-FSI High-Level Meeting for Europe on Banking Supervision in September.

With a view to successfully carrying out financial sector reform, the NBU also strengthened cooperation with international organizations within existing technical assistance projects. In 2018, technical assistance was provided by the following major international donors:



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EU, IMF, World Bank Group, EBRD, and the United States Agency for International Development (USAID). International donors are assisting in the implementation of 37 of 42 projects under the central bank's development program.

Bilateral Cooperation

Last year, the NBU also actively cooperated with and strengthened relations with other central banks. These included Narodowy Bank Polski, De Nederlandsche Bank, People's Bank of China, the Central Bank of the Republic of Turkey, Sweriges Riksbank, the Bank of Lithuania, the National Bank of Georgia, the Bank of England, the National Bank of the Republic of Belarus, the Bank of Italy, the Swiss National Bank, the Central Bank of Montenegro, the National Bank of the Republic of Kazakhstan, and the National Bank of the Republic of Armenia.

In 2018, the NBU Advisory Council held meetings with the National Bank of the Republic of Belarus and an NBU working group met with the Central Bank of the Republic of Turkey.

With a view to strengthening cooperation, last year NBU Governor Yakiv Smolii visited the central banks of Georgia (June), Poland (October), and China (December).

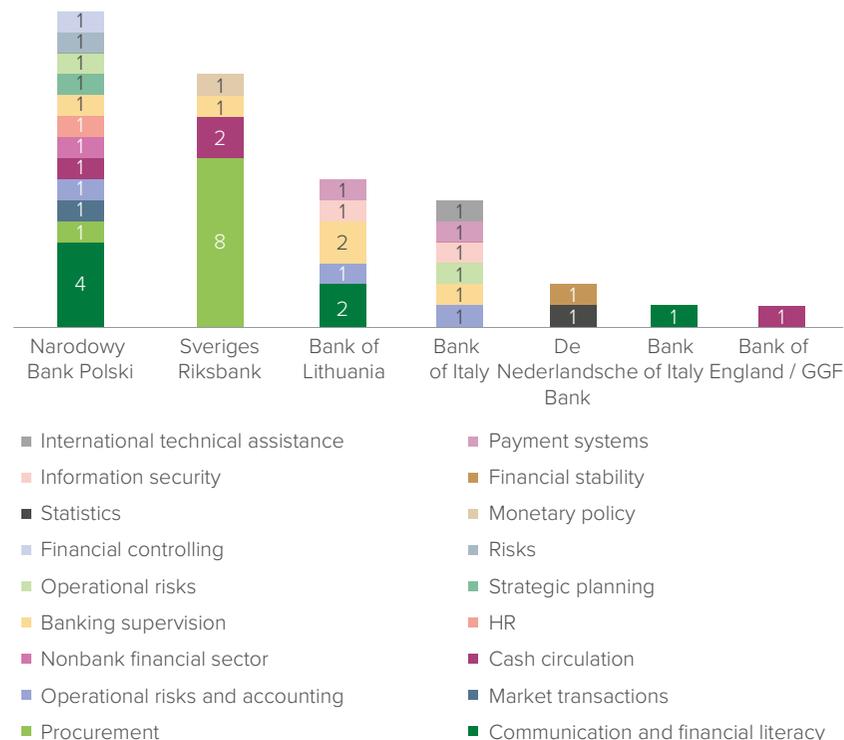
The NBU also worked with other central banks within the scope of technical assistance in the areas of monetary policy, communications and financial literacy, payment systems, financial stability, and market operations.

In 2018 the NBU signed

- Cooperation Agreement in the area of Innovation Development with Bank of Lithuania
- Agreement on Banking Supervision Cooperation with the National Bank of the Republic of Kazakhstan
- Cooperation Agreement on Issuing and Acquiring of Co-badged Cards PROSTIR and UnionPay
- Chinese Yuan/Hryvnia Bilateral Currency Swap Arrangement between the People's Bank of China

Over the course of the year, the NBU held international roundtables, seminars, bilateral expert events, and meetings for other central banks at which participants discussed the achievements and challenges of their institutions in various areas. At these events, the NBU shared its experience in carrying out unprecedented banking sector reform and internal organizational change.

Activities involving international partners





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Expert cooperation with other central banks

Counterparties	Areas of cooperation
European Central Bank	Workshops on monetary policy, market operations, financial stability, and communications policy
The central banks of Poland, Sweden, Italy, Lithuania, and Belarus	Roundtables on risk management
The central banks of Armenia, Belarus, Bosnia and Herzegovina, Croatia, Georgia, Kazakhstan, Macedonia, and Moldova	Roundtables on IFRS 9
Central Bank of Turkey	Roundtables on electronic documentation, legal aspects, IT, and payment systems
The central banks of Georgia, Israel, Latvia, Lithuania, Poland, Slovakia, the Czech Republic, and Sweden	Roundtables on macroeconomic modeling
National Bank of Ethiopia	A meeting to share the central bank's experience in banking supervision
Bank of France	A speech to share the NBU's reform results
Bank of Lao P.D.R.	A meeting to share the NBU's experience in the area of strategic planning, banking supervision, and financial stability

More than once, the NBU's achievements have been acknowledged by the EU, the IMF, the WB, other international organizations and institutions, and other central banks. The main partners with which the NBU exchanged professional achievements and experience in 2018 were the central banks of the Republic of Turkey, Poland, Sweden, Lithuania, and Belarus.

The comprehensiveness and magnitude of the NBU's reforms have resulted in an increase in requests for technical and expert assistance from other central banks to the NBU. The NBU's leading experts are also being invited to the technical missions of international financial institutions like the IMF and EBRD.

A Regulator That Is Predictable for Foreign Investors

The NBU aims to be predictable and understandable for foreign investors. With that in mind, the NBU is working to maintain a stable business environment and is contributing to the perception of Ukraine as an attractive investment destination. To achieve that goal, the NBU is expanding and maintaining relations with foreign investors by holding meetings with private and institutional investors, both in Ukraine and abroad.

In 2018, the NBU held a number of meetings with private and institutional investors both in Ukraine and abroad.

