The Resilience and Integrity of the Financial System in Ukraine
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Overview

In February 2024, the Centre for Financial Crime and Security Studies (CFCS) at RUSI convened an online workshop entitled ‘The Resilience and Integrity of the Financial System in Ukraine: Two Years after Russia’s Full-Scale Invasion’. As Ukraine continues its commitment to strengthening anti-money laundering (AML) efforts and implementing EU reforms, it recognises the significance of preparing for the upcoming enhanced follow-up procedure and 6th round of the MONEYVAL mutual evaluation, the regional body of the Financial Action Task Force (FATF) to which the country belongs. In light of this, the virtual workshop addressed key issues crucial for ensuring Ukraine’s readiness for the assessment. The workshop forms part of CFCS’s Supervising and Monitoring Ukraine’s Reconstruction Funds (SMURF) project, supported by the National Endowment for Democracy. The workshop, held under the Chatham House Rule, gathered representatives from key Ukrainian financial institutions and relevant authorities, including the State Financial Monitoring Service of Ukraine, the Ministry of Finance of Ukraine, the Prosecutor General’s Office, the Ministry of the Digital Transformation of Ukraine and others. This report summarises the main findings of the workshop.

Introduction

Ukraine’s second enhanced follow-up MONEYVAL report, published in June 2020, identified several deficiencies in the country’s technical compliance with standards set by the FATF, the global standard-setter in anti-financial crime. The report flagged areas including risk assessments of new technologies, risk-based supervision and regulation of virtual assets, statistical data on AML and

counterterrorist finance (CTF), and others as key issues where the country still has significant work to undertake.² During the online workshop, participants reflected on these flagged areas, offering insights in how to effectively tackle these challenges. The workshop not only focused on Ukraine’s technical compliance with AML standards but also delved into the effectiveness of the country’s existing response to financial crime. It focused on four principal areas: development of the law on virtual assets; a path to creating a single register of bank accounts of individuals and legal entities; public–private partnerships; and recovery of the proceeds of crime.

Ukraine’s Technical Compliance with AML Standards

Development of the Law on Virtual Assets

Virtual assets and the laws on their regulation emerged as a key topic during the workshop. This was largely due to the spotlight cast on the topic following the downgrade of Ukraine’s rating to ‘partially compliant’ in its second enhanced follow-up MONEYVAL report to in relation to FATF Recommendation 15 on new technologies.³

The first attempt to regulate virtual assets in Ukraine, aligning the country with international standards on AML/CTF and comprehensive financial monitoring, was made in 2022, when the Law on Virtual Assets No. 2074-IX was adopted and signed. However, participants noted that the law is not yet in effect due to delays caused by required amendments to the Tax Code of Ukraine. A participant clarified that the reason behind the delay is that the necessary draft law for taxing operations with virtual assets has not been developed.

Rather than developing the necessary technical amendments to the Tax Code of Ukraine, a different pathway was chosen to address the issues around the regulation of virtual assets. Two alternative draft laws were registered in Ukraine’s legislature, the Verkhovna Rada, to revise the already-adopted Law on Virtual Assets and legalise the market and solve the taxation issue. However, neither has yet been passed. One participant noted that the main difference between the two draft laws lies in the taxation rules and classification of virtual assets.

². Ibid.
³. Ibid.
Draft Law No. 10225,\(^5\) developed by Ukraine’s National Securities and Stock Market Commission in cooperation with EY (Ernst & Young), translates the EU’s Markets in Crypto Assets Regulation (MiCA)\(^8\) standards into the Ukrainian context and proposes a standard tax rate of 18%, with a 1.5% military tax. Draft Law No. 10225-1,\(^6\) on the other hand, was developed by the Ministry of the Digital Transformation of Ukraine, and proposes the combination of the Base Law No. 2074-IX with MiCA standards. This draft law proposes a three-year transition period during which the tax rate would be only 5%, with an increase of this rate to 9% over the subsequent five years and 18% after eight years of market regulation. This second draft law aims to simplify the creation of the virtual asset market, streamline the authorisation process for service providers, and promote market development in accordance with EU standards.

While Ukraine has not adopted either of the two draft laws, workshop participants noted that there is already widespread use of virtual assets in Ukraine and a growing demand among the population, underscoring the need to regulate the industry. Ukraine was ranked fifth on the Global Crypto Adoption Index in 2023,\(^7\) and approximately 6.5 million Ukrainians, 15.72% of the population, owned digital currency in 2022.\(^8\) It should also be noted that while Ukraine’s AML Law offers a legal framework for launching AML/CTF regulation of virtual assets, the law has not be enforced since it came into effect in 2020.

