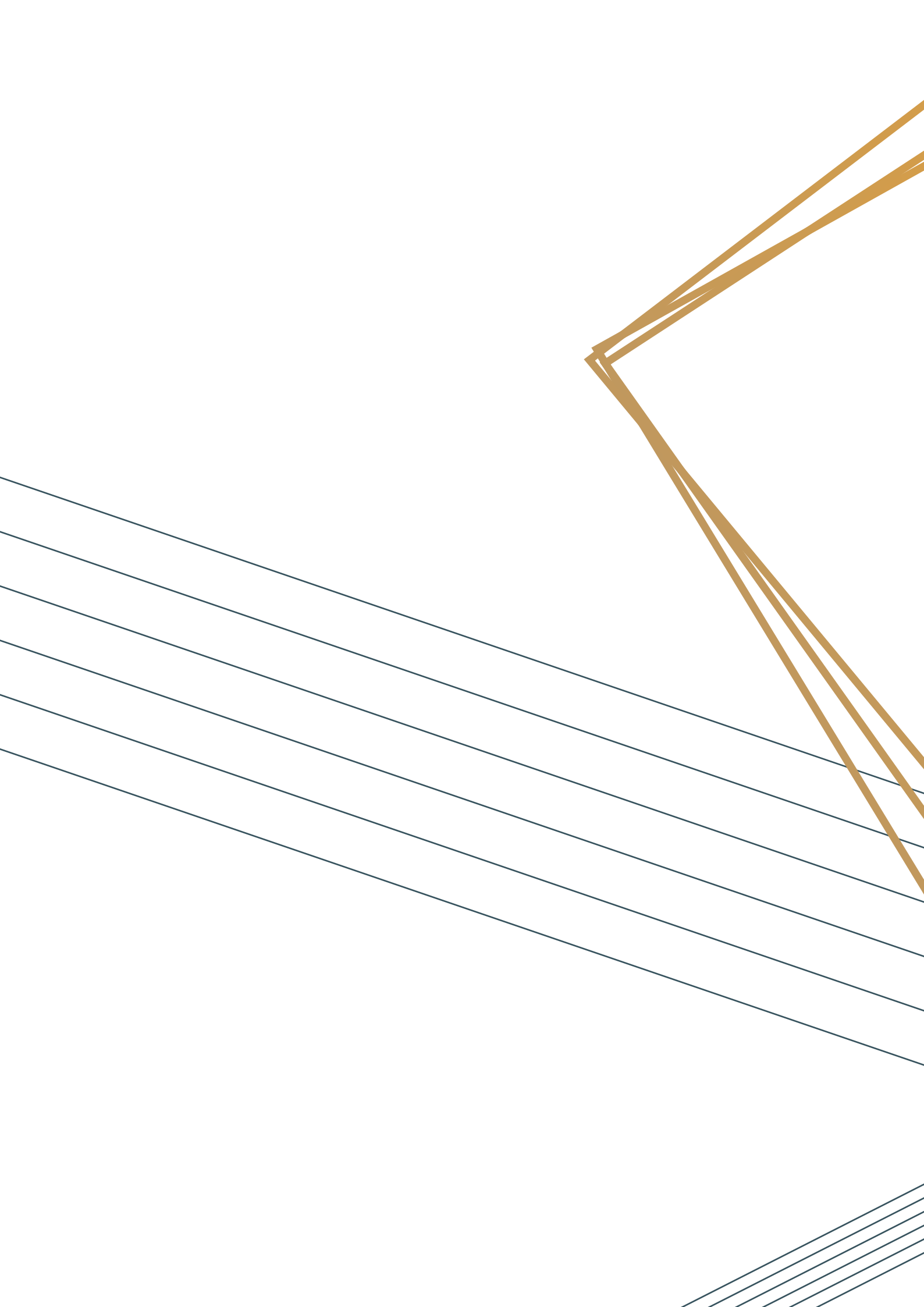


NATIONAL RISK ASSESSMENT report

on preventing and countering
legalization (laundering) of proceeds
of crime and financing of terrorism



2016
Ukraine, Kyiv



NATIONAL RISK ASSESSMENT

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The National Risk Assessment Report has been developed in line with international standards and in accordance with the Law of Ukraine “On Preventing and Countering Legalization (Laundering) of Proceeds of Crime, Financing of Terrorism, and Financing of Proliferation of Weapons of Mass Destruction” and the Cabinet of Ministers of Ukraine and the National Bank of Ukraine Resolution of Sept. 16, 2015, No. 717, and assessment Methodology.

The Report focuses on identification (detection) of risks (threats) of legalization (laundering) of proceeds of crime and financing of terrorism, their analysis and assessment, and is the basis for development of measures intended to prevent their occurrence and/or mitigate negative consequences of the risks (threats) identified.

National risk assessment has been conducted under coordination of State Financial Monitoring Service of Ukraine and under assistance of the OSCE Project Coordinator in Ukraine.

The OSCE Project Coordinator in Ukraine shall not bear any responsibility for the content and the views expressed by experts in this publication.

Національна оцінка ризиків проведена за координації Державної служби фінансового моніторингу України та підтримки Координатора проектів ОБСЄ в Україні.

Координатор проектів ОБСЄ в Україні не несе відповідальності за зміст та погляди, висловлені експертами у цій публікації.



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FOREWORD

This Report is the first fundamental research into carrying out of the National Risk Assessment on money laundering and financing of terrorism in Ukraine.

The National Risk Assessment on the national level is a system of measures taken to identify (detect) risks (threats) of legalization (laundering) of proceeds of crime and financing of terrorism, analyze and assess them, and develop measures intended to prevent their occurrence and/or mitigate their negative consequences.

The results of the National Risk Assessment is a summary of joint activities of all the participants of the national financial monitoring system. Specifically, NRA is based on the official information received from:

- state authorities (financial and non-financial market regulators, law enforcement and intelligence authorities, judicial authorities, and other government agencies);
- private sector (primary financial monitoring subjects, branch associations and self-regulated organizations, experts, researchers, scientists, etc.).

The NRA results have been verified by using modern scientific and sociological methods.

The National Risk Assessment was organized and coordinated by the State Financial Monitoring Service of Ukraine.

The results of the National Risk Assessment demonstrate that the authorities properly understand risks, have planned risk management actions, and take risk mitigation measures. It is a critical element of objective assessment.

It should be noted that risk analysis on money laundering and financing of terrorism in Ukraine, and their assessment is not limited to publication of this Report. This Report is the basis for further risk identification in the system of countering money laundering and financing of terrorism, and development of efficient measures for their management.



Ihor Cherkaskyi,
Head of the State Financial Monitoring Service of Ukraine

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ON NATIONAL RISK ASSESSMENT

The obligation of the States to perform National Risk Assessment is envisaged by Recommendation 1 of the Financial Action Task Force (FATF) International Standards¹.

Ukraine must implement the FATF Recommendations in the fastest possible and complete way. FATF Recommendation 1 concerns assessing of risks and applying of a risk-oriented approach. Also, a risk-oriented approach that, pursuant to the previous revision of the FATF Recommendations, used to be just optional for countries has become an obligation and is referenced in many of recommendations.

To verify compliance of countries with the FATF Recommendations, a “Methodology for Assessing Technical Compliance with the FATF Recommendations and the Effectiveness of AML/CFT Systems” was developed and adopted in February 2013².

The Methodology concerns two aspects of assessing the implementation of the FATF Recommendations – the technical compliance and the outcomes, indicators, data and other factors used to assess how effectively the FATF Recommendations are implemented.

A risk-oriented approach on the national level means dedicating adequate resources to particular parts of the anti-money laundering and countering financing of terrorism system.

Given the above, the National Risk Assessment mechanism is provided for in the Law of Ukraine “On Preventing and Countering Legalization (Laundering) of Proceeds of Crime, Financing of Terrorism, and Financing of Proliferation of Weapons of Mass Destruction” (the Law)³ and of the Cabinet of Ministers of Ukraine and the National Bank of Ukraine Resolution “On Approving the Procedure for the National Risk Assessment on Preventing and Countering Legalization (Laundering) of Proceeds of Crime and Financing of Terrorism, and Publishing Its Results” of Sept. 16, 2015, No. 717⁴.

At the same time, carrying out of a NRA is stipulated in the Action Plan for 2016 on Preventing and Countering Legalization (Laundering) of Proceeds of Crime, Financing of Terrorism, and Financing of Proliferation of Weapons of Mass Destruction approved by the Cabinet of Ministers of Ukraine and the National Bank of Ukraine Resolution of Feb. 11, 2016, No. 103⁵.

The NRA objective is to detect national risks (threats, vulnerabilities, consequences) in the system of countering money laundering and financing of terrorism and to identify risk management elements.

NRA aims to:

- facilitate detention of criminals through identification and interception of their proceeds of crime;
- facilitate prevention of acts of terror and terrorist activities through identification and interception of their funding sources;
- facilitate identification of the actual impact of money laundering and financing of terrorism on the society, social relations, and financial system in order to determine the actions to counteract the actual threats.

NRA should establish the money laundering and financing of terrorism probability based on the existing threats (a person (group of people)), object or activity with the potential to cause harm, e.g., to the state, society, economy, etc.) and vulnerabilities in the system of countering money laundering and financing of terrorism (things that can be exploited by threats), namely through:

- a) early identification of threats related to a possibility of money laundering and financing of terrorism;
- b) reliable evaluation of their occurrence possibility;
- c) identification of the national financial monitoring system vulnerabilities to threats;
- d) assessment of the consequences and scale of threat occurrence due to vulnerabilities of the national system of countering money laundering and financing of terrorism;
- e) timely elimination or correction of vulnerabilities;
- f) prevention of negative consequences;
- g) determining priorities of the national financial monitoring system;

¹ The FATF Recommendations: [Electronic resource]. – Access mode: <http://www.fatf-gafi.org/publications/fatfrecommendations/documents/fatf-recommendations.html>

² FATF issues new Mechanism to Strengthen Money Laundering and Terrorist Financing Compliance: [Electronic resource]. – Access mode: <http://www.fatf-gafi.org/publications/fatfrecommendations/documents/fatfissuesnewmechanismtostrengthenmoneylaunderingandterroristfinancingcompliance.html>

³ On Preventing and Countering Legalization (Laundering) of Proceeds of Crime, Financing of Terrorism, and Financing of Proliferation of Weapons of Mass Destruction: Law of Ukraine, October 14, 2014 No. 1702-VII: [Electronic resource]. – Access mode: <http://zakon3.rada.gov.ua/laws/show/1702-18>

⁴ On Approving the Procedure for National Risk Assessment on Preventing and Countering Legalization (Laundering) of Proceeds of Crime, Financing of Terrorism, and Financing of Proliferation of Weapons of Mass Destruction: Cabinet of Ministers of Ukraine Resolution, September 16, 2015 No. 717: [Electronic resource]. – Access mode: <http://www.kmu.gov.ua/control/uk/cardnpd?docid=248493531>

⁵ On approving an Action Plan for 2016 on preventing and countering legalization (laundering) of proceeds of crime, financing of terrorism, and financing of proliferation of weapons of mass destruction: Cabinet of Ministers of Ukraine Resolution, February 11, 2016 No. 103: [Electronic resource]. – Access mode: <http://zakon5.rada.gov.ua/laws/show/103-2016-%D0%BF>

h) making decisions on the most effective use of resources.

The NRA was based on the approved “Money Laundering and Financing of Terrorism in Ukraine Risk Assessment Methodology”⁶ using the FATF Guidance on “National Money Laundering and Terrorist Financing Risk Assessment”⁷, as well as best NRA practices of foreign countries.

In the course of the NRA, industry questionnaires were developed and submitted for processing to the participants of the system on preventing and countering legalization (laundering) of proceeds of crime and financing of terrorism.

The said industry questionnaires structurally consisted of various blocks covering the required issues on anti-money laundering and countering financing of terrorism.

Upon receiving the processed and filled out branch questionnaires, the information was structured according to the approved Methodology.

During NRA, the State Financial Monitoring Service of Ukraine used a qualitative and quantitative approach and, apart from the information contained in the questionnaires, statistical information of the SFMSU, law enforcement, judicial and other state authorities, as well as reports by international organizations: Transparency International Ukraine, Political Risk Services, International Center for Peace Studies, Peace Fund, and Economist Intelligence Unit, Ukrainian Sociology Service, etc.

At the stage of risk detection (identification), the threats and vulnerabilities of the system of countering money laundering and financing of terrorism were determined. Subsequently, a risk analysis was performed. This stage determined the nature, sources, likelihood, and consequences of the threats and vulnerabilities identified.

Lastly, the final NRA stage was risk assessment and development of risk management actions. The evaluation stage consisted in determining (based on the results of the previous NRA stages) the following threat-specific characteristics:

- overall risk level;
- effectiveness of the measures currently taken to prevent or mitigate the risk;
- net risk level.

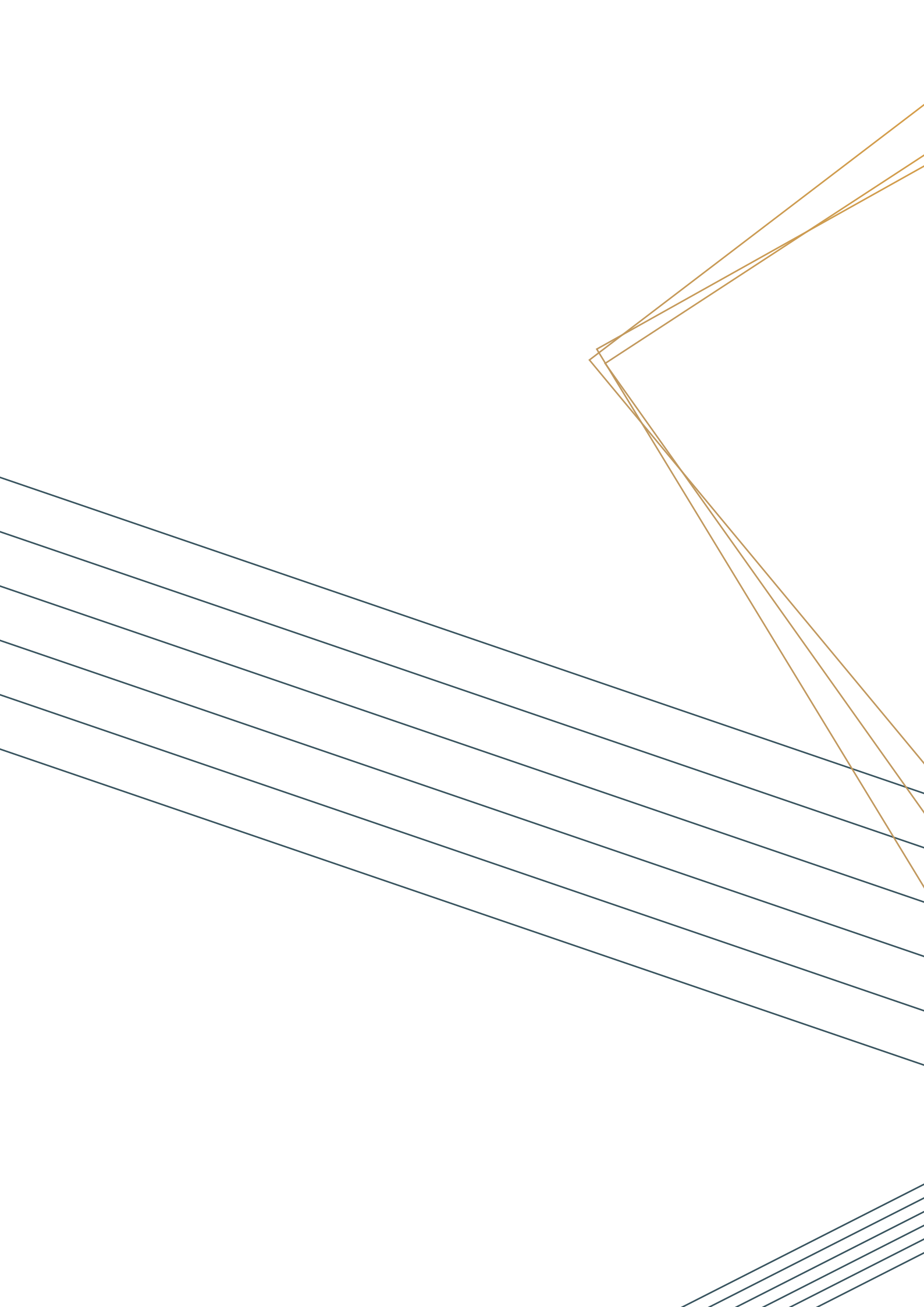
The risk assessment will result in proposals developed and duly submitted to the Cabinet of Ministers of Ukraine on actions to prevent their occurrence and/or mitigate their negative implications.

The NRA was supported by the Organization for Security and Cooperation in Europe (OSCE).

The NRA was substantially contributed to by international experts, specifically Igoris Krzhechkovskis and Giuseppe Lombardo, as well as national researchers, who provided support in training the main stakeholders and advise on best practices and international standards in conducting an NRA.

⁶ The “Money Laundering and Financing of Terrorism in Ukraine Risk Assessment Methodology” was concurred by the Ministry of Finance of Ukraine on Apr. 16, 2015.

⁷ National money laundering and terrorist financing risk assessment (2013): [Electronic resource]. – Access mode: <http://www.fatfgafi.org/publications/methodsandtrends/documents/nationalmoneylaunderingandterroristfinancingriskassessment.html>



The background features a series of thin, overlapping lines in orange and teal. These lines form various geometric shapes, including triangles and polygons, some of which are partially cut off by the edges of the page. The lines are arranged in a way that creates a sense of depth and movement, with some lines appearing to recede into the distance.

GENERAL COMPONENT

1.1. Political and Institutional Component

The structure of the political system of Ukraine can be represented by a sum total of the institutes that form and distribute the state power and govern social processes, as well as represent the interests of particular social groups within a corresponding type of political culture.

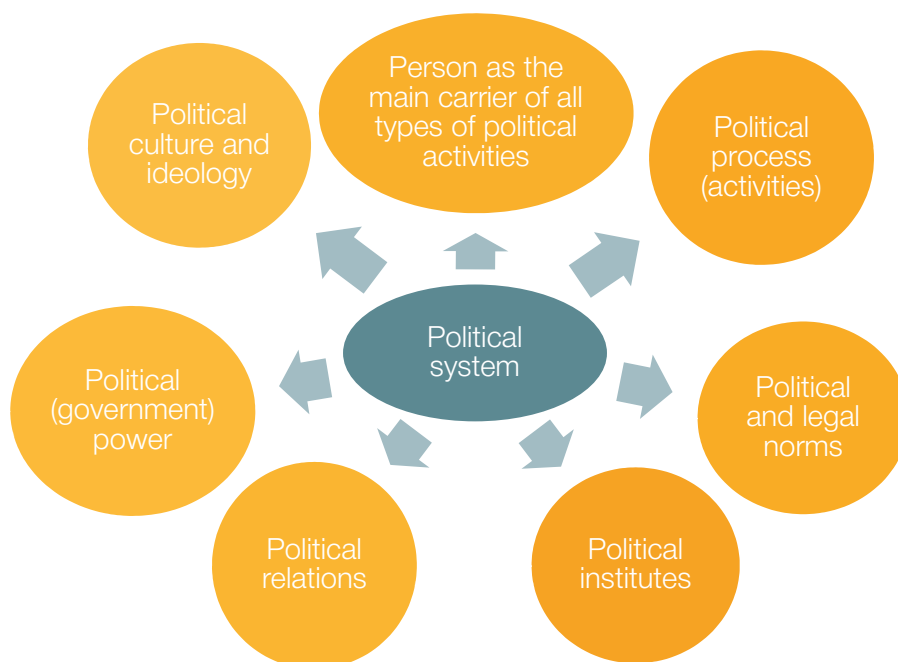


Fig. 1.1.1. Political System Structure

Institutionally, the political system is comprised of such political institutes as the State and its structural elements (parliament, government, political parties, NGOs, church, local governments).

Political risk factor.

Assessment of the political risk in Ukraine was a separate NRA object.

Political risk is a probability of changes in the conditions of the functioning of a State, activities of companies and organizations due to political factors.

In its turn, political stability is the resistance of a political system to unfavorable factors of the political environment.

Political stability indicator and absence of violence/terrorism is one of the six aggregate indicators calculated by the World Bank in a strategic research "Worldwide Governance Indicators" (WGI). This influential international financial organization's report, available for analysis in mid-2014, recorded the results for the period from 1996 through 2012.

Each ranking indicator is calculated in percentage. The lowest rank is "0" and the highest rank, i.e. better ranked, is "100 %".

The data for Ukraine is provided in Fig. 1.1.2.

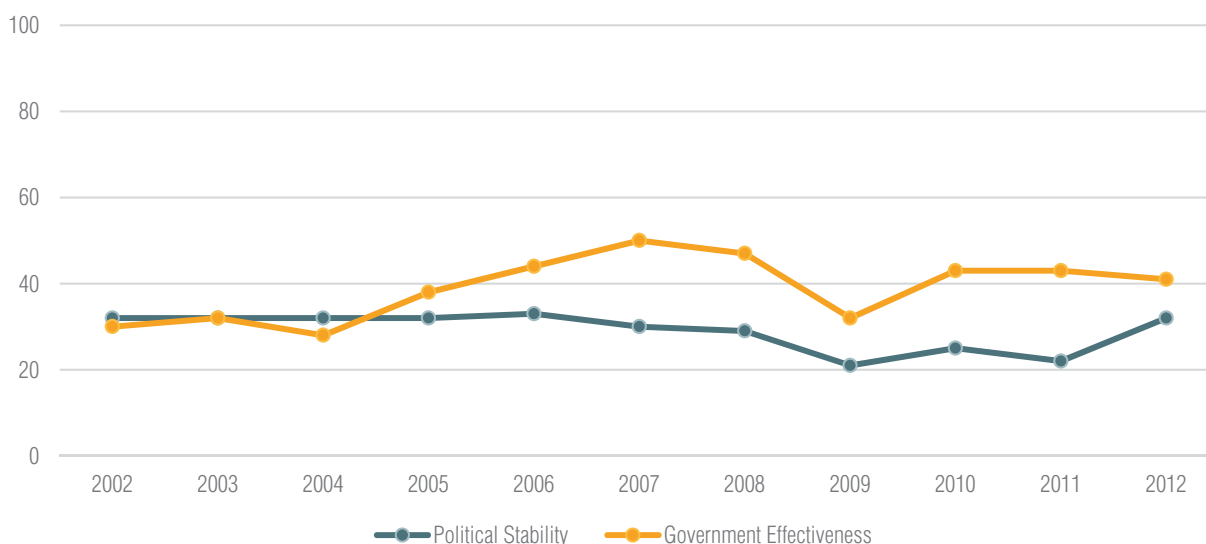


Fig. 1.1.2. Political Stability and Government Effectiveness in Ukraine according to World Bank

As evidenced by the figure, the political stability indicators in Ukraine in the past 10 years have barely reached the level of 50%.