In 2018, the NBU took part in the following events:

- 14th Annual Ukraine Investor Conference held by Dragon Capital (Kyiv, February 2018)
- a meeting with institutional investors arranged by Morgan Stanley (Kyiv, February 2018)
- a meeting with institutional investors arranged by Goldman Sachs International (Kyiv, March 2018)
- Reshaping Ukraine's banking landscape in 2 years: from oligarchy to market (Harvard Law School and Yale Law School, March 2018)
- a high-level meeting with Swiss bankers and top investment managers – members of CFA Society Switzerland and Chartered Financial Analyst (Basel, September 2018)
- Credit and Equity Emerging Markets Conference (London, September 2018)

To raise awareness about Ukraine's investment climate, the NBU also took part in roundtables with business communities in Canada, the UK, the US, and Switzerland.

The NBU also participated again in the Dragon Capital International Investor Conference, which brings together government officials and Ukrainian and foreign business representatives. In March, the NBU also



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presented its internal reform achievements and the results of Ukrainian banking sector reform at the Harvard and Yale Law Schools.

European Integration

In 2018, the NBU was involved in efforts to implement the EU-Ukraine Association Agreement. The central bank focused on harmonizing Ukraine's laws with European laws in terms of banking regulation and supervision, capital market liberalization, and the operation of payment systems.

The NBU, together with other government institutions, engaged in a new area of European integration – integration into the EU's digital single market. This integration envisages:

- easing online access to goods and services
- ensuring the right conditions to develop digital networks
- fostering the growth of the digital economy.

Striving for a gradual shift to the free capital movement, the NBU developed new currency legislation last year that enabled the long-awaited transition to the new transparent model of currency regulation.

In 2018, the NBU also helped prepare legislative proposals and initiatives in the following areas:

- anti money laundering
- protection of the rights of financial consumers
- base erosion
- accounting and auditing
- corporate governance.

2018 EU Integration-Related Activities

- implementation of EU–Ukraine Association Agreement
- Harmonization of regulatory framework with international standards and EU banking legislation
- NBU's participation in bilateral meetings on the association between the EU and Ukraine.

The list of international organization and institutions, where the NBU is a member, represented at various levels or cooperating within Ukraine's membership:

- International Monetary Fund (IMF)
- Black Sea Trade and Development Bank (BSTDB)
- World Bank Group
- European Bank for Reconstruction and Development (EBRD)
- European Investment Bank (EIB)
- Bank for International Settlements (BIS)
- Central Bank Governors' Club of the Central Asia, Black Sea Region and Balkan Countries
- Financial Stability Board (FSB) Regional Consultative Group for Europe
- Basel Consultative Group (BCG) of the Basel Committee on Banking Supervision of the Bank for International Settlements (BIS)
- Irving Fisher Committee (IFC) on Central Bank Statistics of the BIS
- Group of Banking Supervisors from Central and Eastern Europe (BSCEE)
- Vienna Initiative
- European Fund for Southeast Europe (EFSE) Advisory Group
- OECD International Network on Financial Education (INFE)



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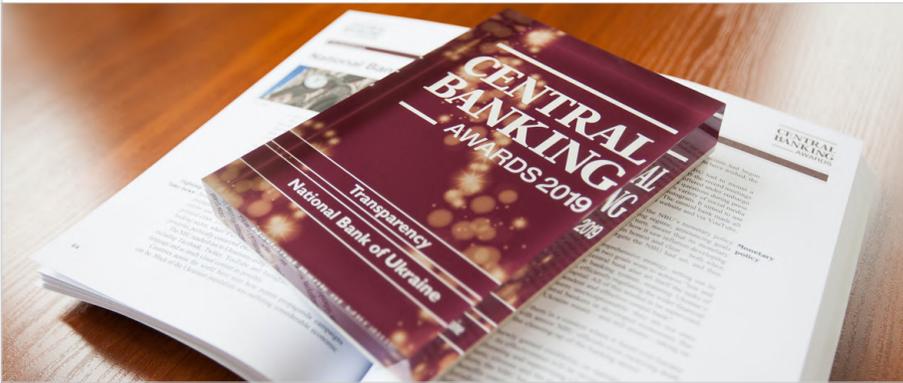
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NBU Communications Strategy



The NBU is committed to transparent and clear public communications. To that end, the NBU continued to hone its communication instruments in 2018 by introducing new products and solutions for audiences.

New Communications Strategy: Say More and Be Clear

The NBU's new Communications Strategy, approved in late 2018, aims to increase the effectiveness of the central bank's communications to the public. The NBU communicates what it does and why, and how its decisions affect both the lives of individuals and the development of Ukraine's economy. The world's most advanced central banks recognize that they would not be able to effectively implement policy without strong communications. The NBU views communications as one of its strategic functions.

The new Communications Strategy has three main goals. The first is to reinforce trust in the NBU itself – an important prerequisite for strengthening the public's confidence in the domestic currency and in the banking sector.

The second is to maximize the impact on the behavior of economic agents to guide their expectations, and also to create a well-developed culture of financial product consumption. The third is to reduce information asymmetry and economic uncertainty by ensuring access to the information required to make informed decisions.

The new Communications Strategy accounts for the main trends of today's information technology space, including the evolution of social media and the erosion of trust in the media and in government institutions. The NBU is intensifying its direct dialogue with different audiences by increasing both its presence on social media and the frequency of offline events, like meetings with businesses, roundtables, conferences, lectures, and more.

Focusing on the Client: How the NBU Interacts with Various Target Audiences

The central bank's main methods of communication – publications on its website, stakeholder-oriented events, and communications with the media – continued to evolve in 2018. Last year, the NBU published more press releases, had its speakers interviewed 55 times on TV, radio, and in print, hosted over 50 media events, and responded to 807 requests from journalists. Those activities are primarily aimed at communicating with policymakers, business entities, experts, academics, and the central bank's international partners.

The NBU also increased its direct communication with target audiences through social media in 2018. Its coverage and subscriber numbers increased on Facebook, Twitter, Instagram, YouTube, and Flickr. The NBU now has 38,000, 6,000, and 1,800 subscribers on Facebook, Twitter, and Instagram, respectively. The NBU tailors its content to the audience of each of the three social media platforms, focusing on English-language news for Twitter, and on visual and more accessible items for Instagram.

On 16 March 2018, the NBU presented its mid-term strategy, and it made sure to make that event publicly accessible to its stakeholders. Representatives of international financial institutions, embassies, financial market regulators, the banking community, nongovernmental organizations, the expert community, media, the government, and the central bank attended the presentation.

Borrowing from the experience of the world's most communications-oriented central banks, the NBU continued to build communications with customers across Ukraine. To do so, the NBU held information days, which had two main components: the educational, youth-oriented component, which included university lectures, and the explanatory



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component, which focused on the NBU's policies and consisted of meetings with business representatives. The four regional information days gathered more than 100 business representatives and 1,200 students and academics.