As market regulations continue to develop, it is also becoming necessary to understand what effective financial monitoring of the virtual asset industry would look like. Participants agreed that effective monitoring relies on a strong market framework. This includes having a diverse range of service providers that serve a broad user base. Without such an ecosystem, the necessary data for effective monitoring would be lacking. Therefore, it is essential to simplify the authorisation procedures for these services, especially during the initial stages, to foster market growth and stimulate demand among a wider population. In the first period of market development, the authorisation process should be as

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\(^5\) Проект Закону ‘Про внесення змін до Податкового кодексу України та інших законодавчих актів України щодо врегулювання обороту віртуальних активів в Україні’ No.10225 від 7 листопада 2023’  

\(^6\) Проект Закону ‘Про внесення змін до Податкового кодексу України та інших законодавчих актів України щодо врегулювання обороту віртуальних активів в Україні’ No.10225-1 від 17 листопада 2023’  


straightforward as possible, as this will help to shape the market and create demand for the service providers from a larger population. Once the market is shaped, additional tools for regulatory influence, impact and review/control will be implemented and become a regular element of the financial market.

Pseudonymity of virtual assets was another key topic that emerged during the discussion. One participant posited that most users and customers of virtual assets do not consider anonymity the most important aspect of virtual assets, and would be willing to comply with Know Your Customer measures and allow themselves to be identified to ensure they have no criminal intent. Both of the draft laws noted above propose that all service providers must fully identify their users in every case. With the implementation of the law, virtual asset users will have the opportunity to participate in a regulated and transparent market.

Another issue identified during the workshop was the lack of crypto-to-fiat gateways in the market. It is important for customers to have the freedom to move their money, especially for exchanging between fiat currency and virtual currencies. However, due to various complications and currency regulations, this task remains quite challenging.

Despite the above-mentioned challenges, one participant drew attention to the benefits of legalising virtual assets in Ukraine, particularly the impact on technical compliance with AML standards and market developments. They noted that legalisation of virtual assets can provide opportunities for business growth, technological advancement, and an increase in state revenue. Additionally, it can help to eliminate the use of Ukraine’s market by criminals for money laundering of crypto assets and sanctions evasion. In the long term, it can also provide access to EU markets in crypto assets and offer additional channels for money flows towards Ukraine’s reconstruction.

The next important steps for the legalisation of the market are expected from the Tax Committee of the Verkhovna Rada. The Committee is currently reviewing the draft laws and will choose one as the main law for market development. Workshop participants acknowledged that it is difficult to provide a timeline because of the obstacles caused by the war. Nonetheless, the representative of the Ministry of the Digital Transformation of Ukraine noted that the decision as to which law will move forward is expected by the end of summer 2024. After that, amendments to the basic law could take effect by the end of 2024. With virtual asset companies already working in Ukraine, differing opinions were expressed as to whether the market can operate without waiting for a specific regulation to be adopted.

Participants in the workshop and authors of the draft laws have been in constant dialogue with the community, the market and potential participants. Overall,
workshop participants agreed that there is a need to create a regulatory environment as soon as possible and pass the relevant law.

A Path to Creating a Single Register of Bank Accounts and Safe-Deposit Holders

With Ukraine’s progress towards EU accession, another concern identified by workshop participants was the necessity of creating a central register of bank accounts and safe-deposit holders, stemming from the requirements of the 5th Anti-Money Laundering Directive.9 Ukraine has in fact initiated the development of a single register of bank accounts. During the workshop, participants noted that the register of bank accounts of legal entities is already in place, administered by the State Tax Service of Ukraine, and that law enforcement authorities have access to it. However, information about the bank accounts of individuals is not included in the register, and it was agreed that this should be the focus of future work.

One participant drew attention to efforts by the Ministry of Finance of Ukraine in this regard. The Ministry had prepared a draft law entitled ‘On Amendments to the Tax Code of Ukraine and Certain Legislative Acts of Ukraine Regarding the Establishment of the Unified Register of Accounts of Individuals and Legal Entities and Individual Bank Safes’.10 Yet the participant said that in 2023, after the draft law was submitted to the Cabinet of Ministers of Ukraine, concerns about privacy, confidentiality and human rights compliance were raised, and the matter was approached with caution.

The passage of the law was delayed as specific legislative amendments in relation to confidentiality were required, which the Ministry of Finance continues to work on. The law’s drafters were asked to research the confidentiality issue and prepare the necessary amendments to provide safeguards in relation to private information. Currently there is a concern among government officials regarding how personal data could be leaked or misused for malicious purposes.


One participant noted that officials have identified as a major obstacle a lack of coherence of Ukraine’s data protection regulations in relation to the EU framework. The country has not yet adopted the EU’s General Data Protection Regulation provisions, which would impact the entire process. Participants also noted that Russia has made attempts to abuse the register and use the information included in it. To deal with cyber security threats, a deadline for the establishment of the register has been set for 2027. This will give Ukrainian authorities time to involve cyber security experts in its development and prepare the appropriate procedures and protocols.

One participant recalled that the EU’s Ukraine Facility programme requirements mandate the implementation of a single register by 2027. Ukraine’s National Revenue Strategy for 2024–30 acknowledges the importance of building trust and confidence within the population in the use of private information about bank accounts in the register.