The connection between the political risk and, as a consequence, the country's political stability and economic development is clearly demonstrated by the correlation and regression analysis.

The analysis used the data of the State Statistics Service of Ukraine, World Bank, Political Risk Services, International Center for Peace Studies, Peace Fund, and Economist Intelligence Unit. The political stability was measured using the “Political Stability and Absence of Violence” index, which reflects mass perceptions of the likelihood of unconstitutional removal of the government, as well as politically motivated violence, including terrorism; Political Instability Index, which demonstrates the level of threat to the government due to social protests; Failed States Index Scores, which focuses on the potential of emergence of an inner conflict in a state; State Fragility Index, which reflects the ability (or inability) of the authorities to control the territorial integrity, as well as the demographic, political, and economic situation in the country. Another indicator used to measure the political stability is occurrence of government crises in Ukraine. The economic development was measured using the per capita GDP, investment growth, population growth, and the country's import and export level.

Thus, the table provides calculated coefficients of the correlation of GDP and political stability indicators.

Political risk indicators	GDP (independent variable)
Occurrence of government crises	- 0.029
Political Stability and Absence of Violence Index (PSAV)	- 0.344
Failed States Index Scores (FSIS)	- 0.712
State Fragility Index (SFIndex)	- 0.874
Political Stability Index (PSI)	- 0.611
Political Instability Index (PIIndex)	- 0.151

Table 1.1.1. Correlation analysis data on Ukraine

The above calculations evidence that government crises in Ukraine lately had been adversely affecting the economic indicator of the per capita GDP at the level of (- 0.029). The connection between these indicators is very weak, because the indicator of government crises in Ukraine is not a comprehensive one and reflects only some contradictory trends in Ukraine's political system.

The Pearson correlation coefficient for GDP and Political Stability and Absence of Violence Index, calculated by the Political Risk Services, is at the level of (- 0.344). This evidences a weak inverse relation between the economic development (per capita GDP) and the dynamic level of political stability in Ukraine in the said period. A similar correlation coefficient can be observed for the Political Instability Index and GDP level, which is at (- 0.151) and also evidences a medium inverse relation between the political stability and the economic development. The

Pearson correlation coefficient for GDP and the Fails States Index Scores (FSIS) is at the level of (- 0.712). This evidences a medium inverse relation between the economic development (per capita GDP) and the dynamic level of political stability in Ukraine in the said period. Medium inverse relation was also demonstrated by the Political Stability Index (PSI), which is calculated by an international research institution the World Bank Group. In this case the correlation coefficient is (- 0.611). The Pearson correlation coefficient for GDP and the State Fragility Index (SFI) is at the level of (- 0.874). This evidences a strong inverse relation between the economic development (per capita GDP) and the dynamic level of political stability in Ukraine in the said period, which also evidences the already existing trend of inverse relation between the political stability and the economic development.

Thus, it can be stated that Ukraine for a long time witnessed an inverse relation between the political stability and the economic development; however, depending on a specific political stability indicator, this relation varies from weak to strong, since each of these indicators focuses on different political stability dimensions which affected the economy to a higher or lesser degree.

In terms of the components and factors, which cause a high level of political risk in Ukraine and, consequently, an increased economic risk level (one of the obvious instances is the ML/FT risk), the following should be stated.

Note should be taken of the management efficiency index which characterizes governance efficiency under the influence of different factors. The said index is calculated by the Bertelsmann Foundation, and in the past years this index is extremely low, which appreciably separates Ukraine from the European community (Table 1.1.2).

Countries	MI	LD	MP	IC	CB	RE	SC
Slovakia	7.32	1.4	9.0	10.0	8.8	8.0	9.3
Lithuania	7.00	1.9	8.5	9.7	8.8	7.3	8.3
Croatia	6.88	2.5	8.3	9.0	8.0	7.3	8.7
Latvia	6.78	2.6	8.1	9.3	8.2	6.7	8.3
Turkey	6.52	5.0	7.3	8.3	6.7	6.3	8.0
Bulgaria	6.51	3.1	7.7	8.7	8.4	6.7	7.0
Poland	6.36	1.9	7.8	8.7	8.3	6.7	7.3
Romania	6.33	3.8	7.3	8.0	7.3	6.7	7.3
Georgia	5.91	5.9	6.5	7.3	6.7	5.7	6.3
Ukraine	4.69	3.9	5.4	6.7	5.3	4.3	5.3
Kazakhstan	4.13	4.5	4.7	5.7	4.5	4.3	4.3
Russia	3.84	4.1	4.4	4.7	4.3	4.0	4.7
Moldova	3.50	6.1	3.8	5.0	4.3	3.0	3.0
Belarus	2.74	4.4	3.1	3.3	2.5	4.3	2.3

Table 1.1.2. Indicators of the State Management Efficiency Criteria⁸

The table clearly demonstrates that Ukraine has 4.69 points on the state management efficiency and ranks only 65th, trailing behind such representatives of the former Soviet Union, as Georgia and Armenia. The governance difficulty level is assessed at a mere 3.9 points. This indicator is based on conditions for implementation of political leadership, capacity of the civil society, per capita GDP, level of stateness and rule of law implementation.

Another manifestation of stateness is whether the supremacy of the national priorities on economic issues is ensured and whether the power mechanism is adapted to efficient management. It should be noted that the country's economic system, its economic potential were severely damaged due to inadequate restructuring of the property system. A significant share of the national resources ended up in the hands of specific owners who, firstly, do not always and do not necessarily agree their actions with the country's interests and, secondly, directly influence the authorities and the state economic policy. All of this substantially distorts the government system, orientation of its activities, and social and political role.

⁸ MI — state management index; LD — level of governance difficulty; MP — management performance; IC — international cooperation; CB — consensus building; RE — country's resource efficiency; SC — steering capability.

Another indicator which significantly increases the political risk of Ukraine is the number, composition, and orientation of the Verkhovna Rada of Ukraine Committees. Unlike many foreign countries, the numerical strength of the Verkhovna Rada of Ukraine Committees and their general number are determined mostly in an arbitrary format, and not exclusively through scientifically substantiated criteria and positive foreign experience. This results in a significant disproportion in the number of the Committees' personal composition: the Members of Parliament of Ukraine find it more important to be on the "economic" committees, whereas the "attractiveness" level of the committees on, e.g., pensioners, veterans and disabled, sports, environmental policy, European integration, etc. is low.

Total number of committees	Election cycles		
	2007-2012	2012-2014	2014 - ...
Stable			
Committee for Pensioners, Veterans and Disabled	8	8	9
Committee for Culture and Spirituality	10	10	11
Committee for Youth Policy, Physical Culture, Sports, and Tourism	-	-	13
Committee for European Integration	9	16	-
Committee for Freedom of Speech and Information	12	10	13
Committee for Science and Education	10	10	15
Committee for Human Rights, Ethnic Minorities, and Inter-Ethnic Relations	10	9	11
Committee for Social Policy and Labor	11	12	14
Committee for Environmental Policy, Utilization of Natural Resources, and Chernobyl Accident Response	19	14	14
Committee for Legislative Support of Law Enforcement	17	16	33
Committee for National Security and Defense	17	13	19
Committee for Combating Organized Crime and Corruption	24	13	22
Committee for Parliamentary Procedure, Member of Parliament Ethics, and Organization of Work in the Verkhovna Rada of Ukraine	22	17	9
Committee for State Construction and Local Self-Governance	17	-	-
Committee for Foreign Affairs	13	16	11
Committee for Legal Policy	15	15	
Committee for Construction, Transport, Housing and Utilities, and Communications	-	-	18
Committee for Agricultural Policy and Land Matters	23	-	30
Committee for Economic Policy, National Economy, Property, and Investment	24	-	15
Committee for Finances and Banking	20	14	13
Committee for Fuel and Energy Complex, Nuclear Policy, and Nuclear Security	23	21	9
Committee for Budget	36	36	28
Ad Hoc			
Committee for Privatization	32	32	-
Committee for Health Protection	8	12	-
Committee for Transport and Communications	26	17	-
Committee for Economic Policy	21	15	15
Committee for Tax and Customs Policy	-	26	26
Committee for Industrial and Investment Policy	-	14	14
Committee for Information System Development and Information Technologies	-	-	9

Committee for Construction, Bridge Construction, and Housing and Utilities	17	-	12
Committee for State Construction, Regional Policy, and Local Self-Governance	13	-	-
Committee for Construction, Bridge Construction, Housing and Utilities, and Regional Policy	-	16	-
Committee for State Construction and Local Self-Governance	-	17	-

Table 1.1.3. Structure and Strength of the VRU Committees

Further, the political risk is directly increased by conflicts related to the institutes of parliamentary majority and parliamentary opposition.

Continuous conflicts, as well as ideological and political confrontation in the Parliament have perpetuated a situation, when the influence effectiveness in the Verkhovna Rada of Ukraine resides with the parties that have the smallest faction in the Parliament. This leads to a situation, when, firstly, the efficiency of the Parliament's legislative function becomes a problem, and, secondly, acute proneness to conflicts in the relations of the most influential parliamentary factions paralyzes the work of the Parliament on the whole.

Also, one needs to consider the political and economic transformation criterion, the low level of which results, specifically, from a significant political risk present in the country. The scale, that is the proportion, of the publicly controlled, semi-legal, and criminalized economy, is a measure of the capacity of the authorities. For instance, shadow economy on the one hand reflects the overall state of society and alignment of economic relations between the authorities and citizens, and on the other hand – is a result of a conscious inaction of the authorities and their helplessness.

Summarizing the overview of the political risk and political stability in Ukraine, it can be stated that the magnitude of the political risk in the country is high. In the most concentrated way it manifests itself in obsessive crave for power, with prevailing aspiration not for power effectiveness, but for its expansion. Rights and privileges outweigh obligations, whereas governance functions and serving the social needs are viewed predominantly as a way of strengthening the position in power. All of this substantially distorts the government system, orientation of its activities, and social and political role.

Staking on preservation of shadow schemes causes influential elite groups to be interested in slowing down democratic and market reforms. The depth of the problem of power and business mating is such that the focus is not on making the authorities keep large capital within legal boundaries, but on making the authorities themselves, which are insufficiently transparent and primarily serve the interests of large businesses, protect national interests.

For these reasons the institute of opposition cannot assert itself, while the boundaries between the political forces remain changeable and uncertain and their unions unstable. In such conditions, enhancing the efficiency of the state mechanism requires a separate analysis.

Corruption factor

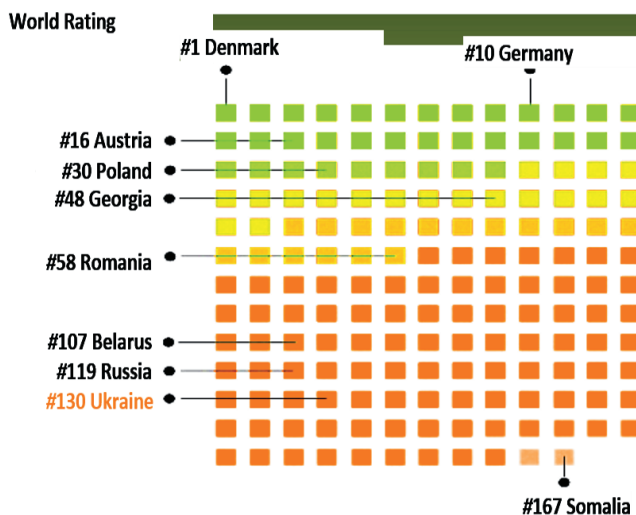
The second element of the political and institutional component is assessment of the corruption level in Ukraine.

The overall corruption level in Ukraine is rather high. According to the study conducted by the Kyiv International Sociology Institute in August-October 2015, almost 2/3 of the respondents stated that they encountered corruption within the past 12 months.

In 2014, according to the NGO Transparency International, Ukraine ranked 142nd out of 175 world countries with a high corruption level in the country. Within a year, Ukraine managed to gain only one additional point according to the Corruption Perceptions Index, and in 2015 Ukraine ranked 130th out of 168 countries in terms of corruption perception.

Ukraine managed to demonstrate a positive index dynamics due to social condemnation of corrupt officials, establishment of anti-corruption agencies, and emergence of the corruption watchdog movement. However, according to the position of the public, delaying real punishment of bribe takers and increased corruption component in the relations of business and authorities prevent Ukraine from making a decisive step forward in terms of the corruption perception level indicators.

CORRUPTION PERCEPTIONS INDEX IN THE WORLD



Today, the Corruption Perceptions Index of Ukraine is 27 points out of 100 possible, which is only 1 point higher than last year.



The following have the same corruption perception level:



Fig. 1.1.3. Corruption perceptions index in the world in 2015 (for Ukraine)⁹

According to the Public Perceptions of Reforms in Ukraine Monitoring conducted by TNS together with the National Reform Council, the least corrupt structures, in the opinion of the respondents, are secondary and pre-school education institutions and police, whereas the most corrupt are courts, customs, militia, and the prosecutor's office.¹⁰

⁹ Source: according to Transparency International.

¹⁰ Source: according to TNS Ukraine LLC. The polling was done by online questioning in the period from Nov. 18, 2015 through Nov. 24, 2015. The survey geography covers the entire Ukraine (except for the Autonomous Republic of Crimea), rural population, men and women aged between 18-55. Sampling of 1,000 respondents, with a quota by gender, age, regions, and size of the community: [Electronic resource]. – Access mode: <https://tns-ua.com/news/na-dumku-ukrayintsiv-sudi-ta-mitna-sluzhba-naybilsh-korumpovani-strukturi>

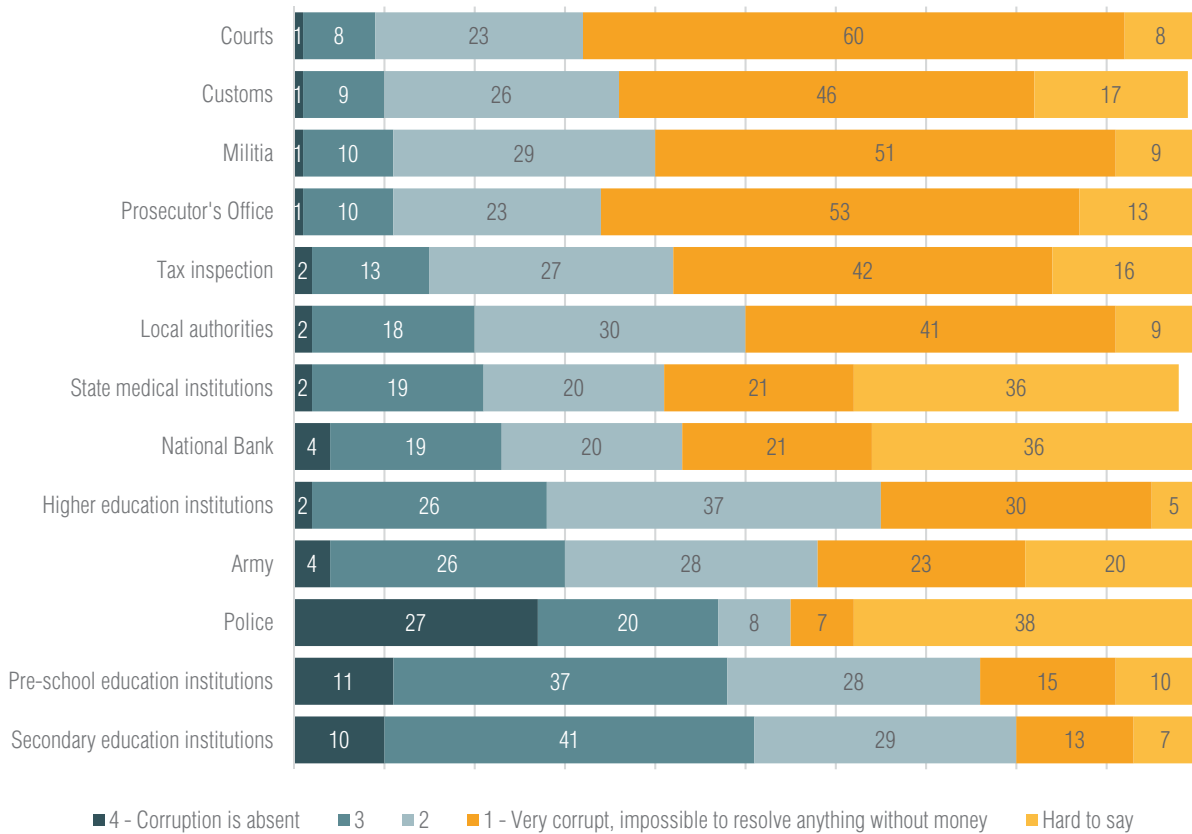


Fig. 1.1.4. Corruption level of spheres and institutions in Ukraine

According to sociological surveys, over 1/3 of the respondents in the past 3 months personally encountered corruption. Over half (54 %) indicated they understood that the situation could not be resolved without a bribe and 26 % more emphasize that a government official directly or indirectly demanded a bribe (the share of such responses grew compared to September this year).

Compared to September 2015, there was an increase in the share of those who stated that they would not bribe and would try to resolve their issue officially if they were to encounter corruption in the future.

When assessing changes in combating corruption, over half of the respondents did not notice any actions and 18 % more could not say anything on this account. This opinion is appreciably more shared by the population of Western Ukraine (60 %). However, 19 % stated that real criminal cases against corrupt officials had been brought, 12 % – that the State punished bribers, and 7 % stated that the State made punishment for corrupt officials harsh and inevitable.

The figure below illustrates the development of the corruption perceptions level in Ukraine (the data are normalized to a comparable methodological scale used by Transparency International since 2012) from 2001 through 2015:

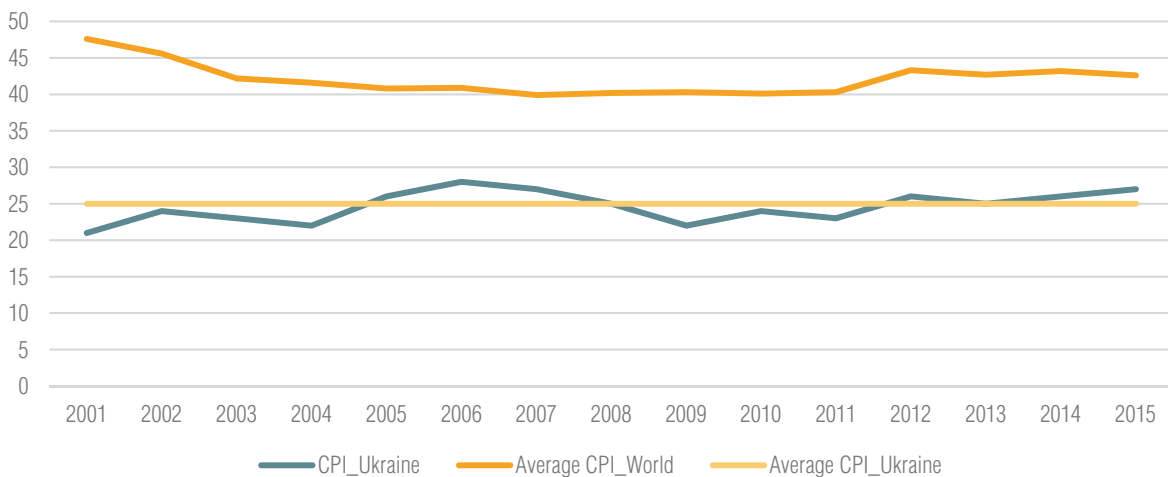


Fig. 1.1.5. Corruption Perceptions Index (CPI) in Ukraine and the World

It should be noted that CPI = 0 indicates the highest corruption level in the country, whereas CPI = 100 – absence of corruption. The data of the above figure demonstrate that in the past 15 years Ukraine's CPI has been within the lower (25 %) quantile (red line), which evidences a very high probability of corruption occurrence in Ukraine. On the average, Ukraine's CPI was 17 % worse than the world CPI.

Empirical data and expert opinions give reasons to state the following negative consequences of corruption occurrences in Ukraine:

- inefficient distribution and spending of the state funds and resources;
- the scale of corrupt financial flows in terms of the country's economic development;
- loss of tax revenues (fiscal agencies appropriate part of the national income in the form of bribes);
- loss of time related to creation of artificial bureaucratic hurdles (instead of producing material values, individuals spend time on unproductive search for corrupt revenues);
- oppression of the private initiative in the economy;
- outflow of qualified personnel, educated youth, and people with entrepreneurial skills to other countries;
- reduction in direct investment and slowing down of economic growth;
- reduction in the quality of social services;
- misuse of the international assistance and inefficiency of such assistance;
- growing social inequality;
- increasing role of organized crime;
- losses for the political legitimacy of the authorities;
- deteriorating public morality and general virtues.

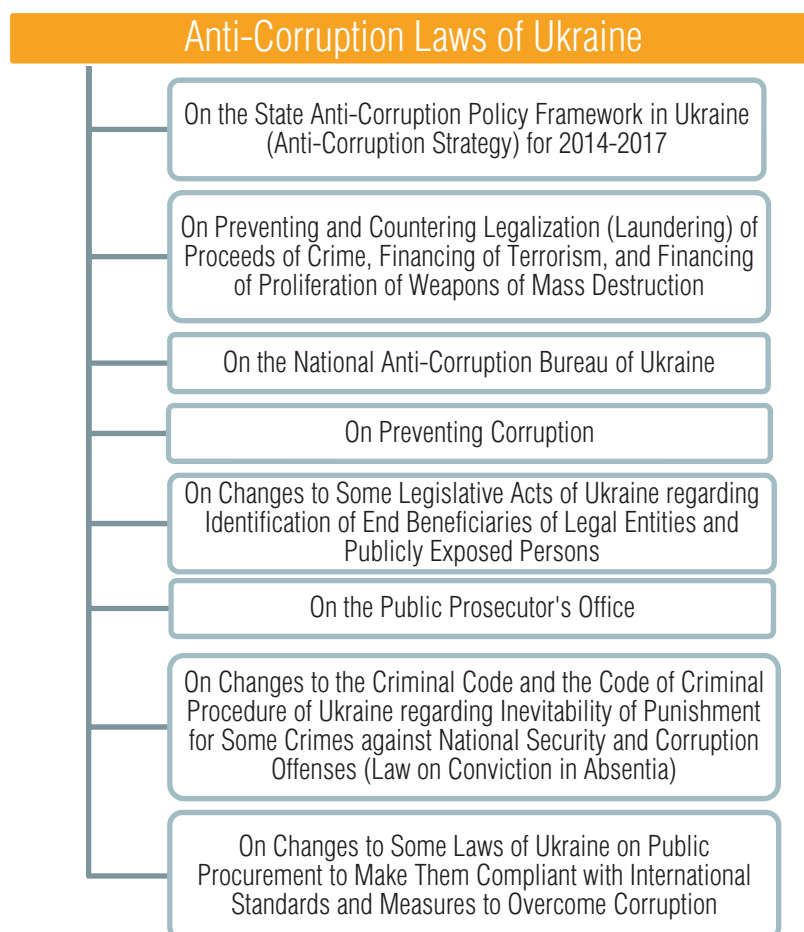


Fig. 1.1.6. Anti-Corruption Laws of Ukraine

Given sufficient legislative regulation of the corruption prevention and countering processes, the respondents note low efficiency of practical corruption combating results.