Towards a National Strategy for Financial Literacy

Financial service consumers and the public need the central bank to communicate in simpler and clearer terms. This communication should not only clarify the NBU's mandate and functions but also facilitate the formation of a new, European culture of consumption of financial services. In this effort, the NBU places most of its focus on youth as the demographic that will shape Ukraine's future.

In 2018, in what had by then become a tradition, the NBU led the nation in hosting events as part of the international Global Money Week, which ran from 12 to 18 March. Nearly 150,000 Ukrainian school-aged children and university students participated in workshops, lectures, tours, and financial flash mobs under the motto "Money Matters".

Aimed at youth, the NBU also hosted university lectures by NBU executives, motivational meetings, and a financial quest that took place as part of the Statesmen's Forum project.

In line with the NBU's openness and transparency policy, in 2018, the NBU's Money Museum served as a major venue for educational events and communications with youth. Adults make up only one-third of the 6,000 visitors that have visited the museum so far. In 2018, the Money Museum significantly expanded its experience. Now, apart from the ability to view a historic collection of money and tour the NBU's building on 9 Instytutska St., visitors can attend lectures on economics, participate in quests and workshops, and take a walking tour titled Instytutska Street: Kyiv's Financial Hub in the 1800s and early 1900s.

The NBU is on track to develop a national strategy for financial literacy, which stands to serve as a long-term guide for all interested parties. The NBU has intensified its international collaboration with the OECD's International Network on Financial Education and has engaged consulting support from the world's top experts.

A Powerful Brand to Instill Greater Confidence

An important goal within the NBU's communications is to improve trust in the regulator by creating a powerful brand. That includes promoting the NBU as an independent, modern institution, an architect of the financial sector, a leading reformer, and an efficient central bank that ensures price and financial stability and that facilitates economic growth.

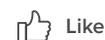
The NBU took its first step towards building a strong brand in 2018 when it completed a rebranding. The new identity is intended to visualize the NBU's fundamental transformation, and to reflect the regulator's vision, mission, and values. The new brand book is already being implemented: in 2018, the NBU launched over 330 informational products under its newly adopted corporate style.

International Recognition: The Transparency Award from the Central Banking Awards

The NBU won the prestigious Transparency Award at the Central Banking Awards for significant achievements in transparency and for building a strong dialogue with stakeholders.

In 2014, the NBU found itself facing multiple challenges – hostilities in eastern Ukraine, a spike in inflation, and a dysfunctional banking system – the Central Banking Awards said in a statement. In those circumstances, the central bank resisted the temptation to withhold all information and become even less transparent as an institution. On the contrary, the NBU, then headed by Valeriia Hontareva and Yakiv Smolii, chose to significantly expand the scope of information it published on its operations and is now working hard to make this information available in a clear and timely manner.

The award is proof that the NBU is headed in the right direction as it implements its communications strategy. The fact that the international community placed the NBU on par with the central banks of Sweden, Canada, the Czech Republic, Ireland, and Israel is undoubtedly a recognition of the NBU's achievements.



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Managing Human Capital



2018 was a decisive year for human capital management at the NBU, as the central bank for the first time adopted an HR strategy (for 2018 – 2020), set strategic HR goals and measurement metrics, and updated the human capital management system.

The central bank also introduced a new grade-based payroll approach and, for the first time in its history, struck an employment agreement between top management and employees. The NBU also changed its approach to leadership, the corporate culture, and internal communications.

2018–2020 HR Strategy

All NBU employees are guided by the HR strategy for their self-development, motivation, team-building, and process improvement. The 2018-2020 strategy, which sits within the NBU's overall strategy, identifies the ways in which the NBU will create a modern, open, independent, and effective central bank in terms of human capital management.

The main objective of the strategy is to develop human capital, including new leaders and teamwork, and with a focus on the individual. The strategy sets five strategic goals with regard to forming and developing human capital:

- creating a flexible motivation system (financial and non-financial incentives)

- developing a flexible and innovative corporate culture
- introducing new leadership
- promoting the employer's brand
- ensuring organizational development (enhancing the central bank's capabilities as an institution).

For each goal, the central bank has developed an action plan and key performance indicators (KPIs). The NBU has also updated its human resource management system by adding new products and instruments.

The HR strategy is a joint effort of all NBU units and is based on a study of current conditions and general labor market trends in Ukraine and abroad.

New Leadership

The NBU is developing leadership in two areas:

- A complete assessment of the management potential of managers on two fronts: Leaders and Teams. The assessment is part of the annual performance assessment and of additional surveys.
- The NBU is working to create an environment that fosters self-development and broadens the experience of leaders by introducing job rotations, holding workshops for managers, and continuing to promote the practice of providing feedback.

Developing a Corporate Culture and Internal Communications

In 2018, the NBU continued to develop a flexible corporate culture based on balanced decisions, innovative ideas, openness to new things, social and environmental responsibility, rapid response to change, multitasking, and broad thinking.

This provides all employees, regardless of position, with the opportunity to play different roles and to influence the NBU's corporate culture in different ways – from making decisions and developing teams to spreading this culture across and beyond the central bank.

The third annual survey of the NBU's corporate culture focused on assessing employee motivation based on the following factors:

- interactions between colleagues and employees and their managers



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- availability of development opportunities
- labor conditions
- the meaning and scope of work.

The survey returned a 77% motivation level, which is considered a relatively high response rate.

The focus of internal communications has shifted from informing employees to increasing their involvement, especially by encouraging greater interpersonal communication. Unit leaders and their teams have started to increasingly take on the role of creating a single information field in the organization inside the central bank.

Outside of working hours, NBU employees visited the central bank's Money Museum and attended lectures on finance and economics. In addition, in 2018 the NBU launched W5H-style intellectual games where contestants (NBU employees) match wits with one another.

New Payroll Plans and Nonfinancial Incentives

In 2018, the NBU introduced new payroll plans based on a position grade-leveling system, pegging the salaries of all NBU employees to their position grades.

A grade is defined as a level of value assigned to an employee's position for the central bank's current operations. It is determined on the basis of a role's expertise, difficulty, and responsibility. Salary ranges for each grade were developed based on surveys of wages on the Ukrainian labor market, meaning the NBU's wages are competitive.

As a result, the central bank's new remuneration plans have allowed the NBU to create a presence for itself on the labor market. The NBU plans to optimize and automate payment processes and to create more flexible financial and non-financial incentives.