The Effectiveness of Ukraine’s Response to Financial Crime

Public–Private Partnerships (PPPs)

Beyond the discussion of Ukraine’s technical compliance with AML standards, the workshop also placed a spotlight on the issue of the effectiveness of the country’s response to financial crime. The 2017 Mutual Evaluation Report (MER) on Ukraine\(^\text{11}\) concluded that the implementation of measures necessary to fight financial crime in the country was not sufficiently effective. Consequently, the workshop discussion extended beyond the technical ratings of the FATF. Among the topics raised against this backdrop was the current status of public–private partnerships (PPPs) in Ukraine.

Participants emphasised the key role of PPPs, particularly in the evolving landscape of AML technology. They underscored how PPPs significantly enhance the formulation of efficient market rules and regulations in two key ways. First, they serve as effective deterrents against market violations, while driving progress. Second, given the potential unfamiliarity of state officials with emerging technologies and their business applications, PPPs offer a collaborative platform for knowledge sharing to facilitate deeper understanding of these technologies. However, it was noted that the bureaucratic nature of certain authorities can

cause challenges in establishing robust PPPs. Nevertheless, one participant argued that the key to initiating and sustaining PPPs lies in their voluntary nature. Thus, there needs to be a strong emphasis on fostering willingness and providing incentives for the private sector to collaborate with the public sector. Positive examples of PPPs in Ukraine emerged during the discussion, although these were not always in relation to conventional financial crime. Participants argued that PPPs in Ukraine are often used for such purposes as raising awareness and establishing communication channels, showcasing the diverse and innovative ways in which they can be leveraged for mutual benefit. On this, one participant highlighted the efforts of the National Bank of Ukraine in raising awareness and establishing a direct communication channel with the private sector. Also mentioned as a good example of a PPP was the Public Council under the Ukrainian Ministry of Finance, a group that includes representatives of public organisations, trade unions and other citizen associations, which gathers annually to discuss issues related to financial services and their impact on society. It was noted that the State Financial Monitoring Service has also set up a Public Council on AML issues. Another participant highlighted that the Ministry of Digital Transformation is actively working on developing a regulatory ‘sandbox’, scheduled for completion by the end of 2024. This sandbox aims to streamline communication between businesses and government authorities, fostering an environment conducive to PPPs. While some of the initiatives mentioned by the participants suggested promising steps towards PPP development in Ukraine, it was agreed that there remains a need to further strengthen and expand these efforts and learn from foreign experience.

Recovery of the Proceeds of Crime

Another key topic raised concerning the effectiveness of Ukraine's anti-financial crime measures related to the country’s efforts to recover the proceeds of crime. Asset recovery is a key FATF priority, particularly under the current Singaporean presidency. In fact, Ukraine’s MER noted that the country needs to ensure that prosecutors handling proceeds-generating cases are well-trained in modern

financial investigative techniques, and highlighted a need for focused guidance on the importance of early restraint and confiscation of proceeds.\textsuperscript{15}

On Ukraine’s efforts to recover assets, a participant from the Prosecutor General’s Office noted that considerable effort has gone into developing the efficiency of pre-trial investigations of criminal cases. The Prosecutor General’s website has published reports on the results of AML investigations, noting that 7,832 criminal offences related to AML and CTF were investigated in 2023.\textsuperscript{16} The report also shows that, according to indictments, the established value of legalised property obtained by criminal means in this period was UAH 2,998,290,540 ($78,263,910), of which UAH 212,426,030 ($5,544,923.50) has been seized.\textsuperscript{17} However, despite these achievements, it was highlighted that the key to ensuring effectiveness in recovering the proceeds of crime lies in taking a comprehensive approach during pre-trial investigations. Participants noted that while accessing information about assets or accounts within Ukraine is swift, investigations involving international partners take a long time and can be delayed by prolonged procedures. That said, Ukraine’s formal and informal cooperation with EU countries on mutual legal assistance was reported as working well. Additionally, attention was drawn to the importance of court judgements authorising confiscation, highlighting the key role that these play in asset recovery. It was noted that Ukraine’s particularly low score on Immediate Outcome 7 of its MER – which relates to the effectiveness of a country’s money laundering investigations and prosecutions – should serve as a reminder of the need to demonstrate effective use of financial investigations to recover assets.

Overall, one workshop participant emphasised that it is crucial to recognise that the impact of the FATF assessment of Ukraine is still ongoing. Ukraine’s 2020 MER requires the country to continually report on its efforts to address the deficiencies identified in the MER, and it must submit a progress report by December 2024.

Looking ahead, while Ukraine’s next MONEYVAL Assessment will not occur until 2027, workshop participants emphasised that all relevant stakeholders in the country should take the necessary measures to both uphold high standards of technical compliance by passing relevant legislation and ensure their effectiveness by ensuring that these laws are implemented. The world – and the EU in particular – is watching.


\textsuperscript{17} Ibid.
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