

Fintech Industry in Ukraine: Regulatory Framework and Recent Trends

Digitalisation of the world economy, boosted by the COVID-19 pandemic, inevitably leads to the respective transformation of the financial sector and its established foundations. Keeping up with global trends, the Ukrainian fintech sector has also been growing remarkably in recent years and, thus, attracts the special attention of lawmakers and regulators. Since the financial services area is always heavily regulated the authorities also need to adapt and become more flexible to accept the new "digital" reality.

The most remarkable recent fintech-related regulatory achievements include:

- introduction of the new law on payment services;
- introduction of new legislation on use of electronic signatures based on EU standards;
- launch of the Bank ID remote identification system by the National Bank of Ukraine to facilitate access for customers to financial and other services;
- remote customers identification by the banks, including via video conference and qualified electronic signatures;
- liberalisation of foreign currency control regulations.

The new *Law On Payment Services* just passed by Parliament¹ is the most anticipated novelty among the above developments. This law is designed to implement the principles of EU Directive 2015/2366 (PSD2) into Ukrainian legislation. This law names and regulates the new payment services and lays the foundations for so-called "open banking" standards, envisaging close cooperation between banks and other market players via banks' open APIs. In particular, PSD2 requires banks to create mechanisms to enable third party providers to work securely, reliably and rapidly with the bank's services and data on behalf of, and with the consent, of their customers. By virtue of such cooperation between banks and third party services providers, the payment services which were known as exclusively "banking" ones will no longer be so closely associated with the banks.

In fact, a number of market players already offer some of those new services (e.g., account information services). However, both the National Bank of Ukraine and the services providers themselves often struggled to qualify their activities in a context of outdated existing regulations. This problem is remedied by the new *Payment Services Law* which, on the one hand, recognizes the number of new payment services and concepts, and, on the other hand, implements the idea of a fully-fledged regulatory "sandbox" for testing innovative projects in a friendly environment, whether or not they fall within the existing legal framework. Although implementation of this law will take some time (the law is supposed to be generally applicable one year after coming into force, while "open banking" provisions — in three years), the market should feel the positive effects of the law much sooner in anticipation of this reform.

More updates are still to come, as a number of regulatory initiatives, such as legislation on cryptocurrencies, are still being developed.

E-money

In 2020 the NBU modernised Ukrainian legislation in the e-money area, having brought it into line with EU standards from the standpoint



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of AML requirements. In particular, Ukrainian banks are now obliged to identify and verify customers, using e-wallets to purchase goods and services. In addition, the AML Law requires identification of the payer and the payee in all transactions where e-money is used.

Given the new, stricter requirements prescribed by the AML Law, the NBU cancelled the previously existing limits, applicable to e-money transactions, provided that customers were properly identified and verified. The e-wallets, however, are subject to the following limits: refillable wallet — UAH 400,000, non-refillable e-wallet — UAH 5,000.

E-money in Ukraine can only be issued by banks. However, non-banking financial institutions and other companies may act as agents of the banks and render services aimed at e-money distribution, refilling of e-money wallets and effectuation of settlements.

The NBU is currently working on elaboration and implementation of e-hryvnia, a digital currency of the central bank. The

right of the regulator to issue its digital currency is stipulated by the *Law of Ukraine On Payment Services*, as passed by Parliament at the end of June 2021.

Personal & Business Lending

Ukrainian legislation provides a sufficient legal framework for digital lending. Digital lending, including e-signing of a loan agreement and various ancillary documents, is governed by several core laws of Ukraine, namely *On Financial Services and State Regulation of Financial Services*, *On Electronic Documents* and *On Electronic Trust Services*. These laws enabled Ukraine's integration into the EU's digital environment. They recognize electronic documents, signed with simple or qualified e-signatures, as well as MobileID. The above set of laws provides Ukrainians with modern tools to carry out transactions and obtain loans without leaving their homes. Moreover, the new digital approach gives yet another advantage — fixation of the real time signing of electronic documents.

P2P lending platforms, which are very popular in the EU, keep gaining popularity in Ukraine. Currently, their activity does not fall within the scope of NBU regulations. The NBU started working on the concept of P2P platforms regulation back in 2018. However, this matter is still at the stage of the regulatory concept development. Hence, while implementing P2P business in Ukraine, special attention should be given to compliance with AML, GDPR and customer protection legislation, as well as to risk assessment tools.

Marketplace

The marketplace business model is becoming increasingly popular as people are getting used to the benefits of receiving all they need from various suppliers in the same place. Financial services were always there, given that such online supermarkets inherently require integration of payment gateways to support their purchases. However, this is not sufficient if a customer is looking for a fully-fledged financial service, including money transfers and loans. As banking services are always associated with complicated procedures and requirements, it is much easier for a Ukrainian bank to make its own marketplace rather than join any third-party platforms. Marketplaces are now becoming more sophisticated and include online services which require full-time IT support and maintenance. Therefore, it looks like the banks'

¹ As of the date of this publication the law is pending signing by the President of Ukraine and official publication in order to come into force.