In 2018, the central bank also changed its approach to non-financial incentives. For the first time, staff voted online to nominate the most effective employees and teams for awards.

Improving the Performance Management System

The NBU has two performance models: a management model and functional model, the latter of which was introduced last year.

The management model (for Board, Board-1, Board-2 managers) includes three corporate KPIs that apply to all employees (efficiency, proactiveness, and cooperation) and two managerial KPIs (responsible leadership and effective management).

The functional competence model (for Board-3 managers and non-managerial positions) comprises three corporate KPIs and two functional KPIs that are based on the code of conduct established for employees engaged in a given central banking area. These include responsibility, a client-oriented approach, analytical and operational thinking, resilience to stress, adaptability, effective communications, and emotional intelligence.

New KPIs will be used when planning activities for 2019 as part of the annual performance assessment.

Signing a Collective Agreement between Top Management and Employees

For the first time in the central bank's history, management and head office employees have entered into a collective agreement for 2018–2023.

This document governs operational, labor, social, and economic relations and matches up the interests of employees and administration in terms of:

- payment
- social security and benefits
- health care
- health improvement and holidays.

The agreement was drawn up by a commission made up of central bank management and representatives of the employees' union.



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A Pro-Youth Central Bank

In 2018, the NBU actively engaged young professionals and students and presented its internship and employment opportunities at exhibitions and job fairs. The NBU also held information sessions for students about the central bank's activities during open days and other events.

Last summer, students had the opportunity to participate in the Save 2018 Case Competition. During the case competition, students analyzed the central bank's strategic goals and for each goal determined:

- customer needs,
- the products that satisfy those needs,
- and related potential risks.

The competition attracted over 300 participants who proposed 21 solutions. Those students that were judged as the winners were offered internships at the NBU. Overall, 54 students secured internships at the NBU in 2018.

Balancing Work and Private Life

Starting in 2018, the NBU launched flexible work hours, providing employees with the opportunity to balance work and off-work hours by choosing the working hours they find convenient between 7 am and 8 pm. Over 11% of the employees have already made use of the flexible hours.

In 2018, to help employees grow personally and decrease work-related stress, the central bank began offering mindfulness meditation classes. Outside of working hours, a professional trainer taught over 100 participants how to apply mindfulness to observe their emotional and physical states and to develop attentiveness and emotional intelligence to prevent burn-out and to improve performance.

The NBU also worked to promote the health of its employees by offering a voluntary health insurance program. It currently has over 2,900 participants.

In addition, the NBU Labor Union formed volleyball and basketball teams and continued to field a football team.

Social Responsibility – Employee Initiatives

NBU employees continued to support their colleagues and fellow citizens serving in the Joint Forces Operation, as well as injured soldiers receiving treatment at the Main Military Clinical Hospital in Kyiv.

The NBU also supported orphanages, elderly individuals that lack support networks, and animal shelters. Those initiatives were delivered through corporate volunteer programs run by the NBU.

In June, supported by the Labor Union, NBU employees took part in the 26th charitable Chestnut Run to support the Center for Pediatric Cardiology and Cardiac Surgery of the Ministry of Health of Ukraine.

In spring and in autumn, over 100 employees participated in a blood donor drive organized with the Amosov National Institute of Cardiovascular Surgery and the Kyiv City Blood Center.



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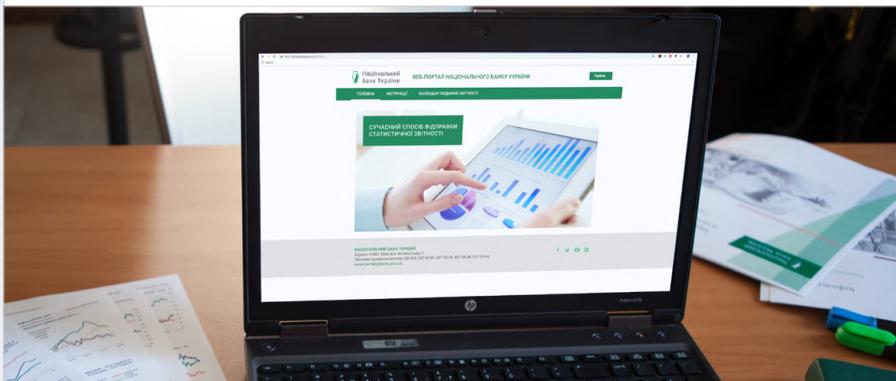
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Modernizing the Reporting System and Ensuring Open Data



The NBU has completed the final stage of the modernization of its statistical reporting in line with the three-year project Reengineering the Processes of Collecting, Processing, and Using Bank Statements and Information. The project introduces cutting-edge technologies for collecting and reporting data.

The NBU has completely abandoned paper-based statements by establishing the use of electronic signatures, introducing the XML format for submitting reporting statements, and shifting to the use of open channels for securely transferring data, particularly using the NBU's website or API.

The process of transferring data has been substantially simplified because banks can now use internal software. To accommodate reporting institutions, the NBU has also developed a public register of statistical reporting indicators based on a data model and published a detailed description of benchmarks, formulas, and requirements.

New rules on statistical reporting (approved by NBU Board Resolution No. 120 dated 13 November 2018) have made the process of data transfer between reporting institutions quicker and easier and increased the flexibility of the updating process for future statistical reporting. At the same time, the quality of reported data will increase as a result of the improvement of control algorithms during the compilation of reported data.

In 2018, to bring financial sector reporting in line with European standards, the NBU created the Rules for Preparing and Releasing Consolidated Financial Reporting of Bank in line with FINREP XBRL Taxonomy. That document will allow the NBU to transition to reporting to European regulators.

The changes to the reporting system were primarily aimed at achieving a balance between the burden on banks and the NBU's need to receive complete, timely, and reliable data in order to exercise its functions.

The NBU also continued to upgrade its monetary and financial statistics system. The NBU has introduced new concepts and classifications for financial corporations based on economic sectors, in line with the revised standard of the System of National Accounts, financial assets and liabilities in light of the introduction of IFRS 9, loans with a breakdown by small, medium, and large business entities, and securities with a breakdown by individual codes.

Considering the substantial internal migration of people in Ukraine in recent years, the NBU has improved its methodology for estimating personal remittances and has revised estimates for 2015–2017. Data from Ukraine's main partner countries, the findings of the latest survey on labor migration from the State Statistics Service of Ukraine (SSSU), and new ways of estimating data in some countries have improved the estimates of private remittances and the accuracy of balance of payments data.