In view of this, below is some statistics on the work of the law enforcement agencies (SBU, PGOU, MIA, NABU) in this area.

The total number of criminal anti-corruption investigations launched on the SBU materials in 2013 was 1,027, of which 456 persons were served a suspicion note on committing corruption offenses (247 under CCU Art. 368 “Taking a Bribe”) and 598 protocols were drawn on administrative corruption offenses.

In 2014 the statistics was as follows: pre-trial investigations – 954, of which 359 persons were served a suspicion note on committing corruption offenses (233 under CCU Art. 368) and 705 administrative protocols were drawn.

In 2015, based on the materials of SBU special departments, a suspicion note was served on committing of 544 corruption offenses, of which 414 are related to accepting a proposal, promise, or receiving of an improper advantage by an official (CCU Art. 368), and 476 protocols on corruption-related administrative offenses were drawn.

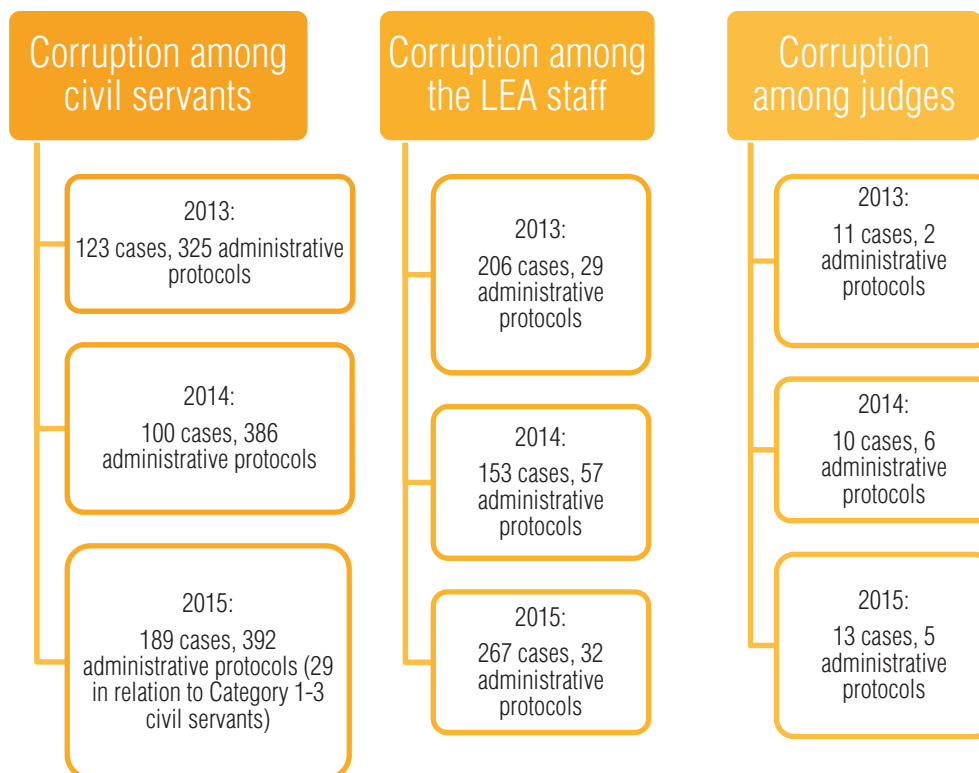


Fig. 1.1.7. SBU Anti-Corruption Activities

The results of the PGOU anti-corruption activities are shown in Fig. 1.1.8.

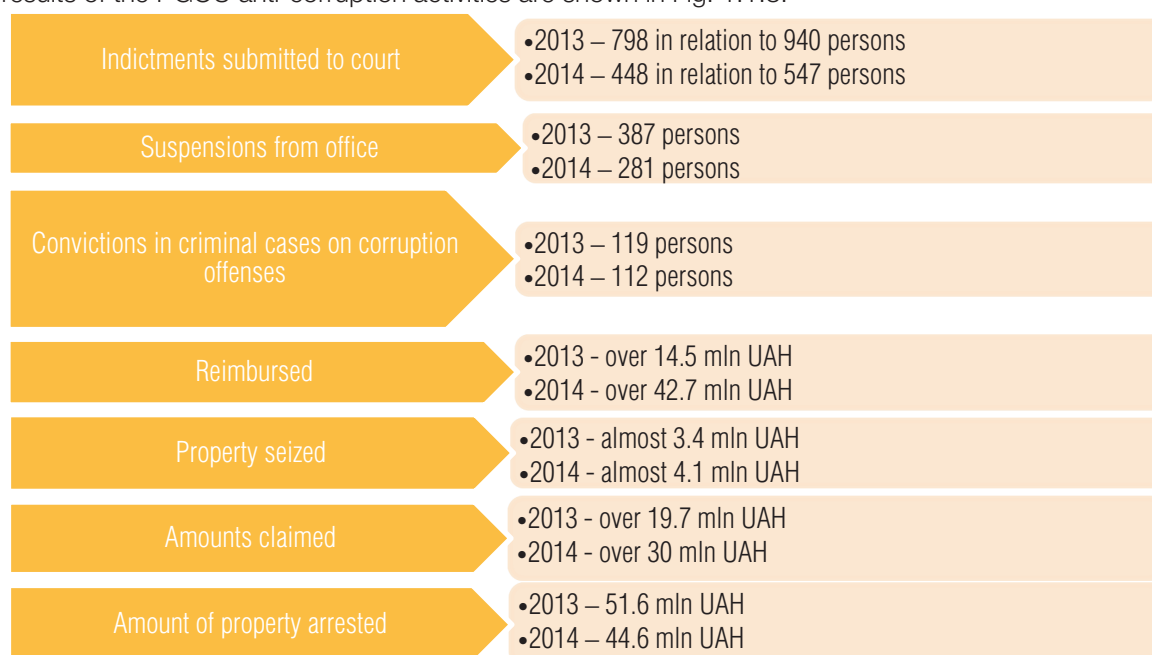


Fig. 1.1.8. PGOU Anti-Corruption Activities

The MIA agencies submitted 668 protocols on corruption offenses to court in 2013, 773 in 2014, and 2,147 in 2015. In 2013 488 persons were prosecuted, with confiscation applied to 76 of them, in 2014 – 553 persons, with confiscation applied to 28 of them, and in 2015 – 1,720 persons, with confiscation applied to 60 of them.

The amount of material damages amounted to over 221.5 mln UAH in 2013 and to over 67 mln UAH in 2014; in 2013-2014 the damages were indemnified to the amount in excess of 11.5 mln UAH and 34 mln UAH respectively.

In 2015 the information on 125 criminal offenses in relation to 137 officers of the SBGSU and 8 other persons was included in the URPI.

63 facts of corruption offenses committed by the SBGU officials were recorded and entered in the URPI.

The committed crimes related to breach of the anti-corruption legislation resulted in 17 convicted military officers, 2 of which for the crimes committed in 2014.

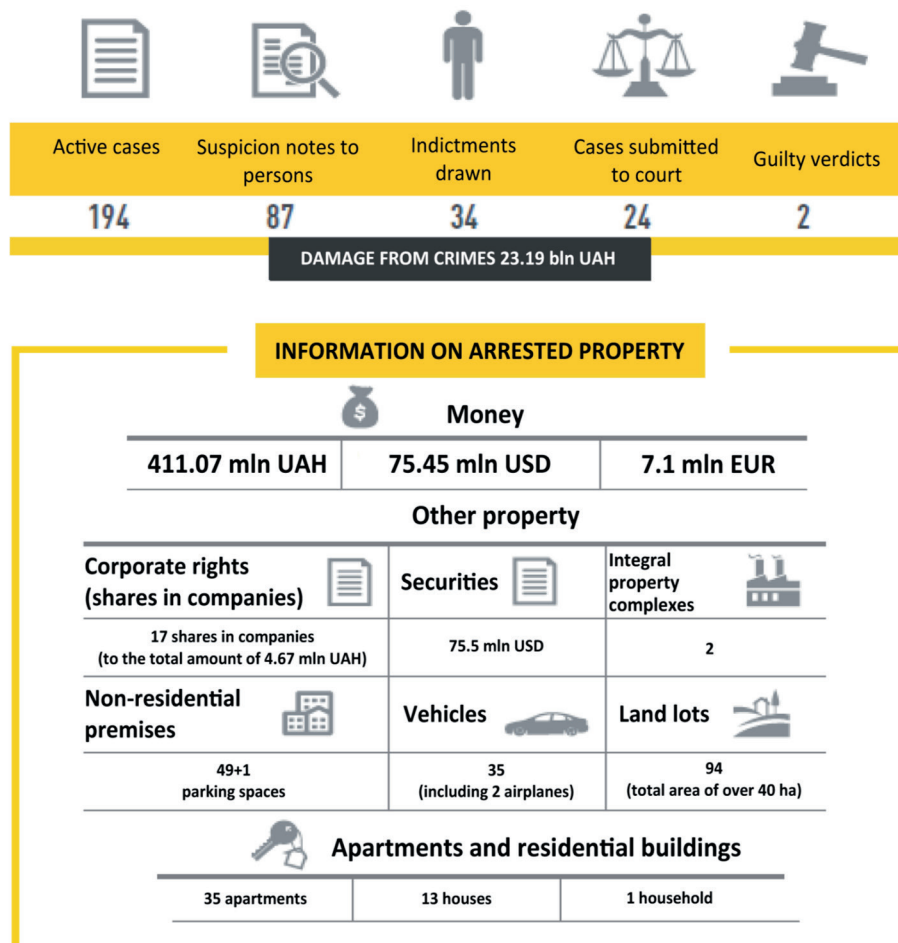


Fig. 1.1.9. NABU investigations Key indicators¹¹

At the end of July 2016, NABU had 194 active criminal cases in review, 100 of which were registered pursuant to applications of natural persons and legal entities to the NABU, as well as pursuant to NABU detectives' and analysts' own work. Another 82 criminal cases were accepted from or registered pursuant to the materials of other LEA. The rest were registered pursuant to a court decision or applications from Members of Parliament of Ukraine. The total worth of crimes in the criminal cases investigated by NABU detectives exceeds 23 bln UAH.

A suspicion note was served to 87 persons under pre-trial investigations. Indictments were drawn and submitted to court in relation to 34 of them. On the whole, as of July 29, 2016, NABU detectives completed the pre-trial investigation and submitted to court the materials of 24 criminal cases.

The pretrial investigations resulted in the arrested cash assets to the amount of 411.07 mln UAH, 75.45 mln USD, and 7.1 mln EUR. Further, NABU initiated the arrest of 2 integral property complexes of enterprises, 94 land lots, 50 non-residential premises, 37 apartments, 13 houses, 35 vehicles, including 2 aircraft, and 17 shares in enterprises and securities worth 75.5 mln USD. NABU activities helped return about 45 mln UAH to the aggrieved parties.

Thus, the law enforcement system (specifically the MIA) is currently undergoing serious reforming, and the newly established agencies (NABU, Anti-Corruption Prosecutor's Office) continue their building up.

¹¹ Source: NABU Report (February – August 2016): [Electronic resource]. – Access mode: <https://nabu.gov.ua/sites/default/files/reports/zvit02-072016.pdf>

1.2. Social Component

The population of Ukraine as of the end of 2013, according to the State Statistics Service of Ukraine, was 45,426,249 persons.

The state statistics agencies receive data on the ethnicity (nationality) of the population only through population censuses. The last All-Ukrainian population census in Ukraine was conducted in 2001.

According to Art. 3 of the Law of Ukraine “On the All-Ukrainian Census”¹², the basis for a population census is a Cabinet of Ministers of Ukraine decision. Pursuant to the CMU Ordinance “On the All-Ukrainian Population Census in 2020” (as amended)¹³, the next population census is to be conducted in 2020.

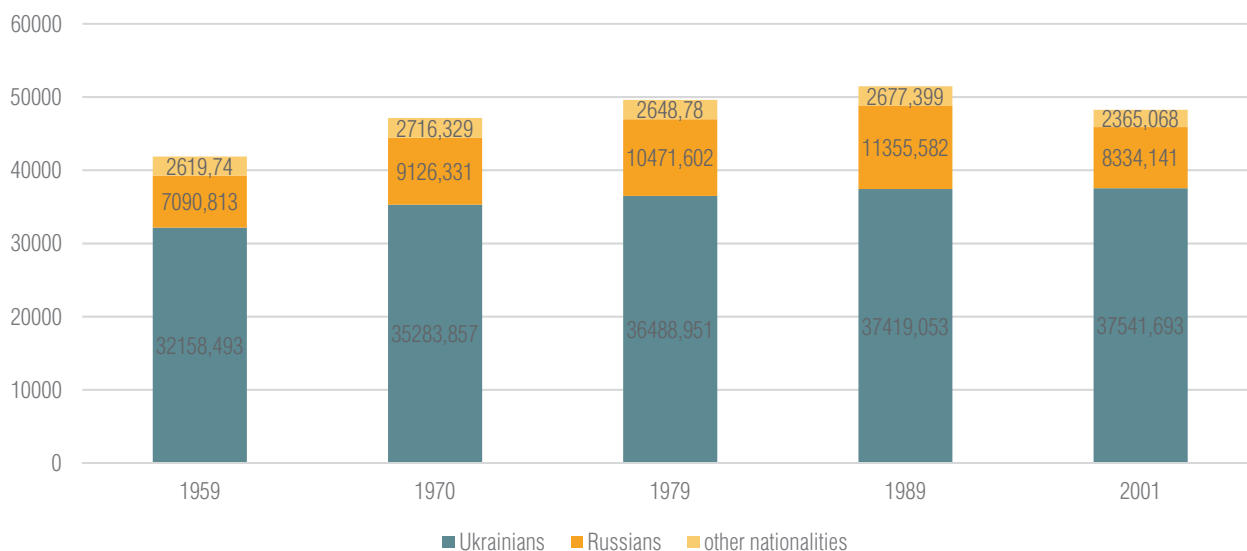


Fig. 1.2.1. Distribution of Ukraine's population by nationality based on census data (thous persons)

According to the Sociological Association of Ukraine, the level of confidence in the authorities is critically low. According to the survey, conducted by the Ilko Kucheriv Democratic Initiatives Foundation and Razumkov Center Sociological Service in July 2015, the highest level of public non-confidence was identified to be related to all the LEA.



Fig. 1.2.2. Level of non-confidence of Ukraine's population in its institutions

¹² On the All-Ukrainian Population Census: Law of Ukraine, Oct. 19, 2000 No. 2058-III [Electronic resource]. – Access mode: <http://zakon5.rada.gov.ua/laws/show/2058-14>

¹³ On the All-Ukrainian Population Census in 2020: Cabinet of Ministers of Ukraine Ordinance, Apr. 9, 2008 No. 581-r: [Electronic resource]. – Access mode: <http://zakon0.rada.gov.ua/laws/show/581-2008-%D1%80>

1.3. Economic Component

There are two different approaches in the world to classification of the economic systems of countries developed by international organizations in line with their needs and activity areas.

Geographically, UN includes Ukraine in the “Commonwealth of Independent States” sub-group belonging to the “Transition Economy Countries” group. In terms of the human development index, according to the 2015 Report, Ukraine is in the “High Human Development Index Countries” group.

Also, the statistical annexes to the Report list Ukraine among the developing countries.

According to the annually revised World Bank classification of countries by the Gross National Income (GNI) in USD per capita, in 2002-2004 Ukraine was listed among the “Lower Middle Income Economies”.

In 2014, the Ukrainian economy developed under the influence of the restraining factors that lie in the plane of the economic and geopolitical environment.

Thus, in 2014 GDP dropped by 6.8 %, and in 2013 remained on the level of 2012.

The ATO in the East of Ukraine, where the industrial development level is the highest, a breakdown of traditional production ties, and destruction of the transport infrastructure have significantly affected the structure of the economy.

Thus, in 2014 changes occurred in the following sectors:

- the Gross Value Added (GVA) share in GDP reduced to 19.8 % compared to 20.2 % in 2013;
- whole and retail sale, repair of motor vehicles and motorcycles – down to 14.2 % from 14.5 % respectively;
- transport, warehousing, post, and economic activities – down to 7 % from 7.1 % respectively;
- construction – down to 2.2 % from 2.5 % respectively;
- other types of economic activities – down to 33.4 % from 34.6 % respectively.

Significant GDP structural changes in the utilization are were observed in the investment component and the foreign commodities and services trade balance.

For example, the specific weight of the gross formation in GDP reduced to 14.1 % in 2014 from 18.5 % in 2013, including gross fixed capital formation to 14 % from 16.9 % respectively. This was prompted by the crises in the investment sphere that started in the second half of 2012 and exacerbated in 2014 due to reduced capacity of most capital attraction channels against the backdrop of temporary occupation of Ukraine's territory (the Autonomous Republic of Crimea and city of Sevastopol), ATO in the East of the country, macroeconomic instability, and imbalances in the financial sector of the economy.

A more than double drop in the specific weight of the foreign trade negative balance (net export) (to minus 4.1 % in 2014 from minus 9.2 % in 2013) was caused by the rate of commodities and services import exceeding the export reduction rate.

The main factors causing reduction in the export of commodities included:

- unfavorable price environment on the world market of ferrous metals and fertilizers;
- trade limitations on supply of a significant inventory of domestic products to the Customs Union¹⁴ member states, primarily to the Russian Federation.

The main contributors to the reduction in the volumes of commodities import include narrower consumer and intermediate demand on the internal market, also through a negative effect of the hostilities in the East of the country.

The consumer imports in 2014 shrank by 31.4 % compared to a 1.3 % reduction in 2013. Its specific weight in the structure of the commodities import reduced to 25.6 % compared to 26.3 % in 2013.

The energy imports in 2014 shrank by 28.8 % compared to a 19 % reduction in 2013. The structure of the commodities imports demonstrated some growth in the specific weight to 27.8 % compared to 27.6 % in 2013.

In 2014 the investment imports shrank by 33.9 % compared to a 14.6 % reduction in 2013. Its specific weight in the structure of the commodities import reduced to 18.7 % compared to 20 % in 2013.

Shadow economy factor

Ukraine's economy is characterized by a rather large shadow sector, which “undermines” the efficiency of the state mechanisms of economic incentives, distorting the conditions for pursuit of economic activities.

It should be noted that the shadow sector has an ambiguous effect on the functioning of Ukraine's economy in today's context.

An undisputed fact is that significant volumes of the shadow economy deepen the disbalances in the economy, remaining a major challenge to the State's economic security, the trends of changes in which will further determine

¹⁴ The Customs Union is a form of interstate trade and economic integration of the Eurasian Economic Union countries. Member-states: Belarus, Kazakhstan, Russian Federation, Armenia, Kyrgyzstan.

scenarios of the country's economic development in general. Correctness of this assumption is evidenced by a steady inverse dependence between the economic security level indicators and the shadow economy (Fig. 1.3.1).¹⁵

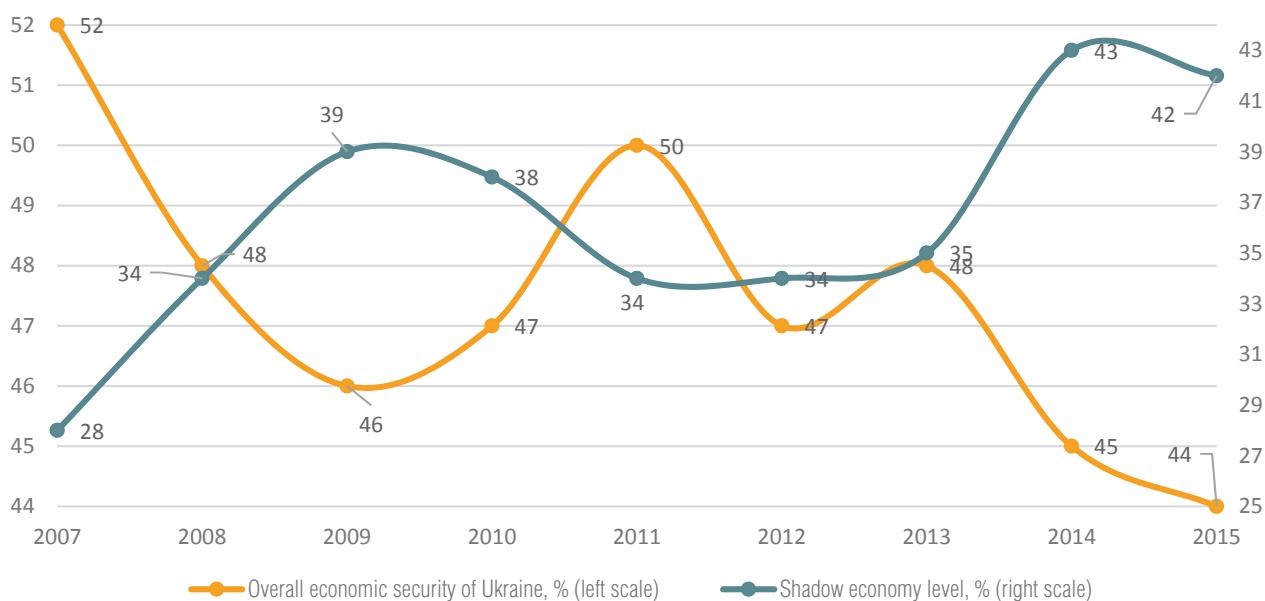


Fig. 1.3.1. Levels of Ukraine's economic security and shadow economy

According to the MEDTU calculations, in 2013 the shadow economy level was 35 % of the official GDP, and in 2014 – 41% of the official GDP.

