

TO: Clients and Friends of the Firm
FR: Frishberg & Partners
RE: Law “On Banks and Banking Activities”

I. Introduction

The original Law “On Banks and Banking Activities” was adopted during the heyday of Ukraine’s independence in 1991. Like other antique laws, this law was drafted on the basis of Soviet banking legislation, which was incompatible with the theories of an open and internationally friendly market economy.

The ongoing political and economic changes that have taken place since the adoption of the original law in 1991 resulted in innumerable amendments, revisions and supplements (over 30 times). All efforts to patch up the law’s flaws failed. Comprised of only fifty-four articles, of which less than forty were in force, the original law became obsolete and ineffective even in terms of the limited issues purportedly covered thereby, including its terminology and definitions. Thankfully, the majority of issues, which should have been covered by the original banking law, were delegated instead to a multitude of supporting legislative acts (e.g., instructions, regulations, resolutions and decrees).

Upon entering the 21st century, Ukraine faced the formidable task of adopting a comprehensive and transparent banking law. Ideally, such law would encompass the lessons learned from past mistakes and provide a comprehensive (and transparent) regulation for the banking sector. Of course, the new banking law would also need to correspond to the worldwide standards of banking regulation.

In light of these lofty goals, the new and improved Law “On Banks and Banking Activities” No. 2121-III (the “Banking Law”) was successfully passed by the Ukrainian Parliament on December 7, 2000. Not surprisingly, adoption of the Banking Law by the end of 2000 was, among others, one of the conditions of the World Bank’s \$100 million Financial Sector Accommodation Loan to Ukraine. Signed by the President of Ukraine on January 11, 2001, the Banking Law entered into force six days later upon its official publication on January 17, 2001.

Below, we discuss the Banking Law’s impact on Ukraine’s banking system.

II. Discussion

Drafted by the National Bank of Ukraine (the “NBU”), and further elaborated by the Parliamentary Committee governing financial and banking issues, the Banking Law, in comparison with its predecessor, is three times larger, with a total of 99 articles comprised in 16 chapters and organized in seven sections. A cursory review of this document reveals that the prevailing goal of the Banking Law is to maintain Ukraine’s banking system via strict control over all commercial banks. At the same time, the Law introduced utterly new provisions, which, if implemented as intended, will bring Ukraine closer to the global standards of conducting banking business operations.

A. Major Novelties of the Banking Law

One of the first departures of the Banking Law is the new opportunities offered for existent and prospective banks with respect to organizational forms, selecting a certain field of specialization, and forming banking groups and corporations. For example, in addition to the classic open joint stock company form, the Banking Law introduces a new possible form for banks, the cooperative bank. According to Article 338 of the Commercial Code of Ukraine, a cooperative bank is created by business and other entities on the principle of territoriality and on the basis of voluntary membership and the unification of share contributions for joint cash-credit activity. Generally, a cooperative bank may only take deposits from its members. One of the hurdles, however, is that a local or regional cooperative bank must have at least fifty (50) members; if the number of bank members falls below the 50-member mark, the bank has one year to bring its membership up to the minimally required number or terminate its activities via reorganization or liquidation.

Generally, the cooperative banking system is aimed at promoting mutual crediting among local farmers and other agricultural institutions. Whether these good intentions will achieve their goal, or suffer the fate of other financial experiments in Ukraine (i.e., trust companies in the mid-nineties), depends on the practical application of subsequent legislation (i.e., instructions), which would supervise and control these unproven financial institutions. In fact, on March 17, 2006, the Ministry of Agrarian Policy of Ukraine formed a working group to develop a draft law “On Cooperative Banks” upon the President’s order of December 28, 2005.

As to the field of specialization, the Law sets forth that a bank may operate either as a universal bank or a specialized one. According to Article 4 of the Banking Law, a bank acquires the status of a specialized bank if more than 50% of its assets are of the same nature or origin. Further, a bank acquires the status of a specialized savings bank if more than 50% of its liabilities are deposits of natural persons. Pursuant to the Banking Law, four types of specialized banks may be established: savings banks, investment banks, mortgage banks or clearing banks. The difference between the above types of specialized banks and universal banks are further described in the Banking Law.

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