Those revisions also addressed foreign direct investment numbers. The NBU has assumed from the SSSU the function of compiling data on the banking sector's foreign direct investment. To that end, the NBU has revised past external sector statistics given banks' reinvested earnings. The new approach has allowed us to bring the value of direct investments closer to market values and narrow the gap between NBU and SSSU data.

The amount of foreign direct investment (FDI) to entities in which the ultimate controlling investor is a resident was estimated for 2010–2017. That analysis allows the NBU to estimate the amount of foreign-origin FDI in Ukraine.

The NBU has continued to pursue openness in disseminating data. To that end, in 2018 the publicly available information on Ukraine's external



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debt was expanded. The NBU introduced a quarterly publication of scheduled repayments of external debt to enable a comprehensive analysis of potential liquidity risks and solvency risks for the national economy.

The NBU also released datasets in machine-readable format (XML, JSON) available through an API. They include balance sheets and reviews of financial corporations, along with a broad range of bank performance indicators, both aggregated and with a breakdown by financial institutions, and expanded information on Ukraine's external debt.



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Internal Audit



In 2018, the NBU's Internal Audit Department assessed the central bank's corporate governance processes and helped improve them, and also audited risk management and internal control processes. The audits were focused on key processes at the NBU.

In 2018, the Internal Audit Department conducted 23 audits to assess the effectiveness of risk management and internal controls over the core activities of the NBU's operating units. These included audits of the implementation of IMF recommendations based on the results of an assessment of safeguards and pursuant to the Memorandum of Economic and Financial Policies with the IMF.

The audits were conducted in 2018 in accordance with the Plan for Internal Auditing of the NBU's operating units, which was approved by the NBU Council.

Those planned audits covered all areas of the NBU's activity and used process- and risk-based approaches to the audited areas.

In 2018, the Internal Audit Department communicated the results of audits and risks identified to the NBU Council, the Council's Audit Committee, and the NBU Board. The findings of the audits were used frequently during meetings of the Council and its Audit Committee to assess the performance of the internal control function.

The NBU also introduced a comprehensive program for quality

assurance and internal audit improvement in 2018. It includes a program for the professional development of auditors within the internal Audit School that has been established for NBU employees.



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Risk Management System

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To achieve its strategic goals and perform the functions stipulated by the Law of Ukraine On the National Bank of Ukraine, the NBU has introduced a risk management system and is continuously improving it. The system aims to support the NBU's institutional capacity and independence by protecting its assets, capital, and reputation, as well as by ensuring that Ukrainians trust in the central bank and its policy.

Principles

adding value	proportionality to the NBU's role and functions
comprehensiveness	integration into decision-making process
objectivity of risk assessment	effectiveness
systematic nature	structure
timeliness	division of control into three lines of defense
independence of the second line of defense	adaptability to change
confidentiality	transparency



The NBU's risk profile comprises both financial and nonfinancial risks.

Financial risks constitute the risks that arise in connection with financial instruments.

Nonfinancial risks include operating, compliance, and strategic risks. The NBU's risk management process consists of the following stages:

- organization of the risk management system
- detection of adverse events and identification of risks in the NBU's processes and products
- risk assessment
- planning and implementation of measures in response to risks
- control function
- communication and reporting
- monitoring of the risk management system.

Operational Risk Management

The NBU's operational risk management focuses on:

- identifying and assessing operational risks
- strengthening the internal control system in terms of the inherent risks the NBU faces
- ensuring operational continuity for the NBU.

In 2018, the NBU updated its operational risk management methodology by introducing new risk management instruments. The NBU now has a standard and structured approach, clearly defined requirements for operational risk insurance, and control over outsourcing.

In addition, an independent assessment of operational risks and controls of 182 second-level processes was conducted. Using that assessment, the NBU's operating units have developed measures to mitigate operational risks and to improve controls.

The NBU also monitored and reported on 28 key operational risk indicators as part of the key risk indicators management.

The central bank regularly organizes trainings to improve the culture of operational risk management and raise awareness among top managers

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and employees of the NBU. In 2018, over 300 employees participated in 10 offline training sessions.

Last year, the NBU held its first roundtable on operational risk management with colleagues from Narodowy Bank Polski.

Internal Control System

As part of the NBU's development strategy to 2020 under the Internal Control System Implementation project, the NBU introduced a standardized, structured approach and requirements for the following: internal control, the effective implementation of the NBU's duties, secure and continuous operation, cooperation between NBU units at all organizational levels, and corporate culture of organization and development of the NBU's internal control system.

Management of Operational Continuity

In 2018, the NBU enacted the following to ensure operational continuity:

- tested and configured backup workplaces as part of testing the NBU's General Business Continuity Plan and Plan for the Recovery of IT Resources After Failures
- conducted its annual analysis of the impact of potential adverse factors on the NBU's processes and the operational continuity of its units
- assessed business continuity plans for the central bank.

Financial Risk Management

The NBU's financial risk management is focused on:

- detecting and assessing financial risks
- different ways of securing that a debtor or counterparty meets the obligations, evaluating and monitoring collateral, adjusting fair value of collateral accounting for haircuts or adjustment coefficients to reduce financial risks
- setting and controlling limits on quantitative financial risk indicators
- establishing the conditions and rules for qualitative financial risk indicators

- creating provisions to cover financial risks at the cost of own resources in accordance with IFRS.

In 2018, the NBU developed a policy for financial risk management. The policy establishes a standard procedure for managing financial risk, tolerance to different groups of financial risks depending on their impact on the NBU's activities and ability to achieve its goals, and systematization of the main measures the NBU can implement in response to financial risks.

The NBU's financial risk management policy covers all of the central bank's assets and liabilities (both on- and off-balance-sheet items).

The NBU is mainly exposed to financial risks pertaining to its policy. The regulator manages the financial risk of its international reserves and works to minimize other financial risks. To minimize other financial risks, the NBU work actively towards the repayment of debt under loans to insolvent banks.

Repayment of Loans to Insolvent Banks

In 2018, the NBU received UAH 2.6 billion of repayment of loans to insolvent banks.

The sale of property rights brought in UAH 1,237.7 million. Real estate sales brought in another UAH 681.6 million. The repayment also came from:

- the redemption of domestic government bonds (UAH 434.8 million),
- acquisition of real estate from property guarantors (UAH 132.3 million),
- the repayment of debt under loan agreements pledged by the NBU (UAH 154.4 million).

