

INTEGRATION OF THE UKRAINIAN BANKING SYSTEM INTO THE EUROPEAN FINANCIAL SPHERE: MAIN TRENDS AND DIRECTIONS

Yulia DIATLOVA

Donetsk State University of Management, Mariupol city, Ukraina

Email: yuliyadyatlova25@gmail.com

The main tendencies of the banking system development in Ukraine have been determined. The place and sovereign rating of European banks in Ukraine have been shown. The legal principles of banking activity in the EU have been analyzed. The current state of European norms implementation and banking regulation principles has been noted. The directions for integration of the Ukrainian banking system into the EU financial sphere have been proposed.

Keywords: banking system; eurointegration processes; main tendencies; EU legislation norms implementation; directions for integration.

A problem statement

The declared integration of Ukraine into the European Union (EU) has become the basis for the transformation processes in the economy, in particular the financial sector and its banking sector. Transformation processes related to European integration led to significant changes in the functioning of the Ukrainian banking system, namely the presence of foreign capital and banks, implementing the EU legislation in the banking sector, the introduction of international and European approaches to national practice of banking business.

The goals and consequences of the European integration of Ukraine's banking system into the EU financial sphere should be consistent with the strategic direction of financial policy to ensure its stability. This requires the improvement of banking standards and banking regulation standards on the basis of international and European practices. Meanwhile, one ought to take into account the shortcomings that exist in the EU banking system and its regulation, the most significant of which was the financial and economic crisis. Proceeding from the importance of the financial sector for the country's stable development, European integration processes in the Ukrainian banking system require constant attention and due diligence.

Analysis of recent research and publications

A significant contribution to the study of integration processes were made by well-known domestic and foreign scientists: A. Abalkin, I. Burakovsky, E. Vinokurov, P. Gaidutsky, V. Heyets, M. Golovnin, A. Krisovaty, A. Libman, E. Savelyev and others. Methodological and institutional aspects of the enhanced integration processes in the European banking sphere were studied by

O. Butorin, J. Dermin, T. Zolotukhin, D. Mark, P. Molina, G. Reznik, D. Smyslov. Theoretical and applied aspects of the influence of European integration processes on the banking system are reflected in the works of such domestic scientists as O. Halyts, I. Klymenko and Y. Belinska, I. Storoniaska and I. Muzika, O. Metlushko and others. Recognizing the contribution of scientists, it should be noted that eurointegration processes in the banking sector are still not sufficiently investigated; therefore the problem of the development of the banking system of Ukraine in the conditions of European integration needs further development.

The purpose of the paper is definition of modern tendencies of the banking system development in Ukraine, substantiation of directions and approaches of its integration into the European financial sphere.

Description of the main research material

The integration of national banking systems into the global financial sphere is one of the manifestations of economic globalization. The processes of integration of the Ukrainian banking system into the European financial sphere require identification of its main trends in the development and expansion of interconnections.

Among the main trends, it ought to be noted, first of all, the reduction of the number of banks as a result of the National Bank of Ukraine (NBU) activity as a regulator in accordance with European norms and standards (Table 1). The trend is maintained further: 90 banks as of 1st July 2017, including 38 banks with foreign capital (42.2 %) were operating. The share of foreign capital in the authorized capital of banks was 56%. The number of foreign banks is stable, however, due to the reduction in the number of commercial banks, their share increased from 17.0 % as of 1st January 2015 to 26.0 % as of 1st January 2017.

It should be noted that the transition of Privatbank into state ownership at the end of December 2016 significantly changed the structure of the banking sector: the share of state banks in net assets increased from 28.1 % to 51.3 %, on deposits of the population – almost three times, to 59.5 %. During 2016, 17 banks were declared insolvent; another 4 were liquidated by the decision of shareholders. Consequently, the concentration increased: the share of the 20 largest banks in net assets for the year increased from 86.4 % to 89.4 %¹.