A challenge to Ukraine's economy is posed not by significant volumes of its shadow component, but by the fact that shadow economy in Ukraine has economic sources of origin (and not criminal, as is the situation in advanced countries).

According to Professor F. Schneider's (Austria) calculations, the EU average shadow economy level in 2014 was 18.6 % of GDP, 10.8 % in France, 12.2 % in Germany, and 23.5 % in Poland respectively.

At the end of the first decade of the 21st century¹⁶, Ukraine's economy becomes one of 15 most shadow-intensive economies with an indicator 17 % higher than the world average shadow economy level, 41.2 % higher than the minimum level of the shadow economy level in Switzerland, but 16.4 % less than the highest indicator of the shadow economy level in the world from 1999 through 2007, which was recorded in Bolivia.

The graph (Fig. 1.3.2) shows that Ukraine is on the right side of normal distribution (see the red vertical line), which is another illustrative example of the abnormal situation related to the national shadow economy.

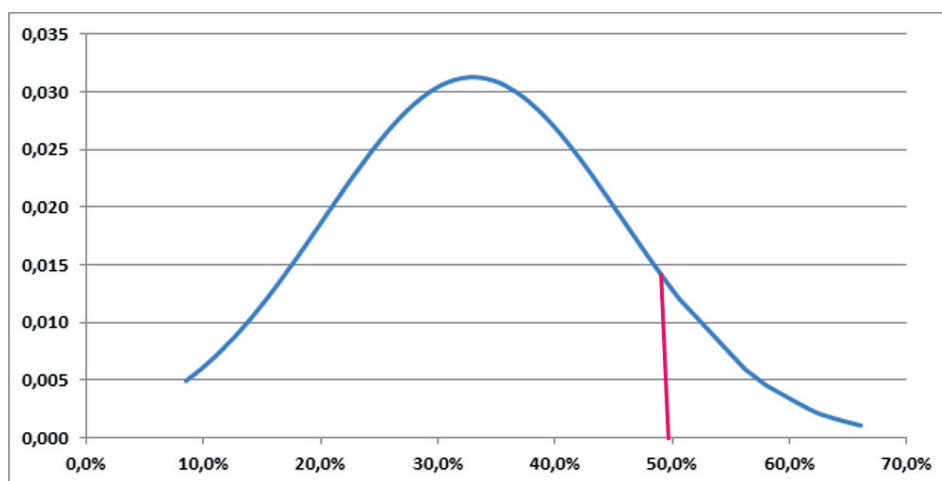


Fig. 1.3.2. World Economies' Shadow Economy Level Probability Distribution Density

¹⁵ Source: MEDTU official web-site "Shadow Economy Trends in Ukraine, 2015": [Electronic resource]. – Access mode: <http://www.me.gov.ua/Documents/List?lang=uk-UA&id=e384c5a7-6533-4ab6-b56f-50e5243eb15a&tag=TendentsiiInovoiEkonomiki>
¹⁶ Reference: the global 2008 crisis and subsequent change of power in Ukraine related to the corrupt and oligarchic regime of V. Yanukovich only exacerbated the shadow economy level.

Data was extrapolated on the national shadow economy level (Fig. 1.13), which is determined by the F. Schneider international comparative method, for 2007-2015, and it was determined that as of the end of 2015 the said level, with a high confidence level of approximation of the trend prediction line, was 40 % of GDP (740 bln UAH in the current prices or 31 bln USD).

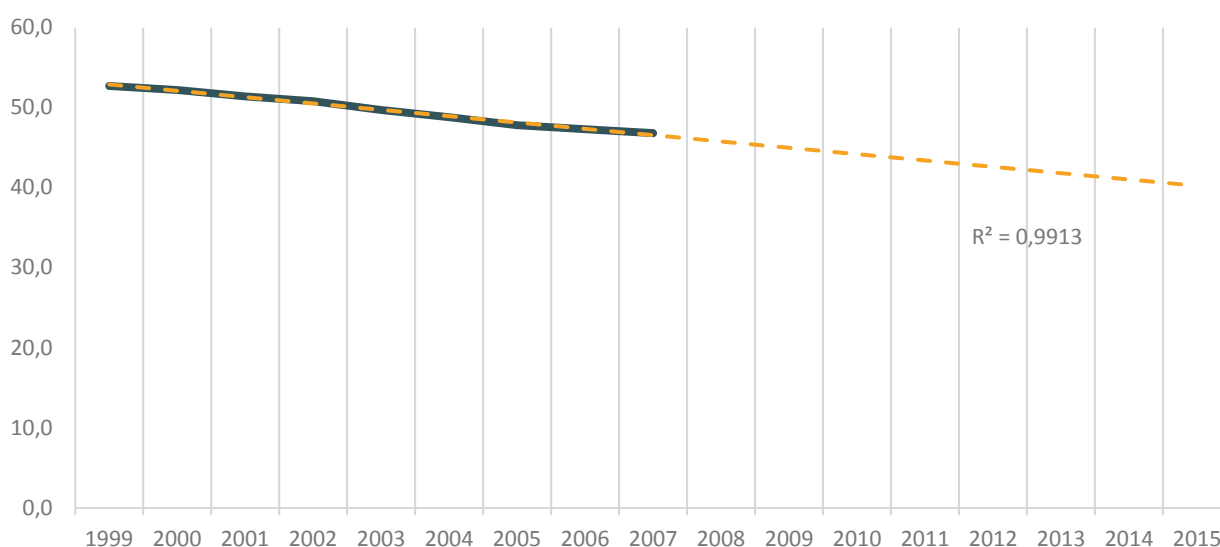


Fig. 1.3.3. Extrapolation of Ukraine's Shadow Economy Level Calculated Using the F. Schneider Method

The above components evidence a very high probability of Ukraine's shadow economy and, given the calculated consequences, allow stating the highest risk level of shadow economy growth (tax evasion) in Ukraine with a trend towards its gradual reduction.

Starting May 2015, Ukraine's economy maintained a positive tendency towards stabilization of the macro-situation. An expected result of a relative exchange rate stabilization was a reduced inflation level – whereas in April 2015 (before April of the previous year) it was 60.9 %, in December 2015 (before December of the previous year) it was 43.3 %. The above, coupled with the deescalation of the military conflict in the east of the country, caused an improvement in GDP development: the seasonally corrected GDP increased by 0.5 % in Quarter III (to Quarter II) and by 1.5 % in Quarter IV (to Quarter III). On the whole, the GDP drop in 2015 was 9.9 %.

These positive trends were reached due to the following:

- fiscal consolidation and harsh monetary policy;
- financial and loan assistance from IMF;
- agreements reached on the restructuring of the external national debt;
- stepping up the processes of economic reforms and deeper cooperation with the EU;
- geographic re-orientation of the Ukrainian exports (specifically to the EU, African, and Asian countries);
- adaptation of businesses to new economic conditions;

gradual restoration and formation of new ties between industries in the economy in the context of “freezing” the conflict intensity in the East of the country.

High confidence of citizens in government institutions is common for developed countries and is one of the primary reasons for a lower shadow economy level compared to the developing countries.

The aggregate effect of the said factors helped break the increasing shadow economy trend started in 2013 and continuing against the background of price and depreciation shocks, as well as escalation of the military conflict. According to the MEDTU preliminary calculations, in 2015 the shadow economy level was 40 % of the official GDP, which is 3 points below the 2014 indicator.

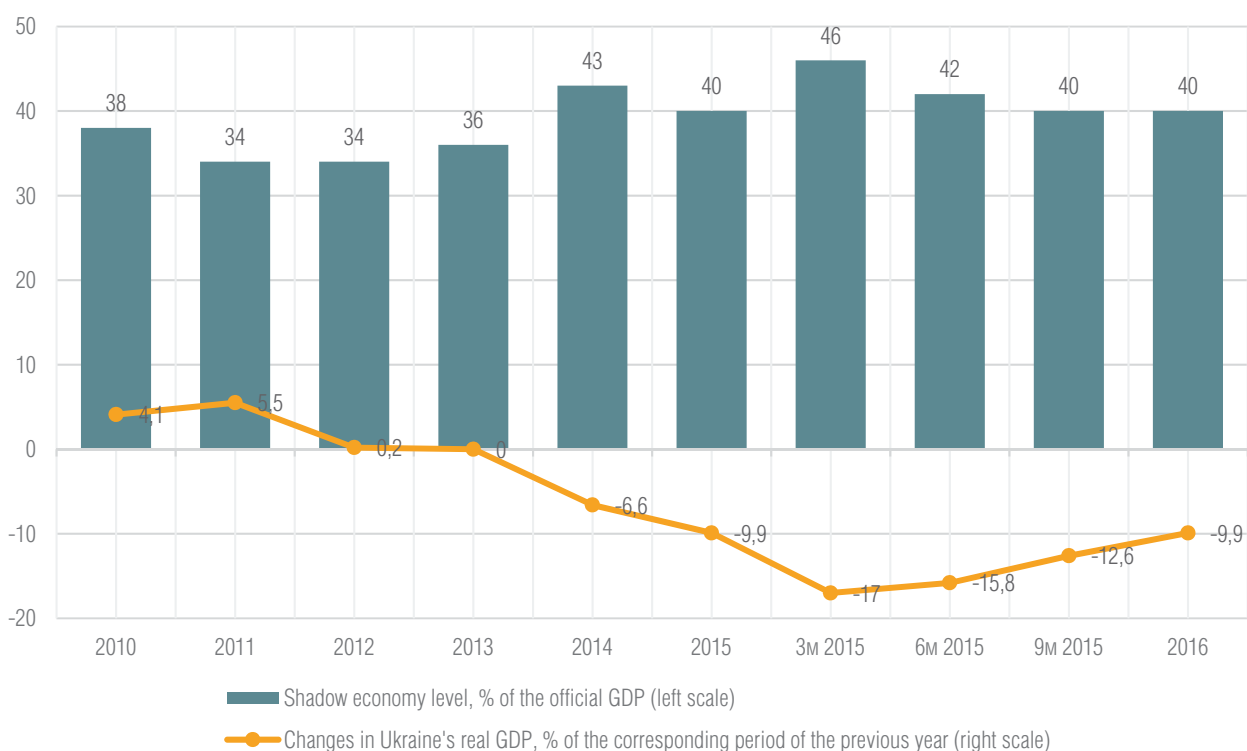


Fig. 1.3.4. Integral indicator of the shadow economy level in Ukraine (in % of the official GDP) and real GDP growth/reduction rate (in % of the corresponding period of the previous year)

De-shadowing of Ukraine's economy in 2015 was hindered by a number of issues that adversely affected the overall country's economic development. Specifically, these include:

- a significant tax burden on the corporate sector against the background of expensive loans;
- unfavorable foreign economic environment on the key commodities markets of the national exports;
- reduced internal demand for domestic products, higher costs of imported raw and other materials due to depreciation of the national currency, and introduction of an additional import duty;
- significant investment risks;
- aggravated international relations with the Russian Federation as the main trade partner, Ukraine's loss of its markets;
- destruction and suspension of production facilities, disrupted logistics, increased incidence of economic smuggling resulting from emergence of the territories uncontrolled by the authorities in the wake of the conflict in the country.

Thus, de-shadowing of the economy will become effective only if the State creates favorable conditions for companies to increase their business activities in the legal economy through improved investment and entrepreneurial climate in the country and building of an institutional environment in which shadow economic activities would be inefficient.

One of the main threats posed by the shadow economy is, first and foremost, blocking the efficiency of tools and mechanisms used to manage the country's social and economic development. Therefore, the Government efforts should focus on measures to minimize the effects of system-based factors contributing to the shadow economy which remain unaddressed and have a high priority, namely:

- low efficiency of the country in providing for institutional foundations for development of a competitive economy;
- excessive regulatory and tax pressure on the corporate sector, high burden on the wage pool, which prompts employers to conceal the actual salary level of the staff and maintain informal employment practices;
- low efficiency of the agencies of the judicial and law enforcement system;
- high corruption level;
- insufficient protection of rights for movable and immovable property, including rights for financial assets.

According to the State Statistics Service of Ukraine, the average monthly salary in September 2015 was 4,012 UAH.

In 2014 the salary nominally grew 6 % over 2013 to 3,480 UAH (in 2013 the growth was 7.0% to 3,282 UAH respectively); in reality (taking inflation into account) the salary in 2014 fell 6.5 % (in 2013 it grew 8.2 %).

In 2014 the actual salary decreased in all the regions of Ukraine. The most significant reduction was observed in the Kyiv (8.2 %), Chernivtsi (6.8 %), and Odesa (6.8 %) Regions.

Additionally, it should be noted that Ukraine has one of the lowest minimum salaries in the world – a legislatively established salary for simple, unqualified labor, below which the monthly or time-based labor cannot be remunerated. The minimum salary is a state social guarantee mandatory all over Ukraine for companies, institutions, and organizations of all ownership and business forms which use salaried employees. The minimum salary is established in accordance with the Law On the State Budget of Ukraine for the corresponding year upon submittal by the CMU (Ministry of Finance).

It should be noted that the social guarantees in 2015 in Ukraine remained on the level of 2014 (the minimum salary, according to the Law of Ukraine “On the State Budget of Ukraine for 2015”¹⁷, remained unchanged). The latest minimum salary increase within the reviewed period (till Dec. 31, 2015) occurred on Sept. 1, 2015 to 1,378 UAH (57 USD):

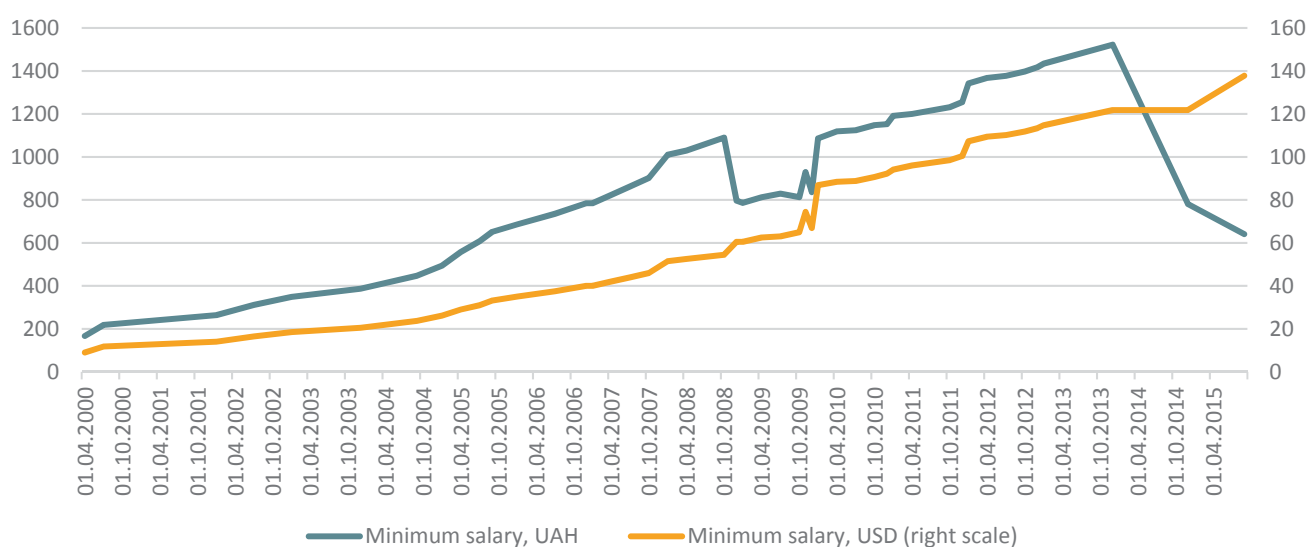


Fig. 1.3.5. Minimum Salary Level Trends in Ukraine

The remuneration received by employees in Ukraine for their labor is measured in UAH which (considering depreciation and inflation) has an ever dropping purchasing power. The actual minimum and nominal salary differ significantly¹⁸.

The above data evidences that the dramatic poverty rate increase in Ukraine, combined with a concentration of the shadow capital and corrupt revenues of a small fraction of population, breeds very high risks of social, psychological, and economic nature (further drop in the levels of production, consumption, business activities, savings, employment in the legal economy, liquidity of the financial sector, its financial stability, tax evasion, etc.).

¹⁷ On the State Budget of Ukraine for 2015: Law of Ukraine, Dec. 28, 2014 No. 80-VIII: [Electronic resource]. – Access mode: <http://zakon5.rada.gov.ua/laws/show/80-19>

¹⁸ The minimum salary is the amount of money received by an employee per month, whereas the actual salary is the amount of commodities and services the employee can buy with the nominal salary.

Factor of population non-confidence in the country's financial system.

The crises in the global financial system at the end of the first decade of the 21st century demonstrated how serious and important are the issues of transparency of financial institutions and availability of information on the risks of their activities. The problem is of prime importance for the developing countries, which also include Ukraine. The institutional and structural weakness of the country's still unformed financial system exacerbates the problem.

Lack of confidence in the financial system is closely related to the concept of “moral risk”, whose vitality, as a consequence, exerts a destructive influence on the financial system and aggravates the crisis in the economy. It is undeniable that moral risks are a prerequisite for the “gregarious” behavior of consumers, which implies a confidence crisis in relation to the security of savings and probability of returning investment, and which prompts “depositor attacks” on banks. One of the prerequisites for the rising of moral risks is asymmetric information, which produces a liquidity risk and an insolvency risk, thus causing panic.

According to a sociological survey conducted at the end of 2015, only every third Ukrainian has confidence in NBU, this confidence level being the highest among the government institutions (Fig. 1.3.6).

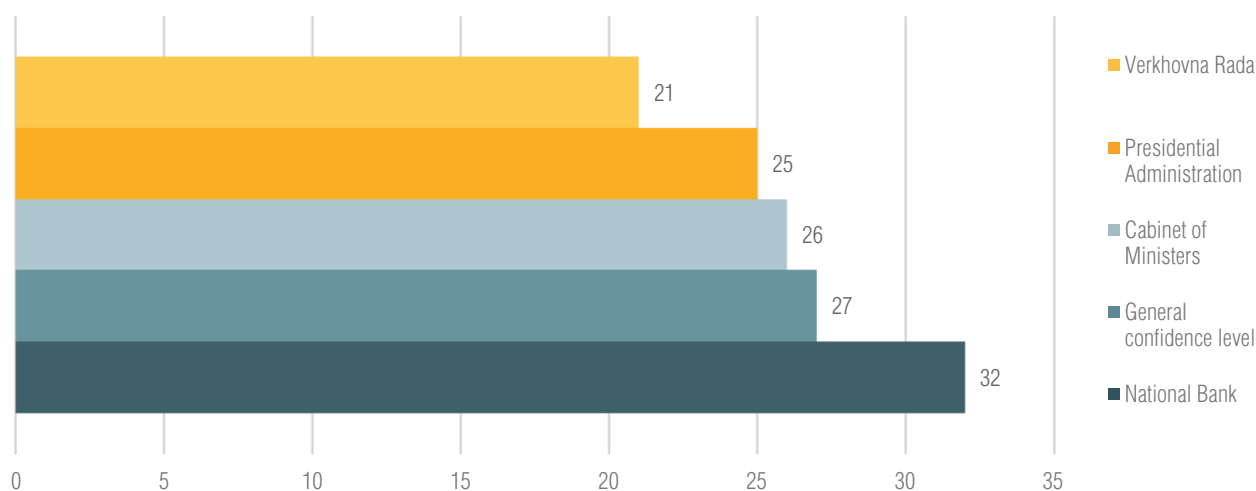


Fig. 1.3.6. Population Confidence in Government Structures

Even fewer Ukrainians trust commercial banks. In 2014 only 28 % of citizens trusted the national bank institutions, 61 % of population did not trust banks, and the rest did not decide on their attitude. On this indicator, Ukraine ranks 9th from the end out of 135 countries. Behind Ukraine are only Greece (13 % of population have confidence in banks), Iceland (16 %), Ireland (16 %), Spain (18 %), Italy (20 %), Chile (25 %), Hungary (27 %), and United Kingdom (27 %). The highest level of confidence in banks was recorded in Rwanda, Sri Lanka, Thailand, Cambodia, and Malaysia (85% and above).

With seemingly sufficient information flows, there is very little credible analytical information about the market participants. The asymmetry of the informational environment poses investors (depositors) with a challenge of making a decision of where to invest, because in absence of reliable and accurate information it is very difficult to identify when and how the informational asymmetry will impact their situation. This, in its turn, diverts the capital flows to the shadow sector.

Since Ukraine's financial system is bank-oriented, it makes sense to pay special attention to the depositors' confidence in the bank institutions.

In this situation it is quite obvious and expected that only 16 % of Ukrainians believe that in the case of misunderstanding between a consumer and a financial institution, the conflict will be resolved in favor of the first.

The results of a sociological survey¹⁹ conducted on Dec. 17-28, 2015 by the Ilko Kucheriv Democratic Initiatives Foundation and the Ukrainian Sociology Service evidence that the absolute majority of Ukrainians have no idea whatsoever on what to do and who to approach for assistance in resolving disputed aspects in their relations with bank institutions, while about 85 % stated they had already had issues related to their interaction with financial dealers.