The value of the approved initial prices on property rights under the pledged loan agreements more than doubled in 2018 (UAH 100.5 billion) compared to 2017 (UAH 45.0 billion). The growth was driven by the introduction of asset sale approvals by portfolios and a streamlined procedure for determining an initial asset sale price corresponding to the volume of total debt under loan agreements.

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In 2014-2018, the NBU pursued legal action in 115 cases to collect the debts of insolvent banks under refinancing loans at the cost of the assets of property and financial guarantors.

Those claims totaled UAH 37 billion, including 10 claims against financial guarantors (UAH 11 billion) and 105 claims against property guarantors (UAH 26 billion).



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We believe that transparency is the only way to gain trust, to tackle populism and to preserve the independence of the National Bank. We will continue the good work. We are open to accepting and to sharing leading practices in the central banking community.

Yakiv Smolii

Governor of the National Bank of Ukraine

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Key Financials of the National Bank of Ukraine



The NBU introduced International Financial Reporting Standards (IFRS) in the preparation of its financial statements in 1998, and has been fully compliant with the standards since 2012.

The NBU's financial statements are consolidated financial statements that reflect the assets, liabilities, and profits or losses of the NBU, its subsidiary, and profits or losses of the associated companies in accordance with its share of their ownership.

As of the end of 2018, the NBU's balance-sheet total increased by 2%, to UAH 1,049 billion.

In 2018, the central bank continued to execute its functions, forming the corresponding profile of its assets, liabilities, and equity.

The NBU's assets mainly consist of:

- foreign securities
- domestic securities
- funds and deposits in foreign currency and investment metals.



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The NBU's liabilities mainly include:

- banknotes and coins in circulation
- liabilities to the IMF, apart from IMF quota contributions
- liabilities to the IMF for IMF quota contributions
- the funds of banks, state institutions, and other institutions
- liabilities to transfer distributable profit to the State Budget of Ukraine
- certificates of deposit issued by the NBU.

NBU's assets and liabilities in 2017–2018, UAH million

Funds and deposits in foreign currency and investment metals	116,681	400,119	Banknotes and coins in circulation
Foreign securities	432,991	38,509	Funds of banks
SDR holdings	100	47,727	Funds of state and other institutions
Monetary gold	27,752	64,898	Liabilities to transfer profits to the state budget
Domestic securities	361,436	61,867	Certificates of deposit issued by the NBU
Loans to banks and other borrowers	22,145	2,769	Received loans
Domestic public debt	1,834	217,300	Liabilities to the IMF, apart from IMF quota contributions
IMF quota contributions	77,472	77,462	Liabilities to the IMF for IMF quota contributions
PP&E and intangible assets	4,780	1,221	Other liabilities
Other assets	4,188	100	Authorized capital
	56,091	53,053	General and other reserves
	81,274	111,740	Assets and liabilities revaluation reserves

■ 2018 ■ 2017 ■ 2018 ■ 2017

The following changes occurred in the NBU's assets and liabilities in 2018.



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International reserves increased as a result of the central bank's policy of accumulating reserves.

Overall, international reserves rose by 10.6%, to USD 20.8 billion as of year-end 2018, up from USD 18.8 billion at the end of 2017. Unlike in previous years, in 2018 the increase in international reserves was due to absolute growth in their amount, as the hryvnia strengthened against foreign currencies at the end of the year, the first such occurrence for several years. The increase in reserves was driven by FX purchases on the interbank FX market of Ukraine, and by attracting foreign currency under financing programs of the IMF and other financial institutions.

In the wake of the rise in international reserves, funds and deposits in foreign currency and investment metals grew by 4.6 times. Moreover, the portfolio of foreign securities increased by 4.5%. However, SDR holdings account for only a minor share of international reserves, as they have been almost completely depleted to pay back liabilities to the IMF and interest on the IMF loan.

At the same time, the increase in international reserves, driven by the receipt of financing under the Stand-By Arrangement in 2018, pushed up the debt owed by the NBU to the IMF on the purchase of SDRs (loans received from the IMF) by 5.4%, to UAH 217 billion (equivalent to USD 7.8 billion).

The NBU's hryvnia assets are mainly comprised of domestic securities, the value of which decreased by UAH 11.3 billion or 3.0% in 2018, to UAH 361 billion. This, together with the rise in assets that form international reserves, reduced the percentage of domestic securities in the NBU's balance-sheet total to 34.4% in 2018, down from 36.3% in 2017. Of the domestic securities, 99.8% are securities held to generate cash flows in line with the terms of issue, and are accounted at their amortized cost.

The NBU's loan portfolio shrank by 31.7%, mostly due to a decrease in outstanding debts. The gross book value of loans (outstanding debts) dropped by almost UAH 12 billion, to UAH 63 billion. The amount of expected credit losses (loan loss provisions formed) also declined, by UAH 1.7 billion. Thanks to an improved macroeconomic environment and lower reliance on loans to support liquidity, banks that remained on the market after the banking system cleanup repaid their loans. Therefore, almost the entire amount of debts outstanding as of the end of 2018

consisted of the problem debts of banks that were being wound up.

Separate from its liabilities to the IMF, the NBU's liabilities changed as follows:

- Banknotes and coins in circulation grew by 11%.
- Liabilities to transfer profits to the state budget increased by 45.5%.
- Funds due to state institutions and other institutions declined by 15%.
- Certificates of deposit issued by the NBU decreased by 8%.

Profit or Loss

Factors that influence the NBU's profits the most are interest income and exchange differences, which result from the revaluation of assets and liabilities that arise from changes in the official exchange rate.

Interest income, mainly from domestic securities and loans to banks, declined compared to 2017 and reached UAH 47.9 billion, accompanied by a decrease in the corresponding asset items.

In 2018, interest expenses increased by 16%, to UAH 13.5 billion, which was mostly due to:

- higher expenses on NBU certificates of deposit as weighted average interest rates grew to 17.03% in 2018 from 13.40% in 2017
- an increase in interest-bearing liabilities to the IMF.

In 2018, the NBU continued to release impairment provisions for loans issued to banks, although at a slower pace. Overall, as a result of a decrease/reversal of the impairment of main financial assets, expenses decreased by UAH 498 million (UAH 3,151 million in 2017).

Net interest income (including the released impairment provisions) totaled UAH 34.9 billion in 2018, which was 23% lower than in 2017.

After the switch to a floating exchange rate regime, exchange rate fluctuations have exerted a significant influence on the NBU's performance. In particular, in 2018, the exchange difference was negative for the first time since 2013, at UAH 2.2 billion (while the total annual profit was UAH 37.8 billion). This was driven by the hryvnia strengthening against foreign currencies.