¹ The review of the banking sector, 2017, No. 2. Source: <https://bank.gov.ua/control/uk/publish/article> (In Ukrainian).

Table 1

The dynamics of the banks number in Ukraine, by category

Categories of banks	As of 01.01.2015		As of 01.01.2016		As of 01.01.2017		As of 01.02.2017	
	Quantity	Change	Quantity	Change	Quantity	Change	Quantity	Change
Capable of paying	147	-33	117	-30	96	-21	93	-3
State	7	0	7	0	6	-1	6	-1
Foreign	25	0	25	0	25	0	25	0
Private	115	-33	85	-30	65	-20	62	-3
Insolvent	16	16	3	-13	4	1	7	3

Source: <https://bank.gov.ua/control/uk/publish/article>

The total assets of all banks in 2016 increased to 1.242 trillion UAH (by 1.8 %). The operational efficiency of the banking sector has declined: the CIR (cost to income ratio) was 58 % versus 52 % in 2015. Net interest income was reduced because of the high funding cost. However, moderate growth in net commission income was noted due to the recovery of demand for banking services and tariff increases. Furthermore, the historically high losses of the banking sector were recorded – 158.4 billion UAH (an increase by 20 %) in 2016, which is due to reserve of the loan portfolio of Privatbank. It should be noted that the banking system of Ukraine for the third consecutive year is unprofitable.

Foreign banks from Austria, the Netherlands, Poland, the USA, France and Hungary ranked in the Top 10 rating of the most reliable banks in Ukraine (Table 2), compiled by analysts of the «Forensurer» magazine on the basis of official statistics provided by the NBU. It ought to be taken into consideration that no bank belonging to the state or international financial holding companies was found to be insolvent in ratings for 2014-2017.

Table 2

Reliability rating of Ukrainian banks

Rank	2015	2016	2017
1	Ukreximbank (state, Ukraine)	Credi Agricole Bank (Credit Agricole, France)	Raiffeisen Bank Aval (Raiffeisen Bank, Austria)
2	Credi Agricole Bank (Credit Agricole, France)	Кредобанк (PKO Bank Polski, Польша)	Credi Agricole Bank (Credit Agricole, France)
3	Savings Bank (state, Ukraine)	Ukrsibbank (BNP Paribas Group, France)	Ukrsibbank (BNP Paribas Group, France)
4	Ukrsotsbank (UniCredit Bank, Luxembourg)	Raiffeisen Bank Aval (Raiffeisen Bank, Austria)	Savings Bank (state, Ukraine)
5	Raiffeisen Bank Aval (Raiffeisen Bank, Austria)	Savings Bank (state, Ukraine)	Ukreximbank (state, Ukraine)
6	Ukrsibbank (BNP Paribas Group, France)	Ukreximbank (state, Ukraine)	Kredobank (PKO Bank Polska, Poland)
7	Citibank Ukraine (Citigroup, USA)	Citibank Ukraine (Citigroup, USA)	Citibank Ukraine (Citigroup, USA)
8	ING Bank Ukraine (ING Groep, Netherlands)	ING Bank Ukraine (ING Groep, Netherlands)	ProCredit Bank (ProCredit Bank, Germany)
9	Privatbank (Privat Group,	Ukrsotsbank (ABH Holdings,	Ukrgasbank (state, Ukraine)

	Ukraine)	Luxembourg, Russia)	
10	OTP Bank (OTP Bank, Hungary)	Alfa-Bank (ABH Holdings, Luxembourg, Russia))	OTP Bank (OTP Bank, Hungary)

From the point of view of the organizational principles of functioning, the banking system of Ukraine has the same general principles that characterize the activities of the banking systems of the EU countries: a two-tiered system, the separation of functions of the central bank and other banks, control over the activities of banking institutions. However, 27 EU countries with different banking regulation systems, based on national rules and the minimum common European ones, reformed their banking systems in the direction of creating a Banking Union after the crisis of 2008. The only centralized supervisory and restructuring mechanisms of banks will allow the formation of a single regulatory system for 28 countries, but is mandatory for 18 members of the euro zone and their 6.000 banks, of which 130 are the largest.