¹⁹ Ilko Kucheriv Democratic Initiatives Foundation: [Electronic resource]. – Access mode: <http://dif.org.ua/ua/polls/>

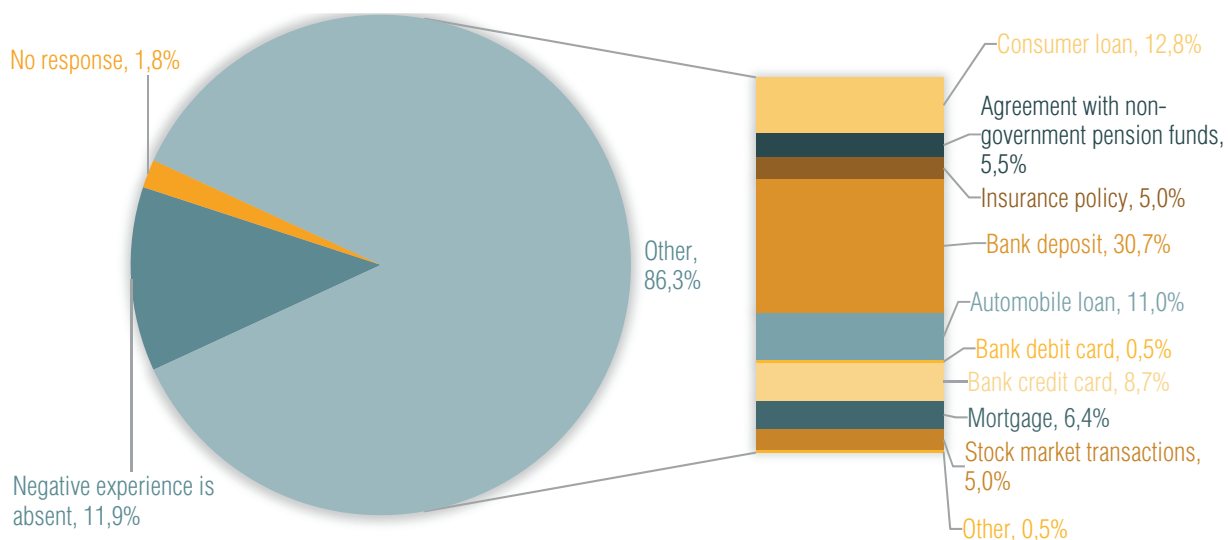


Fig. 1.3.7. Negative experience of Ukrainians in using financial services at the domestic bank institutions

Thus, lack of confidence among the Ukrainians in the financial system and the authorities complicates and hinders accumulation of sufficient resource potential by the financial system and its transformation into investment resources of the economy, and stimulates increased volumes of cash, which is highly volatile in terms of financial monitoring.

It would be wrong to believe that this situation is typical only for turbulent conditions on the financial market which result from the world crisis. Obviously, many problems faced by the clients while using financial services could be related to the financial crisis. A lot of consumers could not retrieve their deposits from the troubled banks. However, at the same time, in the pre-crisis period, when receiving financial resources on the international markets, the Ukrainian banks were not interested in population deposits and development of the financial market's reputation through creating favorable conditions for transactions with households and individual business. Therefore, even in the stable financial and economic state, the bank services market in Ukraine continued functioning in a continuously recreated market asymmetry. As a result, users of financial products state low quality of the information campaigns conducted by banks, low awareness level on the existing financial services and their conditions, and lack of understanding of the real risks of money investment. Of those who faced issues in using a financial service, most either did not react in any way or stopped using the service before expiration of their contract with the financial institution.

Ukrainians take little interest in the financial sector news. The three “money” issues monitored by the majority of the population are the inflation index (20 %), changes in the pension level (10 %), and changes in the real estate prices (10 %); for more information see the figure below. 1.3.8.

Thus, one can state that the behavior of an average Ukrainian financial services consumer is not independent, prompted by a traditionally narrow confidence margin, often irrational in the conditions of continuously recreated market informational and operational asymmetry.

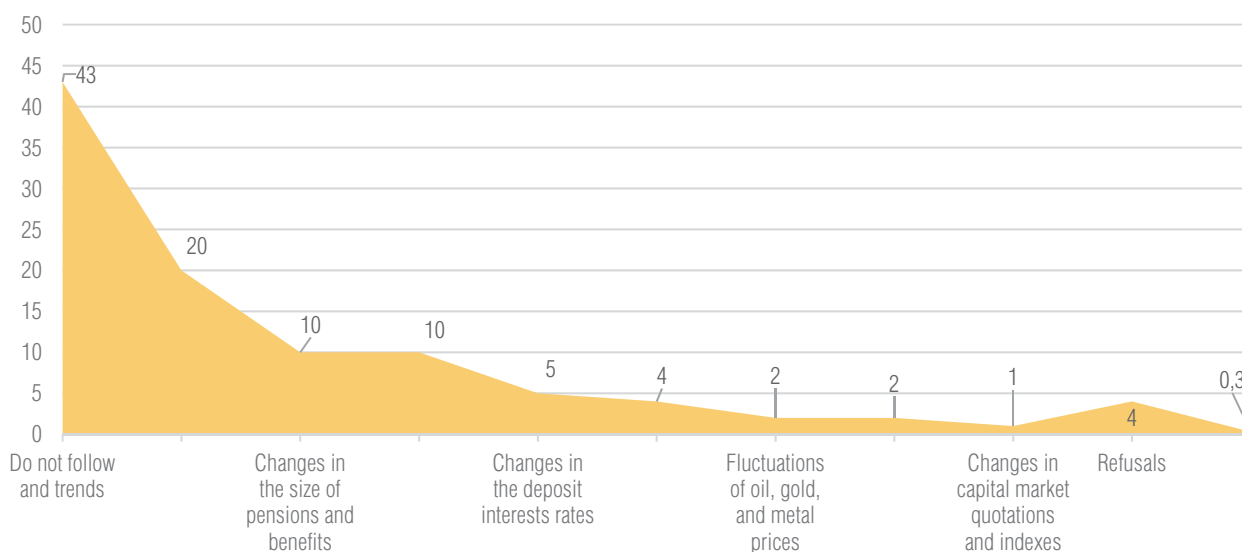


Fig. 1.3.8. Financial Market Trends Monitored by Households

Bankers note that “the pre-crisis level of population confidence in banks has been implemented”. The lack of confidence in banks in 2015 was almost 80% and in today's conditions it is not easy to reduce.

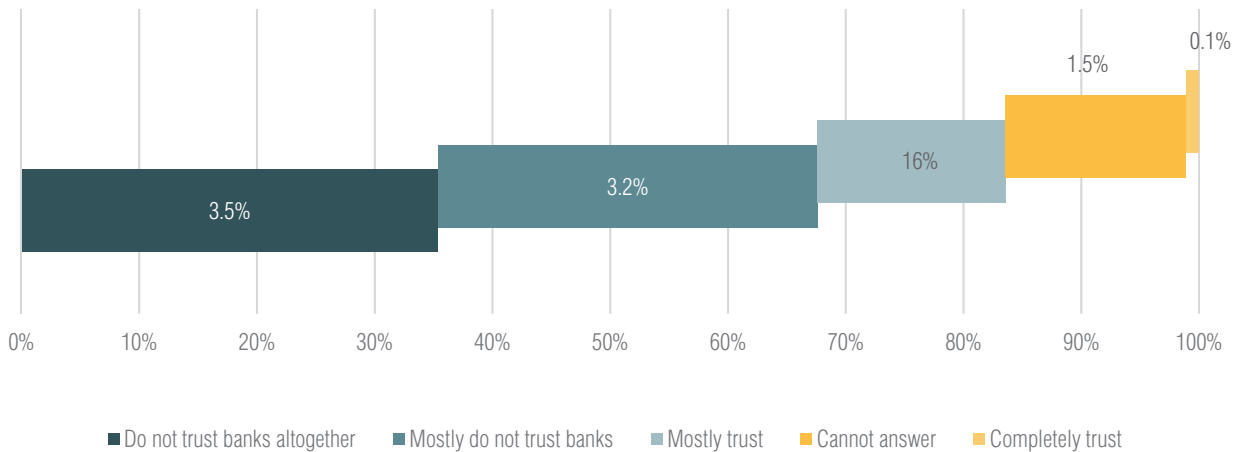


Fig. 1.3.9. Ukrainians' Level of Confidence in Banks

A country's bank system cannot function if four out of five citizens do not trust any bank and, as a consequence, will not cooperate with them in the future.

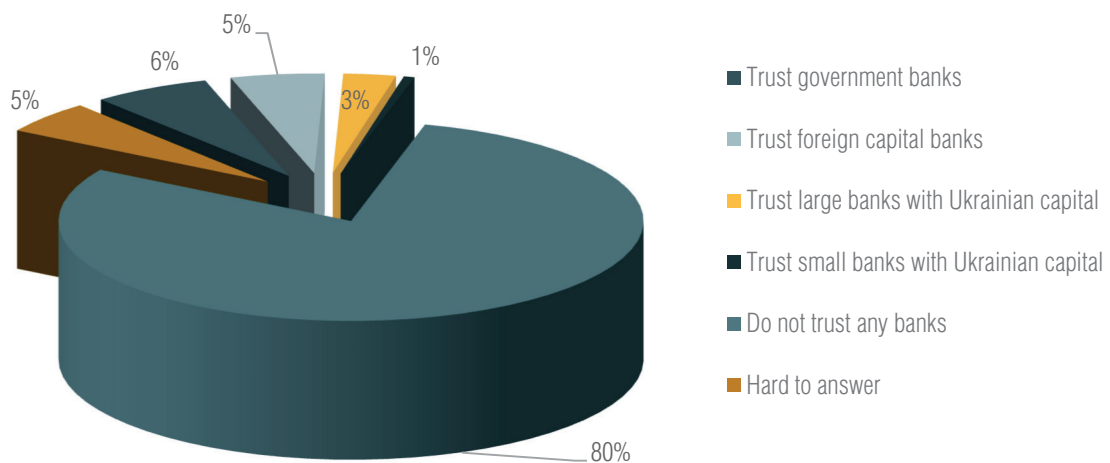


Fig. 1.3.10. Population Level of Confidence in the Bank System of Ukraine in 2014 (Structural Profile)

Lack of confidence among the Ukrainians in financial institutions is the second reason after the low income level which precludes keeping of savings in banks (Fig. 1.3.11).

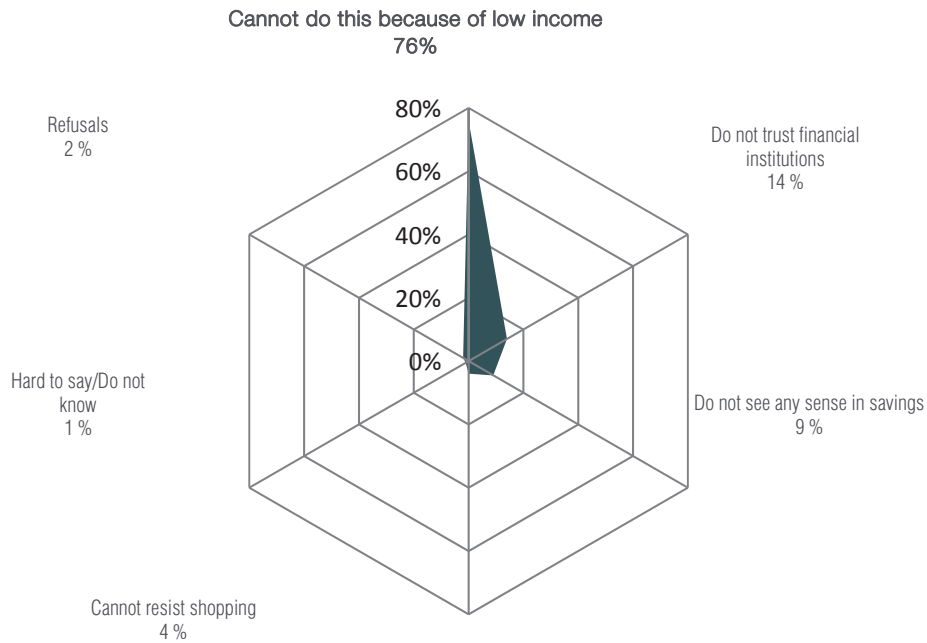


Fig. 1.3.11. Obstacles to Saving

The world financial crisis helped reveal problems related to establishing and using of “non-transparency hubs” in Ukraine's financial system. According to the Commercial Value Institute (US) survey, over one third of Ukrainians hope that possible changes in the legislation in the next five years will primarily relate to improving the transparency and openness of financial institutions.

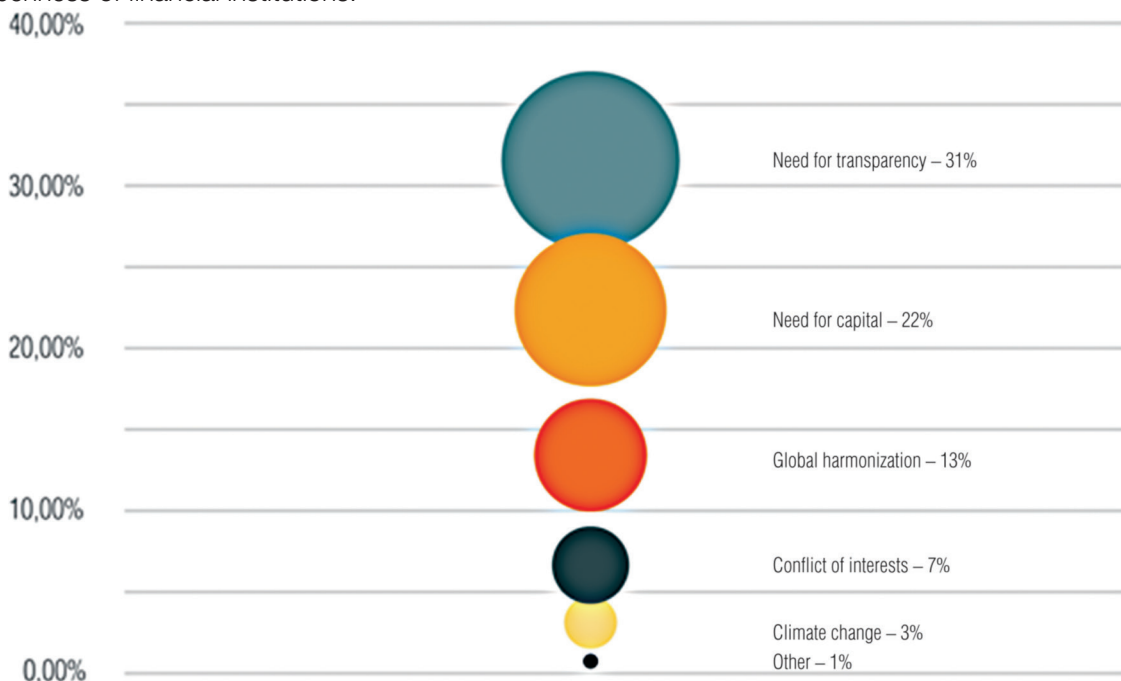


Fig. 1.3.12. Changes in the Legislation Expected by Citizens of Ukraine in the Next Five Years

It should be noted that lack of confidence in the financial system is not least of all caused by problems of regulating the financial market as a holistic phenomenon, which is not taken care of by anybody in Ukraine. De jure, the CMU pursues unified financial, price, investment, and tax policy. NBU develops the basics of the monetary and credit policy and effects control over its implementation. Substantial powers are also granted to the Ministry of Economic Development and Trade of Ukraine and Ministry of Finance; direct influence on the financial market is wielded by the Anti-Monopoly Committee of Ukraine. There is, however, no institution that would be responsible for the integrity, transparency, and efficiency of the financial system, prevent attempts at manipulating it, and

pursue an anti-crisis policy. Thus, on the macroeconomic level and on the level of generalized indicators, no unified financial market regulation in Ukraine is done.

Also, it is necessary to state that on the Ukrainian market, where a small number of investors directly control the financial flows of their own financial institutions, the level of informational transparency is established through “mandatory volunteerism” under harsh pressure of the NBU, NSSMC, and SCRFSMU. The world famous rating agency Standard&Poor's (S&P) notes a reduction in the transparency index of the Ukrainian financial institutions for foreign investors.

Factor of national currency rate instability.

The cost of the Ukrainian currency (UAH to USD exchange rate) significantly affects the actual salary in Ukraine, given a large share of imported commodities consumed.

Until December 2014 in Ukraine, after the economic crisis of the 90s, the level of the minimum salary had been growing continuously, and not only nominally, but also actually (in 2013 the official UAH to USD exchange rate remained unchanged at 7.993 UAH/USD). The only exception was 2009, when after the economic crisis in the fall of 2008, the USD exchange rate added 60 % having increased from 5 to 8 UAH. The above growth in minimum standards, apart from its nominal factor, was also caused by a fixed UAH currency rate (this regime generated a number of other macroeconomic disbalances which are not considered in this context).

In 2014 UAH depreciation compared to the USD was 97.3 % and at the end of the year the official UAH to USD rate was 15.7686 UAH/USD.

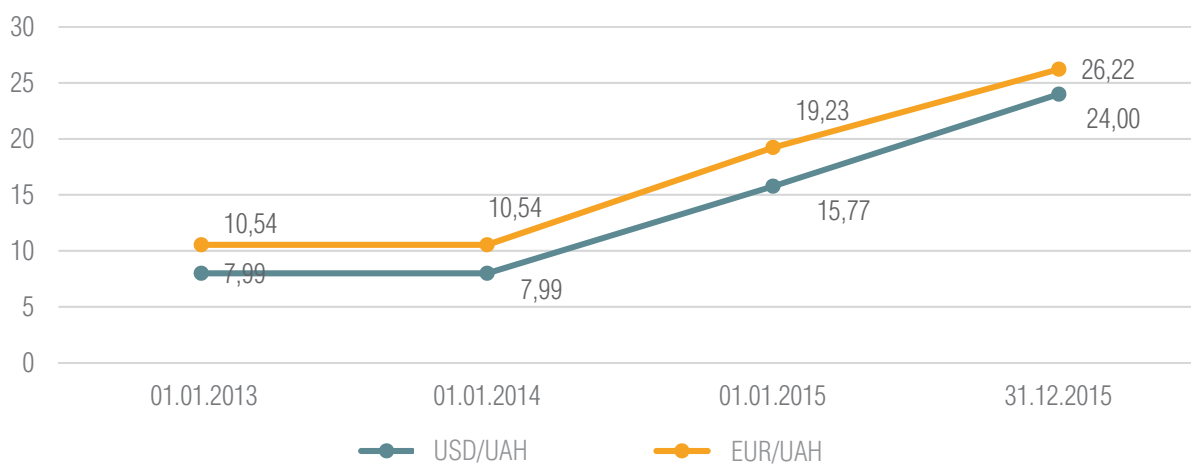


Fig. 1.3.13. UAH Rate Fluctuation

The development of the currency market in 2014 was shaped under the influence of a complex political situation in the country and unraveling of the hostilities in its Eastern regions which traditionally accounted for over 20 % of the national exports.

This formed unfavorable macroeconomic trends, significantly reduced market expectations with a simultaneous growth in the foreign currency demand on Ukraine's internal market, its increased shortage, and excessive UAH exchange rate volatility.

2014 demonstrated net outflow of the foreign currency in favor of non-residents to the amount of 125.8 mln USD (in the equivalent), which occurred for the first time since 2009 (in 2013 the foreign currency receipts was almost 9.4 bln USD).

In general in 2014 the net demand for non-cash foreign currency was almost 10 bln USD (in the equivalent), whereas in 2013 showed the net supply of the non-cash foreign currency of 1.6 bln USD.

Early in 2015, all the accomplishments of the previous years were thwarted, which was caused by the unchanging level of the minimum salary in 2015 and a virtually double increase in the USD to UAH exchange rate – 15.77 from 7.99. In the first months of 2015 the UAH continued depreciation, and as of early 2016 the minimum salary (1,378 UAH) translated to \$57 at the UAH/USD exchange rate of 24.3.

Before the dramatic UAH depreciation, the minimum salary in Ukraine translated to USD was 152 USD at the beginning of December 2013. Employees of the former Asian post-Soviet countries – Turkmenistan and Azerbaijan – have virtually the same remuneration. After an abrupt depreciation of the UAH in 2014-2015, the minimum salary in Ukraine settled at a level of 57 USD, while the countries that neighbored Ukraine in the world ranking, based on the said criterion, now were Liberia, Botswana, and Congo.

Cash circulation factor.

The demand for cash reflects the willingness of the economic entities to keep their assets in the most liquid form at a certain point in time. For instance, the 1st half of 2014 showed a dramatic increase in the cash demand, primarily due to transfer of the term deposits to a liquid form against the background of reduced population confidence in banks.

In Ukraine the ratio of currency outside banks (M0) to GDP was 16.2 % in 2013 and 18.1% in 2014. This is one of the highest indicators among the European, South African, and post-Soviet countries. The reasons include a significant share of the shadow economy, limited access to cashless settlements, low population awareness and low confidence in the national currency and bank system. The fraction of cash in Ukraine has been reducing since 2014, however the specific weight still remains high. For instance, the share of M0 to M3 in Ukraine in 2013-2015 was 26.2 %, 29.6 %, and 28.4 % respectively.

From February 2014 through December 2015, the population withdrew 63 % of USD deposits from the Ukrainian banks, which translates to 12.8 bln USD in the absolute numbers (Fig. 1.3.14):

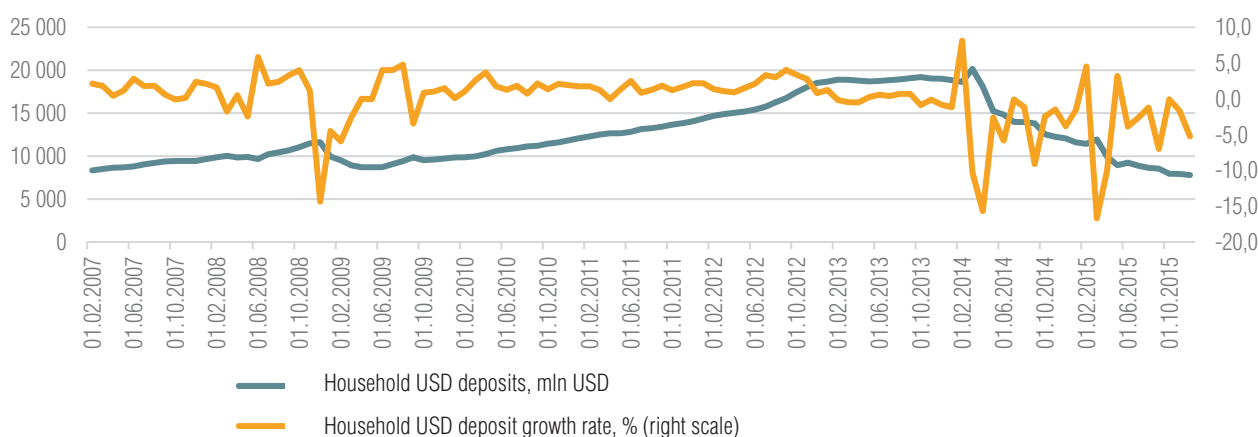


Fig. 1.3.14. Evolution of household USD bank deposits in Ukraine in 2007-2015²⁰

In terms of UAH deposits, despite all the restrictions applied by the National Bank of Ukraine, their continuous withdrawal went on from January 2014 through September 2015 and reached 31 % in relative terms and 80.4 bln UAH in absolute terms.

The data provided in Fig. 1.3.15 shows the evolution of household UAH deposit withdrawal from the bank system, both in the UAH and the USD. The latter indicator was received through calculations, based on the average monthly official NBU exchange rate for the pair USD/UAH. The calculations made allow a conclusion that during the two crisis years the population withdrew a significant amount of UAH deposits from the bank system, the USD equivalent of which is 24.5 bln USD.