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NBU's profit or loss in 2017–2018, UAH million

Interest income		47,901	53,717
Interest expenses	-13,510	-11,631	
Net decrease in reserves for main financial assets		498	3,151
Fee and commission income		354	429
Fee and commission expenses	-1,222	-41	
Profit or loss from transactions with financial assets and liabilities in foreign currency and monetary gold	-2,223		14,344
Profit or loss from transactions with debt securities that are accounted at fair value		6,668	2,657
Profit or loss from transactions with financial instruments, apart from transactions with debt securities that are accounted at fair value		41	2,035
Other income		1,019	1,252
Total net income		39,526	65,913
Expenses	-1,711	-3,622	
Annual profit		37,815	62,291

■ 2018 ■ 2017 ■ 2018 ■ 2017

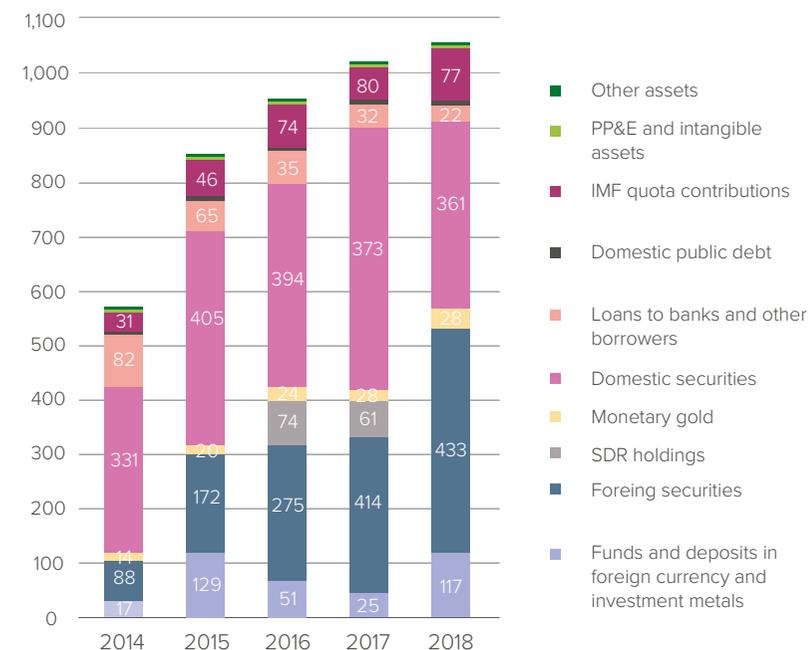
The NBU's expenses declined to UAH 1,711 million in 2018 from UAH 3,622 million in 2017, mainly on the back of the release of securities for legal obligations (as a result of past events), particularly under legal cases the settlement of which was probable (an adverse scenario being more probable than a positive one) to cause an outflow of resources that carry economic benefits.

Over the past five years, the main changes in the NBU's asset structure came from increases in international reserves, decreases in the portfolio of loans issued to banks, and changes in the domestic securities portfolio, which contains mostly government bonds.

The NBU's liabilities were diversified, with banknotes and coins in circulation traditionally being the main type of liabilities, which is common for any central bank acting as the issuer of national currency.

In recent years, external borrowings have grown significantly, especially liabilities to the IMF. A large portion of the NBU's liabilities consists of NBU certificates of deposit and liabilities to transfer part of the central bank's profit to the State Budget of Ukraine.

NBU's assets in 2014–2018, UAH billion



The NBU's equity, which is the residual value of assets after deducting liabilities, was mainly formed from sources other than government contributions. The NBU's equity consisted of the deferred unrealized revaluation of the NBU's assets and liabilities, including due to exchange rate fluctuations, and a part of the profits retained by the NBU as reserves, as required by law.

Net interest income as usual was the main contributor to the NBU's financial performance. The central bank's financial performance is also influenced by changes in the exchange rate due to the floating exchange rate regime and a large share of FX items being on the NBU's

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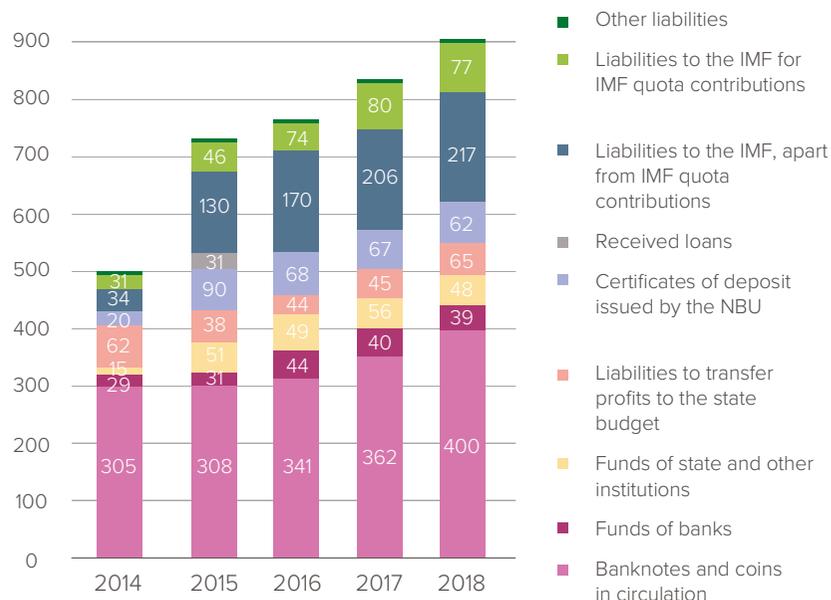
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balance sheet. However, the share of exchange differences in the NBU's total profit declined gradually as the hryvnia exchange rate stabilized.