A decisive step towards building the Banking Union was made on 15th April 2014, when the European Parliament passed three key bills, which approved:

only mechanism for banking supervision that will be carried out by the European Central Bank (the main components are the licensing of all banks; control over large banks, including assets of which exceed 30 billion EUR or represent at least 20 % of the gross domestic product of their country (about 130 banks); monitoring of the state of supervision carried out by the national financial control bodies);

only mechanism for dealing with troubled banks by the European Central Bank;

program of guaranteeing deposits through the Unified Fund for the support of troubled banks, which will be financed by all banks of the member states – participants of a single mechanism for working with problem banks².

According to analysts, the banking sector has traditionally been a leader in the implementation of the best world and European practices³. Therefore, the integration of Ukraine's banking sector into the European Union's (EU) banking system has a certain foundation, but with the implementation of the legal framework for banking regulation, which requires an analysis of the EU legislation in the banking sector and the opportunities and areas of integration justification.

² Klymenko I, Belinska Y. On the integration of the banking system of Ukraine into the European Union banking system: Analytical note. National Institute for Strategic Studies, 2012. Source: <http://www.niss.gov.ua/articles/777>. (In Ukrainian).

³ Comprehensive EU response to the financial crisis: substantial progress towards a strong financial framework for Europe and a banking union for the Eurozone. Source: http://europa.eu/rapid/press-release_MEMO-14-244_en.htm?locale=en.

European cooperation in the field of legal regulation of banking activities was based on the Rome Treaty of 1957 on the establishment of the European Economic Community (hereinafter referred to as the EEC) and the Single European Act of 1986, on the basis of which the formation of a common internal market in the banking sector of the economy took place. In particular, Article 61 of the Treaty on EEC establishment was referred to the liberalization of banking and insurance services, which had to be carried out in line with the progressive liberalization of capital movements. However, in the legal field, it was necessary to overcome the existing restrictions on banking activities in the Member States, which concerned the participation of foreign capital in national banking systems, and foreigners in the management of the bank. This problem was solved in 1973 with the adoption of 73/183/EEC Directive of the Council of the European Union on the abolition of restrictions on the free establishment of banks and other financial institutions and the free provision of independent services to them⁴.

The first act of the common banking law is the 77/780/EEC Council Directive of 12th December 1977 on the coordination of laws, regulations and administrative regulations on the activities of credit institutions⁵, according to which the conditions for the establishment of a credit institution are subject to certain conditions (minimum requirements), with Member States being able to impose more precise requirements. Subsequently, 77/780/EEC Directive has undergone significant changes and additions introduced by 85/345/EEC, 86/524/EEC, 89/ 646/EEC, 95/26/EC, 96/13/EC, 98/33/EC Directives.

The Second 89/646/EEC Directive of 15th December 1989 on the coordination of laws, regulations and administrative provisions related to the take up and pursuit of the business of credit institutions⁶ has become part of Community legislation that is already in force, in particular Council 77/780/EEC Directive, and has also undergone several changes. The provisions of the Second Directive establish the minimum capital of a credit institution, the types of activities that are subject to mutual recognition, and subsequently apply the principles of freedom to provide services.

The next 2000/12/EC Directive dated 20th March, 2000⁷ which abolished the previous ones, has become the main one in this area of legislation; however, it has been a subject to

⁴ Council Directive 73/183/EEC «On the abolition of restrictions on freedom of establishment and freedom to provide services in respect of self-employed activities of banks and other financial institutions» of 28th June 1973. Source: <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A31973L0183>.

⁵ First Council Directive 77/780/EEC «On the coordination of the laws, regulations and administrative provisions relating to the take up and pursuit of the business of credit institutions» of 12th December 1977. Source: <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A31977L0780>.