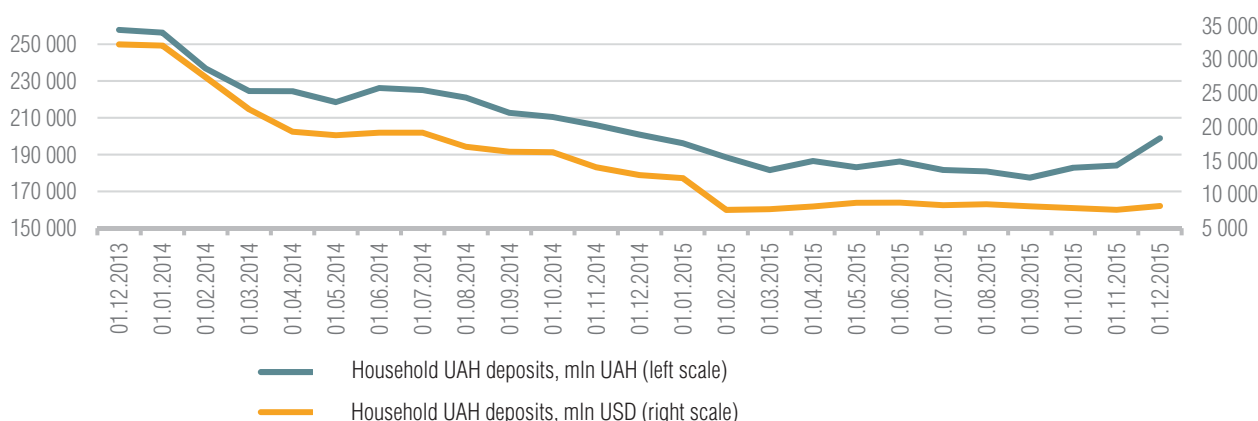


Fig. 1.3.15. Evolution of household UAH bank deposits in Ukraine in December 2013 – December 2015²¹

²⁰ Source: built and calculated using the NBU data posted on the NBU official Internet office pages.

²¹ Source: built and calculated using the NBU data posted on the NBU official Internet office pages.

Thus, in 2014-2015 the equivalent of 37 bln USD worth of deposits were withdrawn from the bank system of Ukraine – this amount is twice higher than the credit resource which Ukraine may receive from the IMF within a 4-year extended fund facility program adopted by the IMF Board of Directors on March 11, 2015 for stabilization of Ukraine's economy and setting the foundations for resuming its growth.

The data shown in Fig. 1.3.16 show the evolution of a significant Consumer Price Index (inflation) growth in Ukraine in 2013-2015:

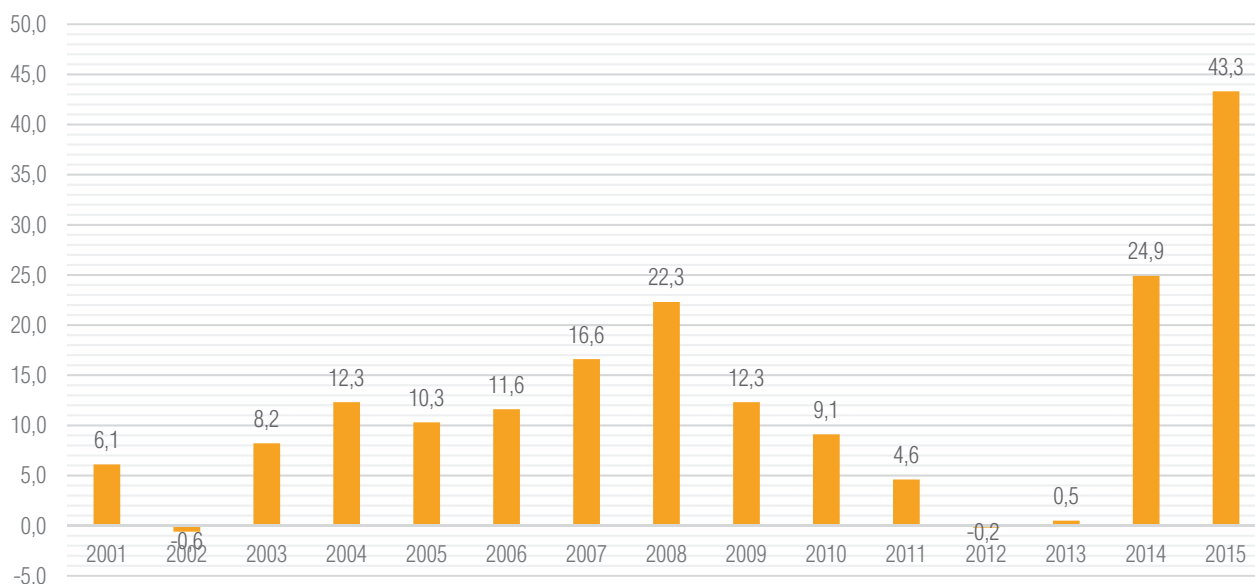


Fig. 1.3.16. Evolution of the Consumer Price Index Growth Rate in Ukraine²²

Reduced demand for cash in the second half of 2014 is to a large extent related to the hostilities in the East and its periodic escalation, which became a significant factor for the shrinking economic activity (Fig. 1.3.17):

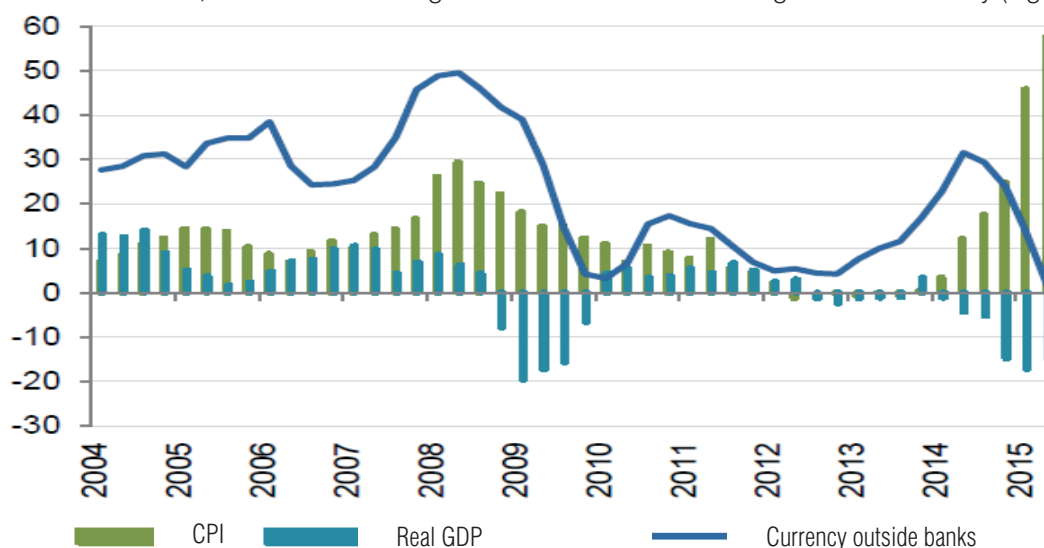


Fig. 1.3.18. Currency Outside Banks, Inflation, and Real GDP (% Annual Change)²³

The depreciation spike at the beginning of 2014 and the panic on the currency market, a triple devaluation of the UAH in relation to the USD in 2014-2015 significantly destabilized the population expectations and precipitated an abrupt growth in the foreign currency demand first on the official, and after introduction of administrative restrictions – the main demand for the currency was concentrated in the shadow – on the “black” currency market.

To stabilize the market situation and restrict high depreciation and inflation expectations, at the beginning of 2015 the NBU used a wide spectrum of monetary and administrative measures. To shape a descending inflation trend and stimulate subsequent return of deposits to the bank system, the NBU, starting April 2014, eleven times

²² Source: built and calculated using the NBU data posted on the NBU and State Statistics Service of Ukraine official Internet pages.

²³ Source: built and calculated using the NBU information posted on the NBU official Internet office pages.

increased the discount rate (Fig. 1.3.19) with a relevant correction of interest rates on its active and passive transactions.

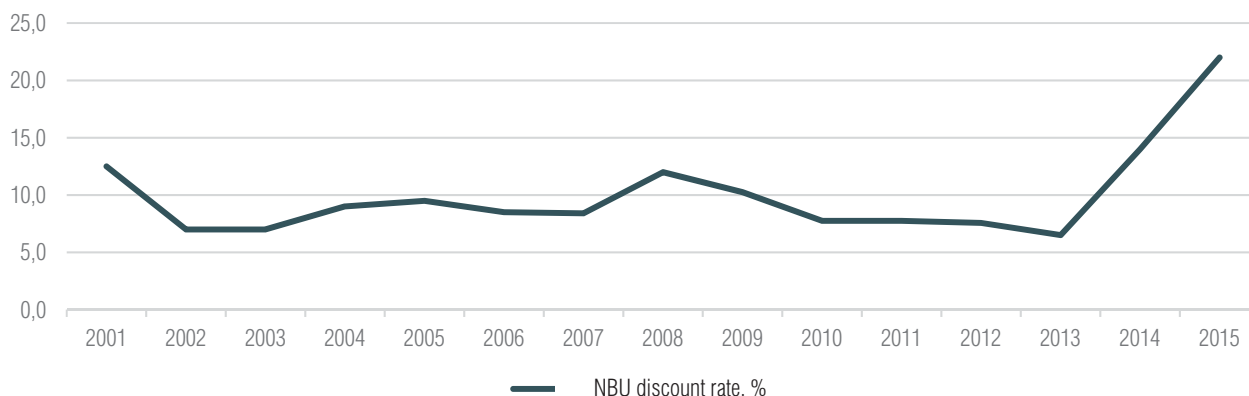


Fig. 1.3.19. Evolution of the NBU Discount Rate (annual %)²⁴

Development of cashless settlements reduces a transaction demand for cash in Ukraine for legal payments. The volume of cashless payments using payment cards on the average doubled every two years, which caused replacement of cash in circulation with payment cards. A slow-down in the growth rate of cashless settlements in 2015 was caused by a reduced private consumption and increased lack of confidence in the bank system.

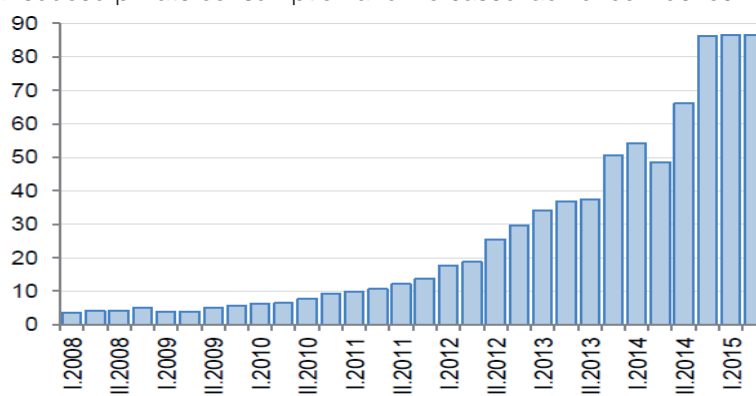


Fig. 1.3.20. Evolution of Cashless Settlements Using Payment Cards, (bln UAH)²⁵

Another substantial component of the bank financial transactions with an average risk level (in the opinion of the respondents polled) is international trading transactions.

An example of settlements of international trading transactions in the ML context includes transactions to illegally withdraw funds to abroad (without supplying goods to the customs territory of Ukraine) with subsequent investment of the funds in Ukraine's economy from offshore territories. These transactions are difficult to detect because the oppositely directed money flow transactions are not related with each other, including in terms of availability of such information to an individual PFMS.

The additional risk analysis of international trade transactions revealed that the main type of the current global offshore zones (which, in their essence are a variation of free economic zones) include:

- export and production (industrial) zones and research and technology zones;
- trade and warehousing zones, port special economic zones;
- British-American accounting model zones (accounting orientated at information requests of investors and creditors);
- continental accounting model zones (envisages a close connection between business and banks, which predominantly meet the needs of financial companies);
- classical offshore jurisdictions (registered companies do not have the right to pursue any activities in the country and pay only a flat annual fee to the budget);
- low-tax jurisdictions (the legislation of which does not envisage tax exemptions, but if certain conditions are met, the companies are granted some benefits).

²⁴ Source: built using the NBU information posted on the NBU official Internet office pages.

²⁵ Source: built using the NBU information posted on the NBU official Internet office pages.

The analysis of the two latter types of offshore jurisdictions merits the biggest attention, because the lion share of Ukraine's foreign trade occurs through them. And whereas presence of some financial centers in the chain from the supplier to the end user is vitally important, our country may safely forgo the services of the latter two types.

The existence of the above risk for Ukraine is confirmed not only by our calculations, but also by the data of international organizations.

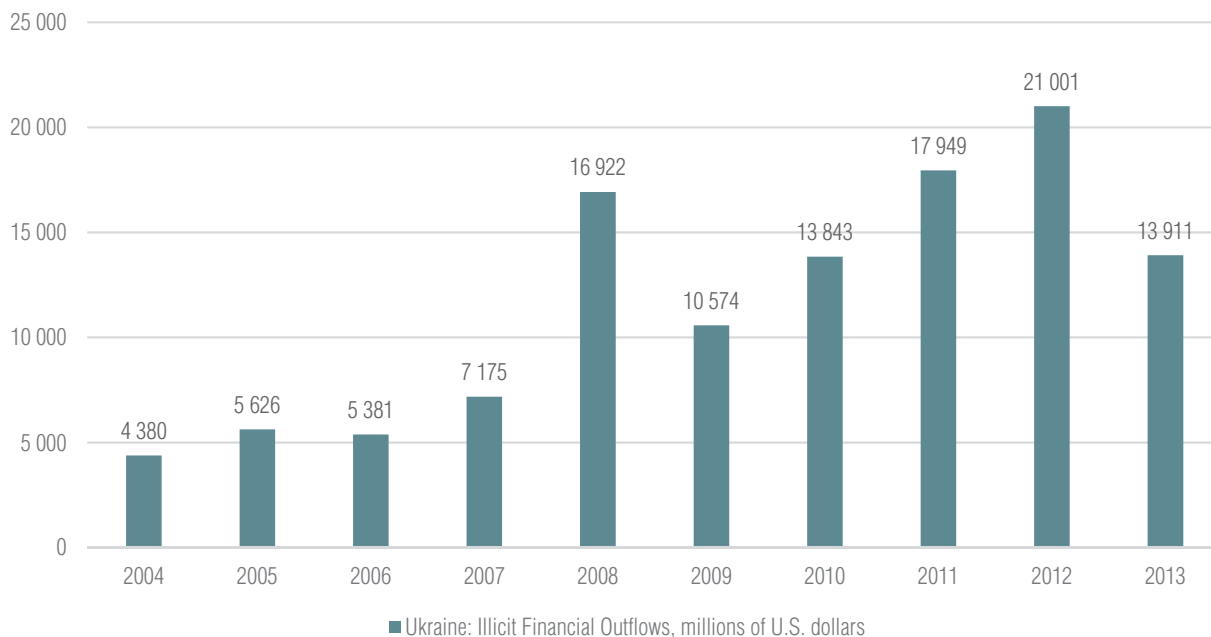


Fig. 1.3.21. Evolution of Illegal Financial Flows form Ukraine (mln USD)²⁶

The structure of the illegal outflow of financial resources from Ukraine looks as follows.

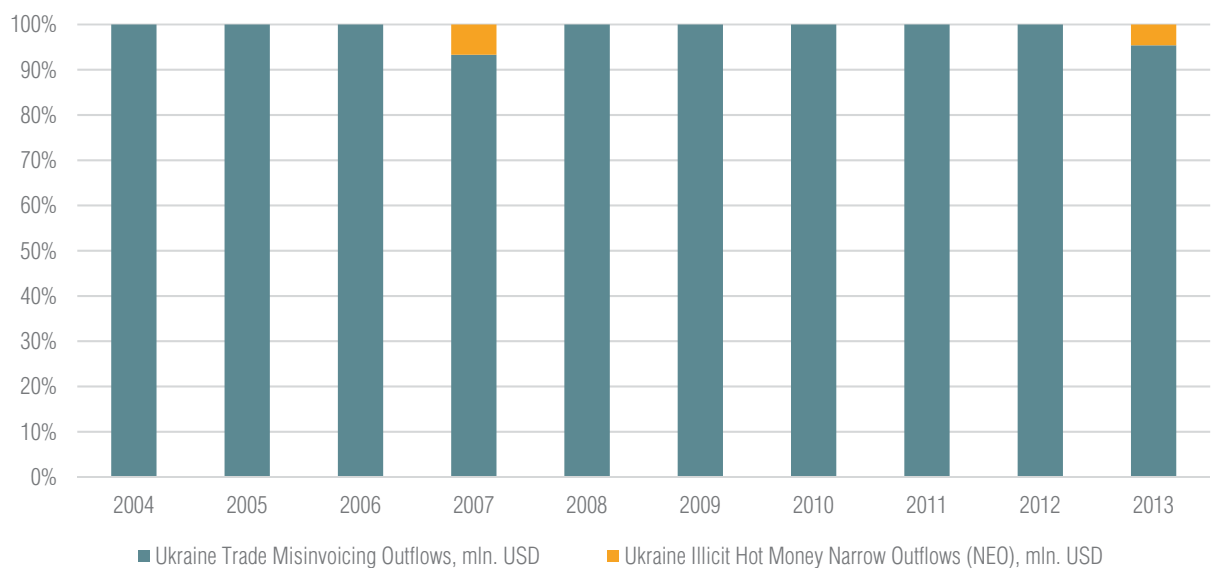


Fig. 1.3.22. Structure of Illegal Outflow of Financial Resources from Ukraine (%)²⁷

The most common schemes for laundering the money of the above origin include: pseudo-export/pseudo-import, export and/or import at overestimated and/or underestimated prices.

In the context of the above, the structure of the Ukrainian export was additionally analyzed.

²⁶ Source: based on the Global Financial Integrity data.

²⁷ Source: based on the Global Financial Integrity data.

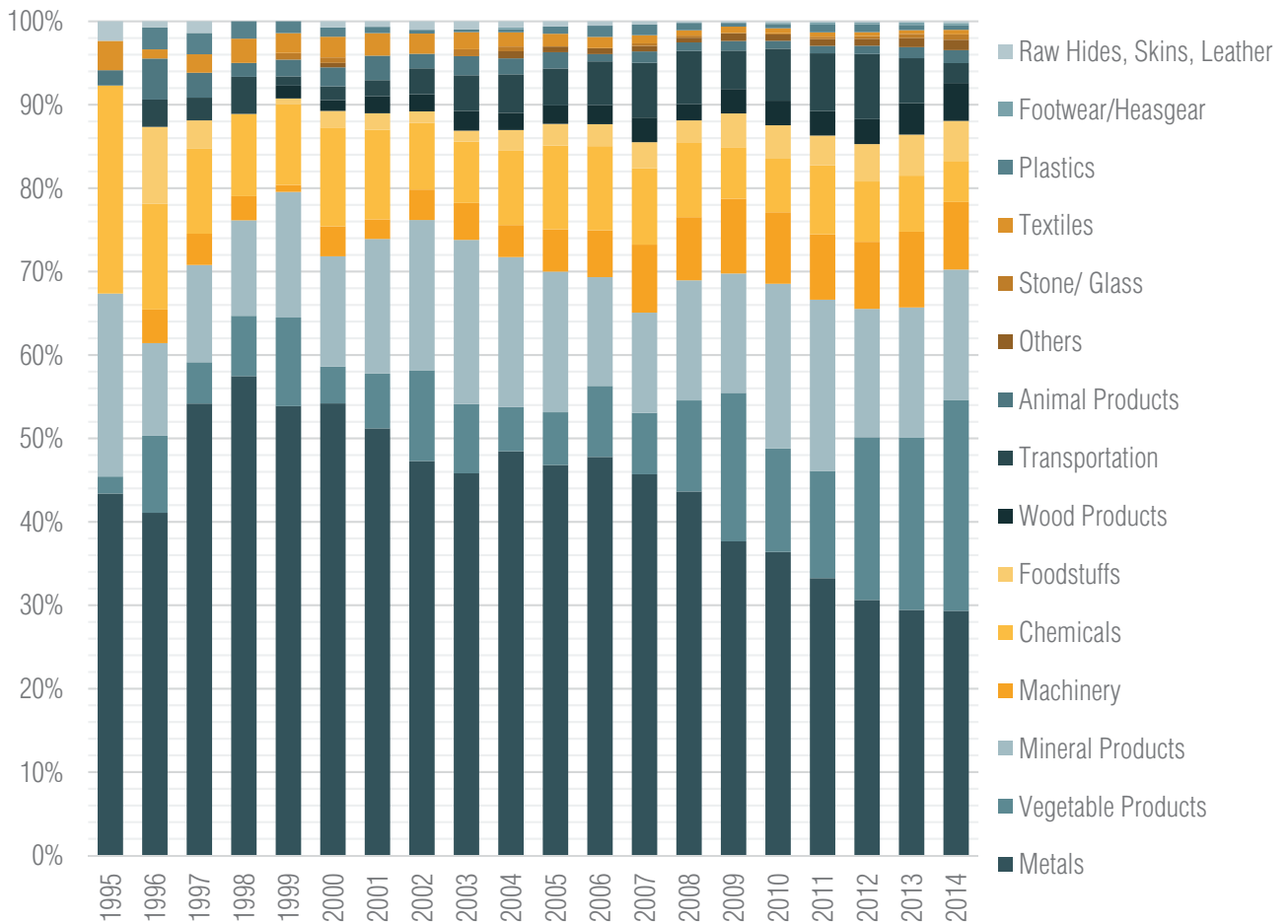


Fig. 1.3.23. Evolution of the Ukrainian export structure in 1995-2014

The above analysis demonstrates that Ukraine's main export goods include metals, agricultural products, and mineral raw materials. Taken together they make up 70 % of Ukraine's export.

In terms of NRA in the AML/CFT area, it is worth noting that a significant volume of the export flow from Ukraine, before getting to the end user, goes through classical and/or low-tax offshore jurisdictions (among them Switzerland significantly stands off in all the three groups of the Ukrainian export).

1.4. Legal Component

The legal system of Ukraine is a comprehensive and structurally ordered through legal sources and other legal means sustainable interaction of the national law subjects, which ensures the appropriate legal order as the prerequisite for the functioning and development of the Ukrainian society.