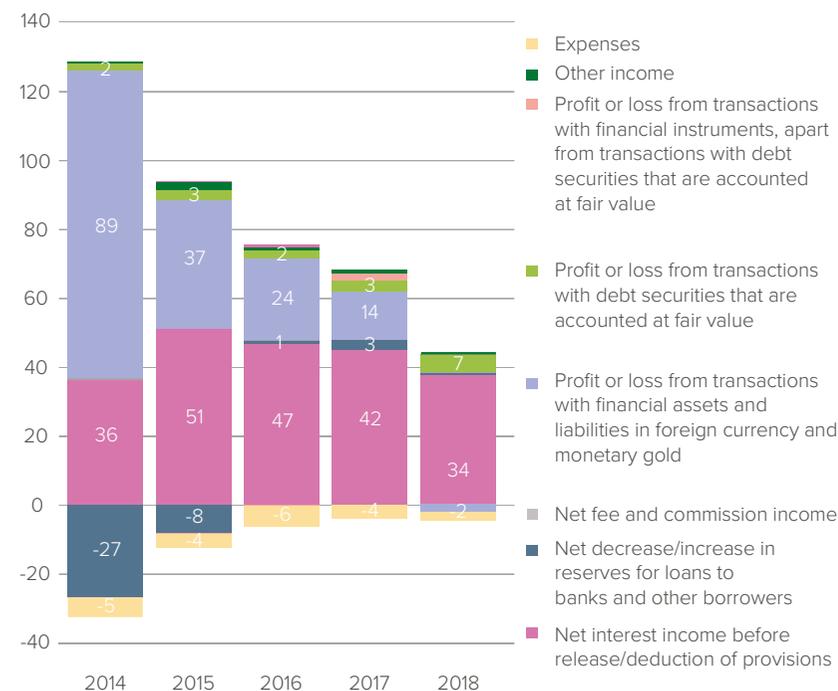
The NBU's liabilities in 2014–2018, UAH billion



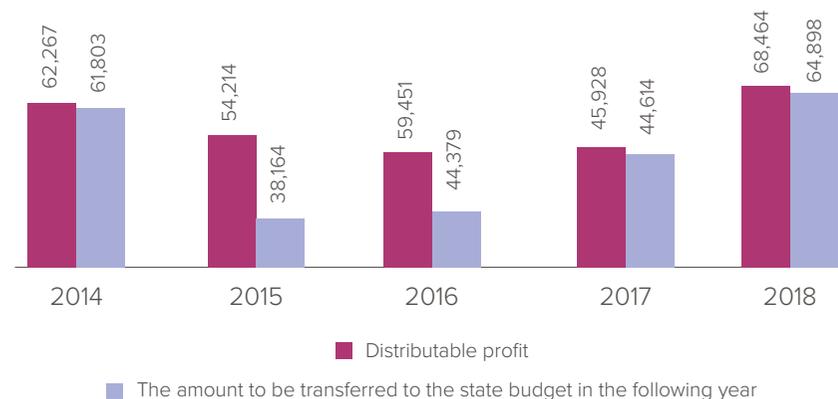
NBU's equity in 2014–2018, UAH billion



NBU's income and expenses in 2014–2018, UAH billion



Transfers by the NBU to the State Budget of Ukraine in 2014–2018, UAH million





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Payments to the State Budget

In 2018, the NBU transferred UAH 44.6 billion to the State Budget of Ukraine. As of 31 December 2018, the central bank recognized its obligation to pay UAH 64.9 billion of its profit to the state budget.

The NBU's remaining distributable profit of UAH 3.6 billion will be set aside to create general reserves of the NBU, once the central bank's financial statements are approved by the NBU Council.

The NBU's distributable profit for 2018 and the recognized liabilities to transfer funds to the State Budget of Ukraine include adjustments to past years' profits amounting to UAH 22 billion, due to the retrospective application of amendments to the NBU's accounting policy and the implementation of the new Procedure for Identifying Unrealized and Realized Revaluation Results.



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Read more about the changes in accounting policy in note 2 of the NBU's Consolidated Financial Statements. Read more about identifying the distributable profit, liabilities to transfer the distributable profit to the State Budget of Ukraine, and creating general reserves of the NBU in note 19.

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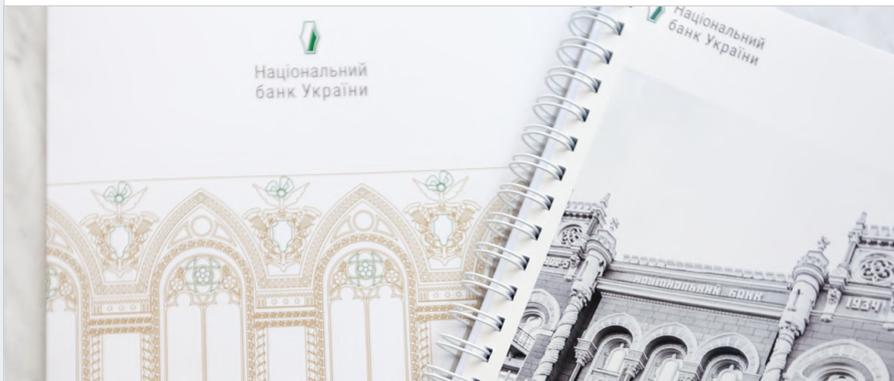
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Converting to IFRS 9



In 2018, the NBU and Ukrainian banks, along with the global financial community, converted to the new IFRS 9 international financial reporting standard.

IFRS 9 was developed to simplify and streamline requirements for classifying financial instruments and measuring credit risk. As part of the change, Ukraine introduced a new classification for financial assets based on a bank's asset management models and economic indicators for cash flows generated by the financial instrument under contractual terms, as well as a new model for measuring credit loss. Most significantly, the previous standard's approach, based on incurred losses, has been replaced by one based on expected credit losses derived from potential risks. We believe IFRS-based reporting will help key stakeholders trust more in the financial statements of Ukrainian banks.

The NBU was one of the first banks in the world to start the conversion to IFRS 9. The NBU views the standard as an important element of economic development and the development of financial markets, and one that contributes to the creation of a transparent information infrastructure in Ukraine. It is also important because the NBU's activities directly influence Ukraine's public finances. The NBU successfully converted to IFRS 9 and, thus, was able to share its experience with other central banks at an international roundtable in the fall of 2018 and

ensure a smooth transition of the Ukrainian banking system to the new standard.

The banking sector has converted to IFRS 9 gradually:

- at the beginning of 2018, the NBU granted banks a three-month transitional period, during which no corrective measures were applied for noncompliance with requirements and reporting rules due to changes in the measurement of financial instruments under IFRS 9
- that grace period was then extended to the end of June to allow banks to smoothly transition to interim reports.

The conversion to the new standard did not have a significant impact on the banking sector's operating performance. Despite concerns about a potential need to increase capital, the conversion to IFRS 9 did not impact the capital adequacy of banks.

Overall, the conversion to IFRS 9 is a positive development, which will encourage banks to be more responsible and more aware of their risks. It will also allow the banking system to respond to threats to financial stability early and mitigate or eliminate them in time.



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