⁶ Second Council 89/646/EEC Directive «On the coordination of laws, regulations and administrative provisions relating to the take up and pursuit of the business of credit institutions and amending 77/780/EEC Directive» of 15th December 1989. Source: <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A31989L0646>.

⁷ Directive 2000/12/EC of the European Parliament and of the Council «Relating to the take up and pursuit of the business of credit institutions» of 20th March 2000.

repeated significant changes. The legal field was gradually improved in order to facilitate the process of initiating and continuing the activities of credit institutions, as well as eliminating the most obstructive differences between the laws of the member states in terms of the rules that these institutions are adhered to.

At present, the main instrument for freedom establishment and financial services provision to lenders in the EU internal market is the current 2006/48/EC Directive of the European Parliament and of the Council of 14th June 2006⁸, which, in its content, is an updated version of the previous 2000/12/EC Directive. 2006/48/EC Directive focuses not only on the principles and technical tools of prudential supervision, but also on the information disclosure. Subsequently, the provisions on technical oversight instruments are more detailed taking into the consideration the main requirements of the «Basel III» Recommendations developed by the Basel Committee on Banking Supervision, approved in 2010, which have become the response of the international community to the global financial and economic crisis.

The documents adopted by the Basel Committee outline a reformist approach to capital composition and regulatory requirements for it. The main changes that are in line with Basel III's principles are improving the quality, transparency and improvement of the bank's capital structure, expanding capital risk coverage and stimulating measures to create its reserve stocks. New requirements for banking regulation will be introduced in countries that are members of the Basel Committee or formally proclaimed to meet their requirements, phased in over 2013-2018.

The EU plans to create a single set of rules for all Member States, not to encourage the strengthening of requirements in individual countries, and thereby reduce the differences in regulatory instruments and the existence of a homogeneous competitive environment. The basis of this approach is the consistent adoption of the previous rules of the Bank for International Settlements (BIS), which will ensure the organic transition from the requirements of Basel I and Basel III.

Integration processes in the banking sector are subject to analysis. Integration into the European community of central banks has been recognized by the National Bank of Ukraine (NBU) since 2015. As part of the implementation of the Association Agreement between Ukraine and the European Union and the implementation of the Comprehensive Program for the Development of the Financial Sector of Ukraine until 2020, the NBU continues to implement the EU directives with the support of the EU, in particular, from 2015 onwards EU Project «Technical Assistance on Priority

Source: <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2000:126:0001:0059:EN:PDF>.

⁸ Directive 2006/48/EC of the European Parliament and of the Council «Relating to the take up and pursuit of the business of credit institutions (recast)» of 14th June 2006. Source: <http://eur-lex.europa.eu/legal-content/en/ALL/?uri=CELEX:32006L0048>.

Areas of the Financial Sector» (EU-FINSTAR). The NBU also implements projects such as the XBRL FINREP Taxonomy and International Financial Reporting Standards (IFRS 9) for the banking sector.

The priority areas for the NBU in the field of implementation of EU practice are the following ones⁹:

- monetary and financial statistics;
- licensing and supervision of financial groups and conglomerates;
- macro-prudential supervision; prevention of systemic risks;
- risk management in banks of Ukraine;
- assessing the adequacy of domestic capital.

According to the NBU, projects are implemented in accordance with the schedule.

Consequently, the integration of Ukraine's banking sector into the European financial sphere has been carried out in recent years through the implementation of EU legislation, the implementation of projects with EU support, which is absolutely reasonable.

The main integration directions of Ukraine's banking system into the European financial sphere, generalizing the above, are:

- continuation of the implementation of norms and principles of regulation of banking activities in the EU;
- organizational development of banking regulation institutions and the activity of supervisory bodies taking into account European experience;
- definition of a long-term monetary policy strategy;
- improvement of NBU monetary policy to improve the efficiency and competitiveness of the banking system;
- development of tools for Ukrainian banks to enter the European financial market;
- introduction of European methods of banking business in domestic practice.