Ukraine officially recognizes the rule of law, priority of human rights, law-governed social democratic state, division of the law into public and private, inviolability of private property, and European legal traditions.

The judiciary of Ukraine is done by the Constitutional Court of Ukraine and the courts of general jurisdiction. The Constitutional Court of Ukraine is the single body of constitutional jurisdiction in Ukraine.

The organization, powers, and procedure for the activities of the Constitutional Court of Ukraine are determined by the Constitution of Ukraine, the Law of Ukraine “On the Constitutional Court of Ukraine”,²⁸ and Rules of Procedure of the Constitutional Court of Ukraine²⁹.

The judiciary system in Ukraine is determined in the Law of Ukraine “On the Judiciary and the Status of Judges”³⁰.

The Law of Ukraine “On the Judiciary and the Status of Judges” determines the organization of the judicial power and administering justice in Ukraine, which is based on the rule of law in line with the European standards and ensures everyone's right for the fair trial.

According to this Law, the courts of general jurisdiction make up a unified system. The Constitutional Court of Ukraine is the single body of constitutional jurisdiction in Ukraine.

The system of courts of general jurisdiction is composed of:

- 1) local courts;
- 2) courts of appeal;
- 3) high specialized court;
- 4) Supreme Court of Ukraine.

The Supreme Court of Ukraine is the highest judiciary body within the system of courts of general jurisdiction. Corresponding high specialized courts are the highest judiciary bodies of specialized courts.

Adoption of Laws of Ukraine pursuant to Part 3, Art. 85 of the Constitution of Ukraine³¹ is within the VRU competence.

Currently, the Ukrainian court system is facing serious challenges. The society actively criticizes courts due to absence of independence, impartiality, transparency, and accountability. It is necessary to restore the public trust in the court system. Representatives of the judiciary are prepared to take specific steps and actions to that effect.

To start the court reform, the Judicial Reform Council was established by the President of Ukraine Decree³². It embraced 32 experts, including representatives of the Council of Europe, OSCE, EU project “Support to Justice Sector Reforms in Ukraine”, Reanimation Package of Reforms, New Country. The Council experts are representatives of the scientific community and best Ukrainian universities involved in training specialists on law, legal practitioners, lawyers, judges, representatives of international organization and Ukrainian experts from civic initiatives. The Judicial Reform Council is a consultative and advisory body at the President of Ukraine.

The first step towards a court reform was made on Feb. 12, 2015, when the VRU passed the Law of Ukraine “On Ensuring the Right for Fair Trial”³³, which was signed by the President of Ukraine on Feb. 24, 2015. The Law aims to simplify citizens' access to justice, implements transparent tender procedures for selection of judges, strengthens responsibility of judges, and envisages anti-corruption mechanisms for purging of the judge corps.

The VRU passed the Law of Ukraine “On Changes to the Constitution of Ukraine (regarding Justice)”³⁴.

The relevant legislative changes provide for the following:

- reorganization of the High Council of Justice (HCJ);
- depriving the President of the right to establish courts;

²⁸ On the Constitutional Court of Ukraine: Law of Ukraine, Oct. 16, 1996 No. 422/96-VR: [Electronic resource]. – Access mode: <http://zakon4.rada.gov.ua/laws/show/422/96-%D0%B2%D1%80/page>

²⁹ Rules of Procedure of the Constitutional Court of Ukraine: Constitutional Court of Ukraine Decision, March 5, 1997 No. 34/2008: [Electronic resource]. – Access mode: <http://zakon5.rada.gov.ua/laws/show/v001z710-97>

³⁰ On the Judiciary and the Status of Judges: Law of Ukraine, July 07, 2010 No. 2453-VI: [Electronic resource]. – Access mode: <http://zakon3.rada.gov.ua/laws/show/2453-17>

³¹ Constitution of Ukraine: Constitution, June 28, 1996 No. 454k/96-VR: [Electronic resource]. – Access mode: <http://zakon2.rada.gov.ua/laws/show/254%D0%BA/96-%D0%B2%D1%80/page>

³² The Issue of Judicial Reform Council: President of Ukraine Decree, Oct. 27, 2014 No. 826/2014: [Electronic resource]. – Access mode: <http://zakon2.rada.gov.ua/laws/show/826/2014>

³³ On Ensuring the Right for Fair Trial: Law of Ukraine, February 12, 2015 No. 192-VIII: [Electronic resource]. – Access mode: <http://zakon5.rada.gov.ua/laws/show/192-19/page>

³⁴ On Changes to the Constitution of Ukraine (regarding Justice): Law of Ukraine, June 02, 2016 No. 1401-VIII (effective as of Sept. 30, 2016): [Electronic resource]. – Access mode: <http://zakon2.rada.gov.ua/laws/show/1401-19>

- granting the Parliament powers to establish, liquidate, and reorganize courts;
- depriving the VRU of the powers to appoint judges for an indefinite term and provide agreement to their detention and arrest, with transfer of the latter powers to the High Council of Justice;
- depriving the President, the VRU, and the Congress of Judges of the right to dismiss the Constitutional Court judges – a judge may be dismissed only by decision of at least two thirds of the Constitutional Court of Ukraine.

The Law increases the minimum age for holding the judge position from 25 to 30 years and establishes a competitive selection for appointment of judges.

It also increases the Prosecutor General's term of office from 5 to 6 years, but forbids him/her to hold this position for 2 consecutive terms.

Further, the changes envisage establishment of the institute of constitutional complaint (complaints on the contradiction between the Constitution and the law used in the final court decision after all the other national legal remedies have been exhausted) and a permission to the Constitutional Court of Ukraine to determine constitutionality on the issues proposed for the all-Ukrainian referendum on the public initiative (at the petition of the President or at least 45 Members of Parliament).

The next steps will be changes to the procedural legislation, improvement of legislation on the bar and prosecutor's office, free-of-charge legal assistance, legislation on implementation of court decisions.

The process of adopting laws of Ukraine is stipulated in detail in the Law of Ukraine "On the Rules of Procedure of the Verkhovna Rada of Ukraine"³⁵. The legislative process consists of independent stages: legislative initiative, preparation of the draft law for its review by the VRU, review and discussion of the draft law by the VRU, adoption of the law by the VRU, enactment of the law.

The law adopted and signed by the VRU Head is submitted for signing to the President of Ukraine. The President of Ukraine shall sign the law within 15 days of its receipt and officially publish it or use his/her veto right regarding the adopted law within the same time, returning it with his/her motivated proposals for another review by the VRU. If during the second review the law is adopted in the same revision by at least two thirds of the constitutional composition of the VRU, the President shall sign it within 10 days of its second adoption.

Laws of Ukraine shall be published no later than within 15 days of their adoption in the state language in the official print media: "Voice of Ukraine", "Official Herald of Ukraine", "Bulletin of the Verkhovna Rada of Ukraine". The law shall take effect 10 days after its publication, unless provided for in the law otherwise, but no sooner than their publication date in the official print media.

The process of new law adoption is not fast, but is largely consistent.

The main drivers for updating the effective legislation include the European integration processes, Ukraine's aspiration to take active international part in the spheres of politics, economics, defense, and international governmental organizations.

The AML/CFT legislative framework in Ukraine is composed of the Laws of Ukraine, CMU Acts, SFMSU Acts, and other government agencies' acts.

The main regulatory and legal act which determines the AML/CFT organizational and legal mechanism is the Law of Ukraine "On Preventing and Countering Legalization (Laundering) of Proceeds of Crime, Financing of Terrorism, and Financing of Proliferation of Weapons of Mass Destruction".

The first revision of the Law was adopted by the VRU in 2002³⁶. The Law specified the limits of the monitoring activities, establishing, first and foremost, the proceeds that are of criminal origin. The Law was based on the national and international experience, current issues of FIU activities, MONEYVAL recommendations, FATF Recommendations, contemporary research and other regulatory support in the AML/CFT sphere.

The next revision of the Law was released in 2010³⁷. The main new features included:

- definition of the term "financing of terrorism";
- comprehensive system of the financial monitoring subjects (financial and non-financial professions);
- risk-oriented approach;
- enhanced precautions (e.g. regarding publicly exposed persons, foreign financial institutions);
- possibility of suspending a financial transaction for up to 14 days;
- more severe liability for violations of the Law.
- The latest update of the Law was adopted in 2014. In this version of the Law the main novelties included:

³⁵ On the Rules of Procedure of the Verkhovna Rada of Ukraine: Law of Ukraine, February 10, 2010 No. 1861-VI: [Electronic resource]. – Access mode: <http://zakon5.rada.gov.ua/laws/show/1861-17/page>

³⁶ On Preventing and Countering Legalization (Laundering) of Proceeds of Crime: Law of Ukraine, Nov. 28, 2002 No. 249-IV: [Electronic resource]. – Access mode: <http://zakon2.rada.gov.ua/laws/show/249-15/page>

³⁷ On Preventing and Countering Legalization (Laundering) of Proceeds of Crime or Financing of Terrorism Law of Ukraine, May 01, 2010 No. 2258-VI: [Electronic resource]. – Access mode: <http://zakon2.rada.gov.ua/laws/show/2258-17>

- implementation of specifying procedures based on the “know your client” principle (identification, verification, specifying information, in-depth examination, etc.);
- definition of the term “end-user beneficiary owner (controller)” and implementation of the relevant precautions;
- definition of the term “national publicly exposed persons” and persons covered by this concept;
- carrying out of NRA.

The Law is additionally supplemented by: Criminal Code of Ukraine, Code of Criminal Procedure of Ukraine, Code of Administrative Proceedings of Ukraine, Code of Administrative Offenses of Ukraine, Civil Code of Ukraine, Law of Ukraine “On Banks and Banking Activities”, Law of Ukraine “On Insurance”, Law of Ukraine “On State Regulation of the Securities Market in Ukraine”, Law of Ukraine “On Financial Service and State Regulation of Financial Services Market”.

1.5. Criminal Component

Organized crime factor.

Organized crime is a substantial factor, which increases social tension and destabilizes social relations, causes deformation in the economic management, and slows down the country's economic development.

Ukraine is becoming the object of a growing interest for international criminal groups, specifically in the spheres of ML, human trafficking, illegal trafficking in weapons, hazardous materials, and narcotic substances. The number of illegal migrants has been increasing and the organized ethnic crime is becoming ever more common.

OCGs are characterized by a rather high level of organization, sustainable corruption and international criminal ties. To accomplish their goals, OCG participants ever more often resort to acquisitive and violent crimes.

Organized crime is facilitated by global social and economic processes: urbanization, interstate and interregional migration, shaping of the global informational and cultural space.

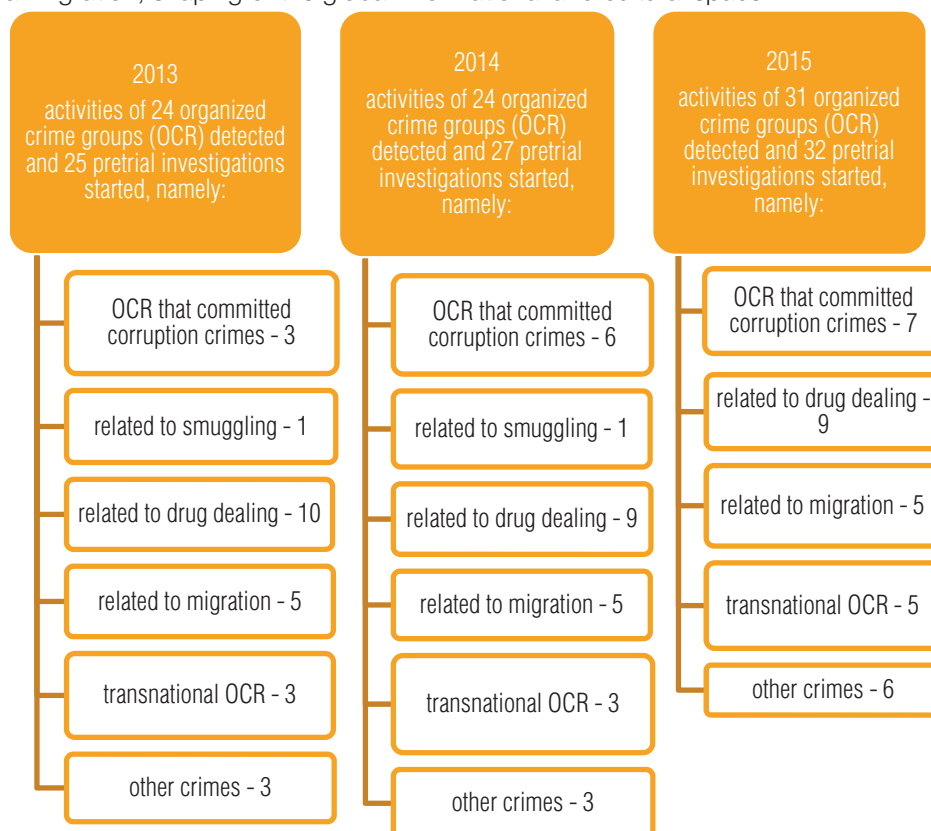


Fig. 1.5.1. SBU Activities on Combating Organized Crime

In 2013-2014, the staff of the organized crime combating units at the MIA detected 25 and 17 ML-related criminal offenses respectively, the material damages of which start at 100,000 UAH. 123 OCGs were detected in 2015.

The existing criminal situation in the country evidences the need to improve and step up measures to neutralize the factors which stipulate the OCG activities.

Money laundering (ML) factor.

One of the main generators of the ML risks in Ukraine is illegal (criminal and shadow) economic activities.

The most informative parameter of the environment, sphere of risks, and ML peculiarities in Ukraine is the analysis of the structure of the most common predicate crimes in Ukraine.

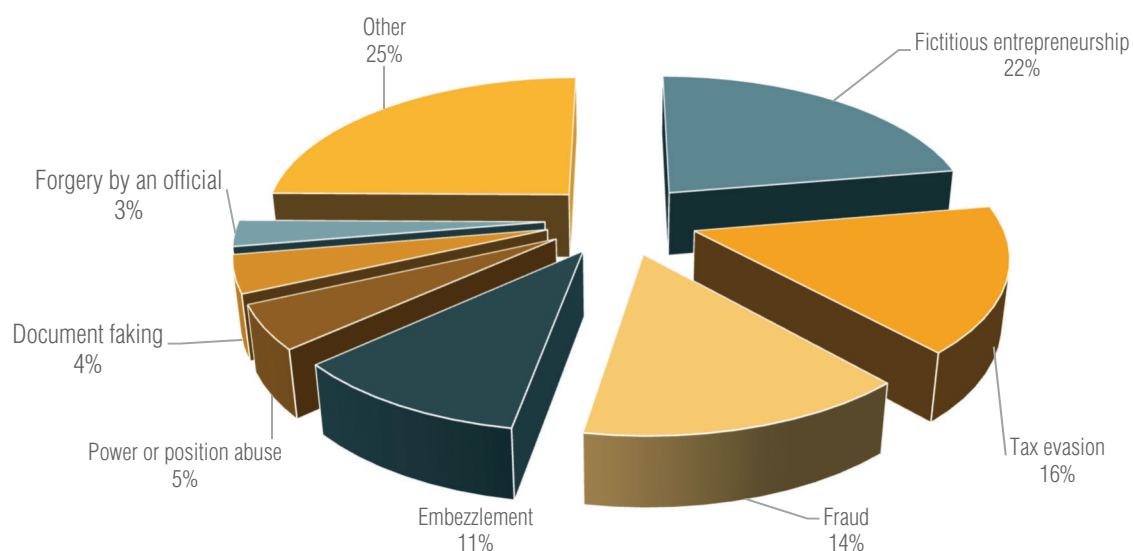


Fig. 1.5.2. Structure of Predicate Crimes in Ukraine as of 01.01.2016³⁸

It will be observed from Fig. 1.5.2 that the first place among the predicates committed in Ukraine is taken by the activities of the subjects of fictitious entrepreneurship. In its turn, fictitious entrepreneurship is one of the key elements of the mechanisms of tax evasion and ML, the essence of which, on the one hand, is to create favorable conditions for committing crimes in the economic sphere and, on the other hand, to mask criminal activities, reduce the object of taxation from taxes, fees, and other mandatory payments, concealing the sources of origin and location of the criminal proceeds for the organizers to avoid liability.

The diagram shown in Fig. 1.5.2 allows stating another fact, which specifies the peculiarities of Ukraine – the national structure of predicate crimes is fiscal and corruptive. About 40 % of the predicate crimes are related to different methods of illegal/shadow redistribution of revenues (fictitious entrepreneurship; tax evasion; fraud; embezzlement), another 40 % of the predicate crimes are related to different types of corrupt activities (abuse of power and office, document faking, etc.).

Thus, the peculiarity of generating national illegal revenues is that their main source is not drug dealing or other types of conventional crime, but white collar crime – tax evasion in large and very large amounts, and committing corrupt actions involving a wide range of the national publicly exposed persons.

The SFMSU, in close collaboration with the AML/CFT system participants, pursues activities to identify and stop ML schemes.

During the typological research³⁹, the SFMSU determined that with each new year the ML schemes become ever more complicated and ramified. The schemes involve a significant number of participants and financial institutions located in different regions of the country. A common phenomenon is participation of non-residents in the ML schemes, both companies and bank institutions located outside Ukraine.

In the situation when government authorities control the financial system and foreign economic activities, criminals focus on using cash in criminal schemes, namely transfer of non-cash resources to cash and its transfer between the participants of such schemes.

Today illegal transfer of non-cash resources to cash remains rather lucrative and common type of illegal business serving the needs of organized crime. Not infrequently such transactions and establishing of “conversion centers” occurs with support, assistance, and even immediate participation of employees of financial institutions, including banks, lawyers, barristers, notaries, auditors, etc.

The most common tools used by “conversion centers” include:

- claim assignment agreements;
- “fictitious” securities (promissory notes, shares, investment certificates);
- financial and charity assistance, other types of loans.

In Ukraine the highest specific weight of crimes is related to loans, unlawful cash withdrawal from accounts, appropriation of deposits, manipulations with the primary documents, which leads to distorted financial reports.

The bank sphere, due to versatility of financial services and tools, client base and accumulation of the money raised, is an attractive object for application of fraudulent schemes.

³⁸ Source: based on the SFMSU data, including the criminal cases brought pursuant to SM or which used SM.

³⁹ Recommendations on detecting money laundering schemes: [Electronic resource]. – Access mode: http://www.sdfm.gov.ua/articles.php?cat_id=114&lang=uk

In most cases, criminal activities during settlement, deposit, and credit transactions involve bank employees, specifically bank institution officials.

The main tools used in the embezzlement and ML of the funds received through stealing them from bank institutions include:

- “trash” securities (shares, promissory notes);
- company debt liabilities with indicators of fictitiousness;
- transfer of receivables;
- converting funds to cash.

Rapid development of financial and information technologies, deeper and more ramified connections, both on the national and international levels, significantly facilitate and contribute to communications of criminals and OCGs, both in Ukraine and outside.

New financial technologies significantly affected the speed of money circulation, both in the bank system and outside it, and also the versatility of forms of settlement between participants, including those related to financial crimes, such as ML.

The services most vulnerable for cybercrimes in the bank sector include online services or services of client remote access to their bank accounts, e-wallets with the card accounts “tied” to them. The number cases of stealing money from accounts of bank institution clients is on the rise.

The list of tools used by cybercriminals for ML is rather extensive, including:

- use of accounts opened on lost or forged documents;
- opening of an account, including card account, in the name of low-income citizens and companies with indicators of fictitiousness;
- use of international payment systems (electronic payments);
- channeling chain financial flows through several bank accounts using remote access;
- electronic money and crypto currencies;
- use of dummy persons.

Possibilities of the insurance market are actively used for scheme transactions aimed to minimize the taxation of business entities, withdraw funds from circulation and transfer abroad, or obtain other economic benefits by both insurers and third persons.

The main tools on the insurance market in the ML income schemes include:

- concluding insurance agreements on low-probability risks;
- fictitious documents on the occurrence of the insured event;
- concluding agency agreements with an excessive commission;
- reinsurance at companies with an unsatisfactory financial status;
- “trash” securities (shares, promissory notes, investment certificates);
- converting funds to cash.

The attractiveness of the securities market in the ML schemes is prompted by a significant number of stock market professional participants, which also include “technical” ones established by a certain group of people for specific financial transactions. After such transactions the newly established market professional participants terminate their licenses or disappear altogether, which is revealed by the state regulator only during verification or when receiving a complaint from investors on absence of a licensee at its location.

In the case of ML through the securities market, the following tools are used:

- securities emitted by companies with indicators of fictitiousness;
- securities circulated on the over-the-counter market;
- promissory notes circulated for over 3 years or issued by newly established companies;
- bearer savings certificates;
- domestic government bonds bought not at a market value;
- converting funds to cash.

The sphere of governance remains rather attractive for embezzlement, given the significant funds allotted for procurement of goods, work, and services based on the needs of companies, institutions, and organizations in state ownership and companies with a government share.

Legalization of criminal proceeds from the State and local budgets, state-owned companies, business entities with a government share in the registered capital was done using the tools typical for such a crime:

- involvement of dummy persons and fictitious companies;
- concluding fictitious trade agreements, document forging;
- use of “trash” securities and non-repayable financial assistance;
- cashing out through accounts of legal entities and natural persons.

The sources of illegal capitals legalized through foreign economic transactions may include incomes received from traditional crimes (e.g. trafficking in drugs and human beings), as well as incomes from financial crimes (appropriation of money and property).

The main tools used in the schemes based on foreign economic financial transactions include:

- pseudo import contracts;
- “trash” securities;
- fictitious companies – residents and non-residents;
- set-off agreements;
- forged document on foreign economic activities;
- loans from non-residents, pseudo investment, cashing out.
- use of dummy persons.

Financing of terrorism (FT) factor.

Stepping up of terrorism and separatism in Ukraine formulates the tasks of combating their financing and requires strict measures to control financial flows. Therefore, the activities to detect and effectively block the channels of financial support to terrorist and separatist organizations should be one of the key areas of the long-term strategy of the state authorities. Financing in itself makes it possible to commit acts of terror, ensuring relevant training of terrorists, their technical equipment and other required expenses, and its termination would be the best weapons in combating terrorism.

Currently, Ukraine is in the “risk zone” of terrorism, whereas the situation in the East of the country is a direct reason for its spreading.