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role in future complex marketplaces will be limited to provision of the banking infrastructure, while the "architecture" of the financial services will be developed and supported by dedicated fintech companies. The newly adopted Law *On Payment Services* (based on European PSD2 standards) creates legal grounds for such cooperation.

Generally speaking, activities on the marketplace may envisage various legal structures and, thus, concern a wide range of e-commerce, consumer rights, banking secrecy and personal data protection laws. Considering that the synergy of the marketplace is often achieved by active cross-selling and, respectively, sharing the data of customers, all these legal aspects require careful consideration.

Neobanks

A neobank is a type of a bank that operates exclusively online without the traditional physical branch networks. The number of neobanks has exploded around the world in recent years, becoming especially popular in 2020 for well-known reasons. A neobank inherently targets individual customers and aims to enhance their user experience. Keeping this primary goal in mind, neobanks often choose not to pursue a banking license themselves, as this is a quite time-consuming and money-consuming exercise, but to rely on the banking license of a traditional banking institution, acting as a cooperating partner.

In the confines of EU regulatory framework neobanks may operate at facilities of "regular" licensed banks by virtue of the "banking as service" solution. It becomes feasible due to the "Open Banking" approach introduced by PSD2 Directive.

As PSD2 is not yet fully implemented into Ukrainian legislation, Ukrainian neobanks invent their own models of cooperation. In particular, Monobank operates on the basis of Universal Bank's license and facilities, effectively making such a neobank a retail unit of an existing licensed bank. Nevertheless, such an approach is not exclusive. Some European fintech start-ups, which expanded their business to Ukraine in 2020/2021, decided to follow familiar to them the "Open Banking" approach — their neobanks established cooperation with existing traditional banks via APIs. In the absence of sufficient legislation any such innovative structure required thorough attention from the compliance perspective, as well as close cooperation with the NBU, as the regulator.

Crowdfunding and Crowdfunding

In the age of Internet and social media, it becomes much easier for businesses and social start-ups to find their investors and donors. Crowdfunding is a model matching a start-up to be funded with donors supporting the respective idea or project through the online platform that brings the parties together to launch the idea. The first Ukrainian crowdfunding platform, Spilnokosht, was established back in 2012.

In the absence of a special legislative framework, Ukrainian crowdfunding platforms have to operate within existing "old school" legal structures. For instance, money donated by supporters and further granted to a start-up are usually qualified as a "charity contribution"



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or a "non-refundable financial assistance", while the platforms themselves are normally registered as NGOs or charity funds. However, until special legislation is passed, the participants of the crowdfunding process are unlikely to be sufficiently protected, and the most promising ideas will keep migrating to Kickstarter and similar foreign platforms.

Crowdfunding, as it follows from the name, has nothing to do with charity. A start-up or developed business in need of capital welcomes "retail" investors to put their money into their project in return for a small piece of equity with any dividends attributable in the future. This model is, in effect, very similar to an IPO, just arranged over the counter rather than at a stock exchange. Hence, it requires much fewer preparatory efforts and resources. The most prominent example of such crowdfunding in Ukraine is Prompylad. Renovation, an innovative public space in Ivano-Frankivsk located in the premises of an old plant. It focuses on four areas of the region's development — new economy, urban design, contemporary art, and education. The project follows the impact investing model, where investors contribute to social changes in the region and get a return on investment in the form of dividend payouts. Investments in this particular project are structured through the acquisition of shares in a corporate investment fund, managed by an asset management company.

Cryptocurrencies

There is no unified approach as to cryptocurrency regulation in the world. Some jurisdictions consider cryptocurrency as a payment method, others as a special type of asset, while the rest prohibits it completely. Most jurisdictions, however, share the view that it is crucial to regulate cryptocurrencies and related activities due to anti-money laundering efforts, customer protection and taxation reasons. As Bitcoin reaches new all-time highs, hedge funds start investing in cryptocurrencies and Visa partners up with crypto wallets, this issue becomes especially topical. However, an extreme volatility and environmental issues associated with this instrument induce most of market makers to keep watching it but not investing yet.

Ukraine attempted to regulate this area a few years ago, but the respective draft laws were rejected by Parliament at the early stage. The matter remained fully unregulated until 28 April 2020, when the new AML Law came into force; the new law treats cryptocurrencies as "virtual assets" (in line with terminology used by FATF) and imposes certain reporting obligations on service providers dealing with virtual assets.

The next "regulatory" milestone might well be the new Law *On Virtual Assets*, the draft of which was adopted in its first reading in the Ukrainian Parliament in December 2020. The draft law is designed to protect the owners' title to virtual assets and regulate the services related to such assets. Notably, the draft law anticipates that the activities of service providers based in Ukraine dealing with virtual assets (exchange, transfer, custody, etc.) require the respective government permit.

If the Virtual Assets Law is adopted by Parliament, lawmakers also plan to introduce a tailored tax regime for cryptocurrencies.