Findings and perspectives of further research

It is determined that the main tendencies of the banking system development in Ukraine are the reduction of the number of banks as a result of the NBU's activity as a regulator in accordance with European norms and standards. It is shown that the number of foreign banks is stable and they rank in the top 10 ranking of the most reliable banks in Ukraine.

The legal principles of banking activity in the EU have been analyzed. Currently, the Directive 2006/48/EC is the main instrument for freedom of establishment and the provision of

⁹ The NBU continues to implement the EU directives: Press release of 02nd June 2017 / Official site of the National Bank of Ukraine. Source: https://bank.gov.ua/control/uk/publish/article?art_id=49511147. (In Ukrainian).

financial services by lending institutions in the EU internal market. It is noted that the NBU implements the rules and principles of banking regulation, introduces the Basel III Recommendations. However, while building the Banking Union, the EU has adopted new Directives on Unified Banking Supervision Mechanisms, cooperation with troubled banks, and deposit guarantees.

The directions of Ukraine's banking system integration into the EU financial sphere, which include legal, organizational, administrative and methodical components, have been proposed.

List of References

Halyts O. V. **The efficiency of functioning of the banking system of Ukraine in the conditions of eurointegration.** The Institute of Regional Researches of NAS of Ukraine, 2008. 19 p. (In Ukrainian).

Klymenko I, Belinska Y. **On the integration of the banking system of Ukraine into the European Union banking system:** Analytical note. National Institute for Strategic Studies, 2012. Source: <http://www.niss.gov.ua/articles/777>. (In Ukrainian)

Storonianska I. Z., Muzica I.S. Perspectives and risks for the banking system of Ukraine in the context of integration processes. **Strategic Priorities.** 2013, No. 3(28). Pp. 30-37. (In Ukrainian)

Metlushko O.V., Pavlova O.A. Eurointegration processes in the banking system of Ukraine: at the crossroads of research and conclusions. **Science young.** 2015, No. 22. Pp. 98-108. (In Ukrainian)

The review of the banking sector. 2017, No. 2. Source: <https://bank.gov.ua/control/uk/publish/article>. (In Ukrainian)

Comprehensive EU response to the financial crisis: substantial progress towards a strong financial framework for Europe and a banking union for the Eurozone. Source: http://europa.eu/rapid/press-release_MEMO-14-244_en.htm?locale=en.

Council Directive 73/183/EEC «**On the abolition of restrictions on freedom of establishment and freedom to provide services in respect of self-employed activities of banks and other financial institutions**» of 28th June 1973. Source: <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A31973L0183>.

First Council Directive 77/780/EEC «**On the coordination of the laws, regulations and administrative provisions relating to the take up and pursuit of the business of credit**

institutions» of 12th December 1977. Source: <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A31977L0780>.

Second Council 89/646/EEC Directive **«On the coordination of laws, regulations and administrative provisions relating to the take up and pursuit of the business of credit institutions and amending 77/780/EEC Directive»** of 15th December 1989. Source: <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A31989L0646>.

Directive 2000/12/EC of the European Parliament and of the Council **«Relating to the take up and pursuit of the business of credit institutions»** of 20th March 2000. Source: <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2000:126:0001:0059:EN:PDF>.

Directive 2006/48/EC of the European Parliament and of the Council **«Relating to the take up and pursuit of the business of credit institutions (recast)»** of 14th June 2006. Source: <http://eur-lex.europa.eu/legal-content/en/ALL/?uri=CELEX:32006L0048>.

The NBU continues to implement the EU directives: Press release of 02nd June 2017 / Official site of the National Bank of Ukraine Source: https://bank.gov.ua/control/uk/publish/article?art_id=49511147. (In Ukrainian).