Further, Ukraine may be most of all vulnerable to the activities of terrorist organizations' supporters aimed at moving or “masking” the sources of origin of the assets for their further channeling to reliable financial institutes of advanced countries. Also, there is a trend towards increasing their interest to financial institutions of our state to be used as transit tools. The main factor facilitating the growth of activity of foreign radical representatives in Ukraine is negative social and economic conditions, specifically high level of “shadow” economy, established mechanisms of fund “conversion”, significant level of corruption in the society, position of financial institutions aimed at attracting the costs regardless of their origin.

While reviewing the national FT risk assessment system, it is necessary to consider that involvement of financial flows which support terrorism has two components: external and internal.

The external sources of funding may include revenues from:

- international extremist organizations;
- radical representatives of the Islamic countries;
- states interested in maintaining instability in Ukraine and incitement to anti-State, separatist moods among the radically-minded segments of population;
- representatives of foreign groups which support participants of regional military conflicts.

The internal sources may include revenues from:

- “shadow” activities in the economic sphere;
- illegal circulation of drugs, weapons, human trafficking and illegal migration;
- supporters of anti-government and anti-State moods among the population.

Currently, the most common tools in the schemes of FT (separatism) are:

- provision of financial assistance;
- claim assignment agreements;
- purchase of goods on the temporarily occupied territory;
- use of charity organizations;
- dummy persons.

The analysis determined the following methods of FT (separatism):

- involving of natural persons money for financing of terrorism (separatism);
- transfer of funds to card accounts of natural persons who pursue terrorist (separatist) activities;
- requiring financial assistance from economic entities by the so-called ranking officials of DNR and LNR;
- use of “conversion” centers;
- raising funds through social networks under the veil of charity by a group of natural persons;
- transfer of funds through electronic payment systems to the address of dummy persons.

In 2014 – first half of 2016, the PGOU published 3,100 criminal offenses for the crimes under CCU Art. 258-258-5.

CCU Art.	2014	2015	1st half of 2016	2014 – 1st half of 2016
258	894	349	449	1,692
258-1	7	1	0	8
258-2	4	3	1	8
258-3	427	567	176	1,170
258-4	11	7	0	18
258-5	48	93	63	204
Total:	1,391	1,020	689	3,100

Table 1.5.1. Information on the number of criminal cases and persons with convictions that took legal effect

In 2014 – 1st half of 2016, the judicial authorities received 679 criminal cases under CCR Art. 258 – 258-5 for offenses against public security, of which:

- in 2014 – 58 criminal cases against 85 persons, of which courts reviewed 39 cases, passed 3 verdicts and convicted 3 persons;
- in 2015 – 425 criminal cases against 553 persons (including 19 in OCGs), of which courts reviewed 226 cases, passed 69 verdicts and convicted 52 persons;
- 1st half of 2016 – 196 criminal cases against 501 persons (including 40 in OCGs), of which courts reviewed 161 cases, passed 92 verdicts and convicted 65 persons.

To detect persons who facilitate terrorism and anti-State actions in Ukraine, in 2015 the State Border Guard Service of Ukraine developed national risk profiles.



Fig. 1.5.3. National risk profiles



Fig. 1.5.4. Application of national risk profiles

Today one of the SFMSU priority areas is focused on identifying non-profit organizations, among financial transaction participants, in relation to which there are suspicions that their activities or financial transactions are used as a channel for FT and/or separatism.

Reported period	SM submitted		ASM submitted		Total materials (SM+ASM)	
	total	including non-profit organizations	total	including non-profit organizations	total	including non-profit organizations
2014	55	4	18	2	73	6
2015	39	7	9	-	48	7
1st half 2016	11	-	7	-	18	-
Total	105	11	34	2	139	13

Table 1.5.2. SM and ASM related to FT Submitted to Law Enforcement and Intelligence Agencies

One of the SFMSU main focus areas is to identify and block the funds related to the activities of persons who finance terrorism and persons who publicly call to a violent change or overturn of the constitutional order or a change in the boundaries of the territory or state border of Ukraine.

In this context, in 2014 the SFMSU prepared and submitted 73 materials to the LEA (of which 55 SM and 18 ASM).

In 2015 the SFMSU prepared 48 materials (39 SM and 9 ASM) regarding financial transactions which may be related to FT or effected with participation of persons who publicly call to a violent change or overturn of the constitutional order or a change in the boundaries of the territory or state border of Ukraine.

In 1st half of 2016, the SFMSU prepared and submitted 18 materials to the SBU (11 SM and 7 ASM).

In 2014 – 1st half of 2016, the SFMSU the LEA of Ukraine received 505 letters on countering FT and separatism in Ukraine, namely: In 2014 – 261; in 2015 – 127; in the 1st half of 2016 – 117.

Procedural actions resulted in disconnection of over 250 terminals from the payment system which were operated on the temporarily occupied territories of the Donetsk and Luhansk Regions, detection of an illegal mechanism of financing of terrorism and separatist groups through electronic payment systems.

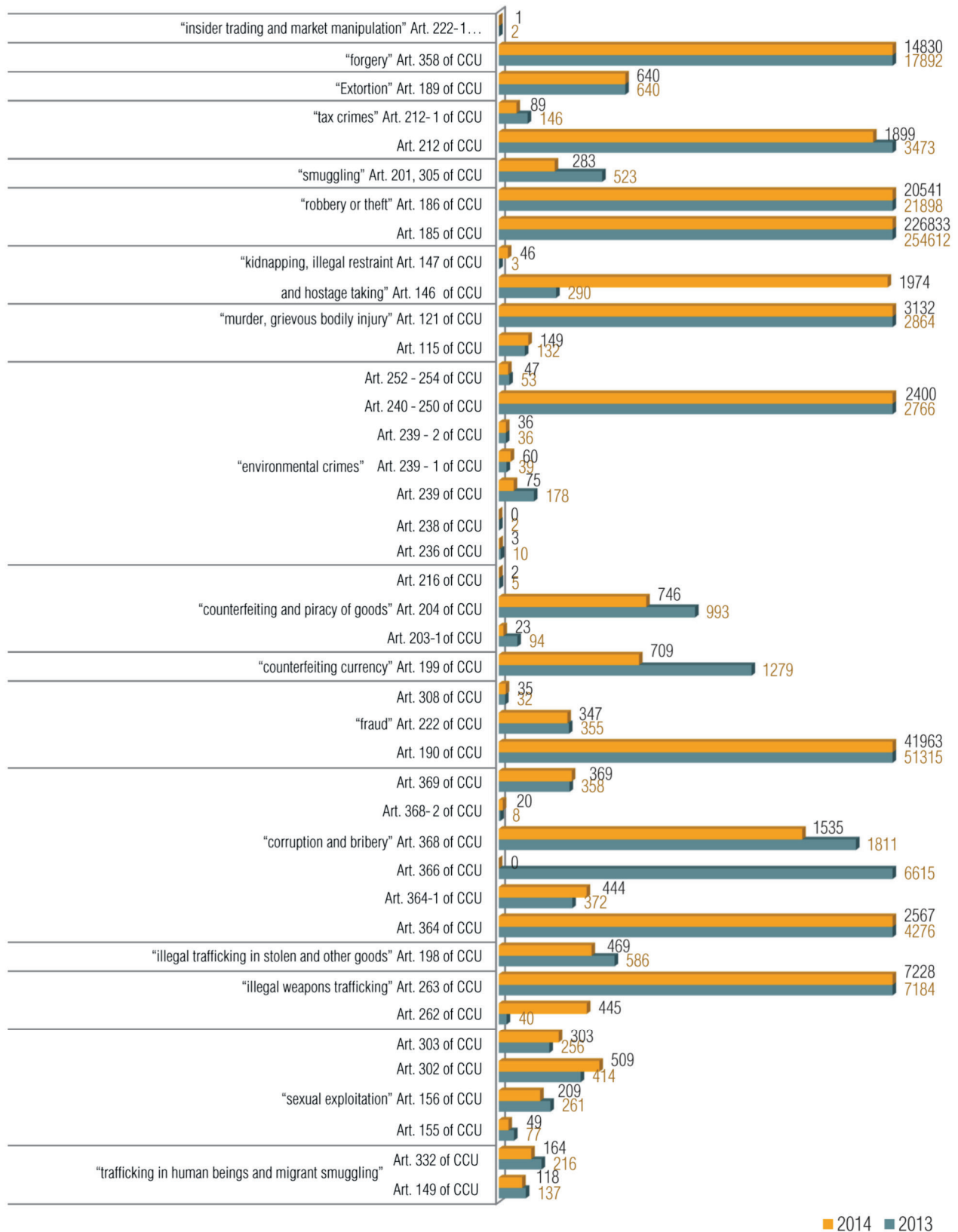


Fig. 1.5.5. Crimes registered by LEA in 2013-2014⁴⁰

⁴⁰ Source: based on the LEA information.

Shadow economic activities factor.

To strengthen combating shadow economic activities and incidents of corruption, the following measures were taken by the executive authorities in 2015.

In 2015, the State Financial Inspectorate of Ukraine⁴¹ and its territorial agencies conducted over 4,000 control measures, of which almost 3,800 audits of a certain range of issues or individual issues related to financial and economic activities and public procurement audits.

Violations of financial and economic discipline was detected at almost 3.1 thous companies, institutions, and organizations.

In general, during 2015 violations were identified at almost 3.1 thous companies, institutions, and organizations of all ownership forms, leading to losses of financial and material resources to the total amount of almost 3.9 bln UAH, of which during use of state resources – almost 2.8 bln UAH and communal resources – 895.4 mln UAH.

During implementation of control measures aimed at effecting state control pursuant to the requirements set forth in the laws of Ukraine, regulatory and legal acts of the President and CMU, there were identified financial violations during use of budget funds that led to losses amounting to almost 1.6 bln UAH, of which over 819.6 mln UAH (52.9 %) were State Budget resources.

The audits conducted resulted in establishing illegal use and embezzlement of funds and material values and their shortage at over 2.9 thous controlled facilities to the total amount of almost 3.1 bln UAH (or 79.6% of the total amount of detected violations which caused losses). Budget-funded institutions and organizations detected illegal use and embezzlement of funds and material values and their shortage to the amount of almost 784.6 bln UAH, which translates to 20.2% of the total amount of such violations detected.

Sale of goods, works, and services at reduced prices, free-of-charge rent out of natural and material resources, etc. caused budgets of all the levels, budget-funded institutions, organizations, and companies to loose profit to the amount of over 790.5 mln UAH (20.4 %).

The State Financial Inspectorate of Ukraine took measures which in 2015 helped: reimburse and restore illegal use and embezzlement and shortages to the amount of almost 753.0 mln UAH (of which 224.0 mln UAH – for violations detected during previous periods), including budget resources – 528.4 mln UAH.

The measures of control conducted by the State Financial Inspectorate bodies resulted in 3,500 submitted proposals on application of financial sanctions to violators of financial and budgetary discipline, of which 3,018 were applied, namely: in 314 cases the budget funding was suspended, in 2,403 cases transactions with budgetary funds were suspended and for 301 controlled facilities that use budgetary funds the budgetary funding was reduced to the total amount of almost 34.5 mln UAH.

In order to take corresponding measures to violators of the financial discipline, the State Financial Inspectorate bodies submitted almost 2,000 materials of audits and checks of public procurements and commission audits to the LEA. The LEA, in their turn, launched over 1,000 pretrial investigations based on the materials of the conducted measures of control in 2015. Further, the State Financial Inspectorate bodies, exercising the right to apply to court in the interests of the state, submitted 576 claims to court on reimbursement of losses of financial and material resources to the total amount of over 814.0 mln UAH. Also, the controlled facility or its governing body, or another government agency initiated 508 civil claims at the prosecutor's office agencies.

In 2015, the SFMSU received 90 information packages on preventing and countering ML to the amount over 3.3 mln UAH.

Over 10.2 thous officials were prosecuted for violation of the financial and budgetary discipline. The total amount of the administrative charges imposed exceeded 2.6 mln UAH. During the reported period, over 2.0 thous officials were prosecuted, of which 265 were released from their posts and 868 held materially liable.

Throughout 2015 Throughout 2015 In 2013 the State Fiscal Service of Ukraine⁴² and its territorial agencies were actively working to detect subjects of minimization of tax obligations which developed a fictitious tax credit and provided it to tax payers in the real sector of economy. For example, in 2015 the State Fiscal Service tax and customs audit units conducted 21.7 thous audits of economic entities (including 3.6 thous scheduled and 18.1 thous ad hoc audits), resulting in additional fiscal obligations to be covered to the amount over 4.6 bln UAH.

⁴¹ Source: official State Financial Inspectorate site: [Electronic resource]. - Access mode: <http://www.dkrs.gov.ua/kru/uk/publish/article/122325;jsessionid=C6A1F691317782731A096263AD2BCD84.app1>

⁴² Source: State Financial Service official site: [Electronic resource]. - Access mode: <http://sfs.gov.ua/diyalnist-/pokazniki-roboti/kontrolno-perevirochna-robota/http://sfs.gov.ua/data/material/000/105/156743/2015.pdf>
<http://sfs.gov.ua/diyalnist-/borotba-z-ekonomichnoyu-zlochinnistyu-ta/informatsiya-pro-vjityta-zahodiv-schodo-bo/231912.html>
<http://sfs.gov.ua/diyalnist-/zapobigannya-proyavam-korupts/insha-informatsiya-pro/232136.html>

In 2015 the State Fiscal Service pretrial investigation agencies brought 7,942 criminal cases, out of which 673 criminal cases in relation to 715 persons were completed and submitted to court with an indictment. Damages were reimbursed on completed criminal cases to the amount in excess of 520.7 mln UAH.

In 2015, the State Fiscal Service customs offices brought 17.8 thous cases on violated customs rules to the amount in excess of 1.8 bln UAH. Out of these in 8.5 thous cases objects of crime were seized to the amount in excess of 628.98 mln UAH. Specifically, the following objects of crime were seized:

- consumer goods to the amount in excess of 366.85 mln UAH;
- food items to the amount in excess of 106.27 mln UAH;
- currency to the amount in excess of 102.28 mln UAH;
- vehicles to the amount in excess of 53.57 mln UAH.

1.6. Research and Educational Activities in the Financial Monitoring Sphere

The SFMSU Training and Methodological Center⁴³ established by the CMU Ordinance⁴⁴ continuously trains AML/CFT specialists on financial monitoring.

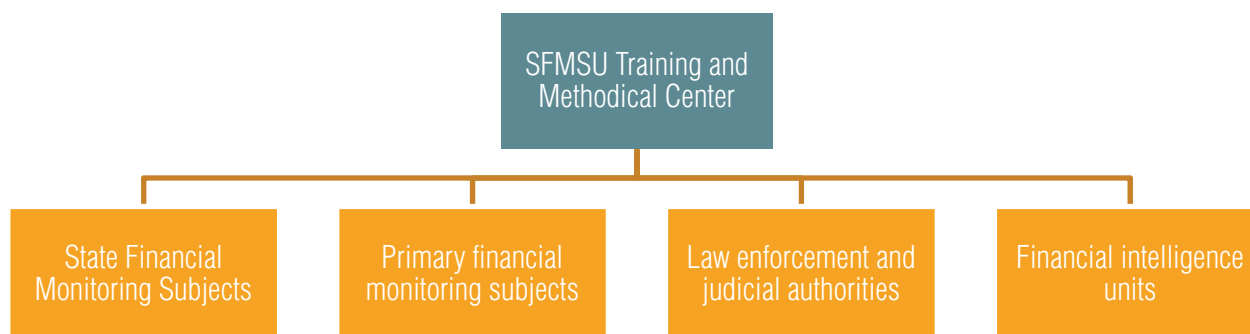


Fig. 1.6.1. SFMSU Training and Methodical Center activity areas

The SFMS and the PFMS employees note a high competence level of the teachers and comprehensiveness of the curricula, which allows boosting theoretical knowledge with practical actions on financial monitoring.

Trainee categories	2013	2014	2015
PFMS			
Number of training activities for the PFMS	32	33	40
Number of workshops for the PFMS	4	9	21
Number of trainees in terms of PFMS:			
financial services market participants	462	451	472
entrepreneurs who provide intermediary services during real estate sales transactions	17	27	15
commodity and other exchanges involved in financial transactions with commodities	7	19	16
professional securities market participants	20	10	97
postal operators	-	43	18
economic entities that provide legal services	-	11	7
notaries	117	156	294
leasing companies	12	-	-
different PFMS categories by the Law novations	-	38	138
SFMS			
Number of training activities for the SFMS	8	5	4
Number of trainees in terms of SFMS	144	43	75

⁴³ The official SFMSU Training and Methodological Center web-site. [Electronic resource]. – Access mode: <http://finmonitoring.in.ua/ua/>

⁴⁴ On Establishing a Training and Methodological Center for Advanced Training and Professional Development of Financial Monitoring Specialists in the Sphere of Countering Legalization (Laundering) of Proceeds of Crime and Financing of Terrorism: Cabinet of Ministers of Ukraine Ordinance, Dec. 13, 2004 No. 899-r: [Electronic resource]. – Access mode: <http://zakon3.rada.gov.ua/laws/show/899-2004-%D1%80>

including their representatives:			
Ministry of Infrastructure	5	-	2
MEDTU	6	1	3
Ministry of Justice	57	18	25
State Commission for Regulation of Financial Services Markets	41	8	4
NSSMC	35	16	23
Ministry of Finance	-	-	7
SFMSU	-	-	11
Law enforcement, judicial, and other agencies			
Number of training activities for LEA	15	15	14
Number of trainees in terms of LEA, judges, and other agencies	466	431	525
including their representatives:			
MIA	33	134	200
SBU	39	16	38
FIS	2	22	23
PGOU	22	5	15
Representatives of court agencies	301	184	99
SFSU	4	15	72
State Customs Service of Ukraine	5	-	-
SBGS	1	-	13
Ministry of Revenue and Duties of Ukraine	30	-	-
CMU Secretariat	-	-	1
Ministry of Defense of Ukraine	1	-	4
State Financial Inspectorate of Ukraine	28	55	60

Table 1.6.1. AML/CFT training of specialists at the SFMSU Training and Methodical Center⁴⁵

The SFMSU Training and Methodical Center periodically polls the representatives of the law enforcement, intelligence and court authorities who take their financial monitoring training.

The questionnaires specifically include questions on instances of corruption at the LEA, risks of using the PFMS for ML purposes, quality of AML/CFT training, etc.

⁴⁵ Source: based on the SFMSU Training and Methodical Center data.

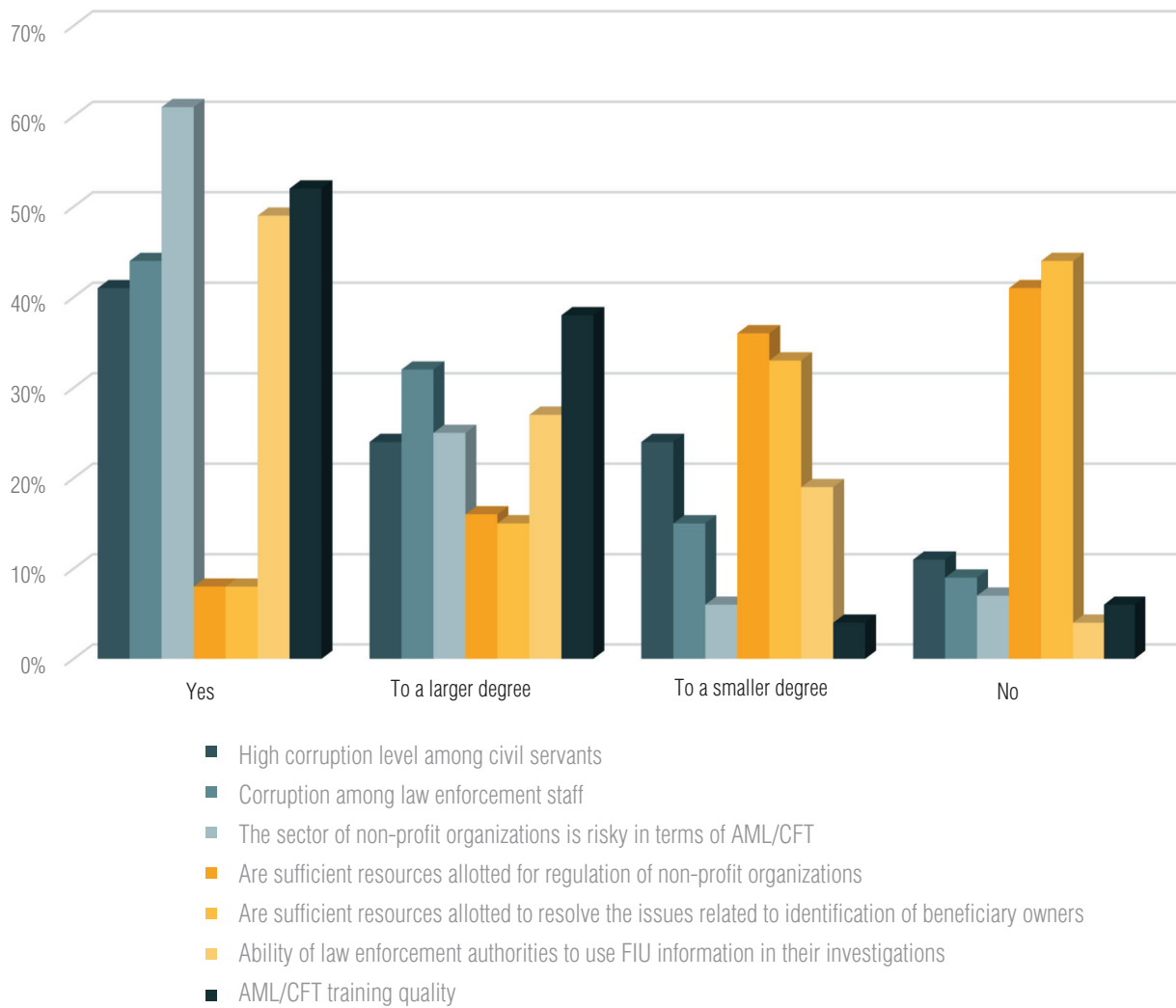


Fig. 1.6.2. Results of polling of representatives of the law enforcement, intelligence, and court authorities in 2015

Further, in 2015, 43 PGOU employees participated in trainings on financial investigations organized by the International Center for Asset Recovery (ICAR) of the Basel Institute on Governance.

In 2014, the Juridical Personnel Training Institute for the Security Service of Ukraine of the National University “Yaroslav Mudryi Law Academy of Ukraine” and the National Academy of the Security Service of Ukraine organized and conducted nine streams of professional development for the SBU operational and managerial staff, where 67 SBU took their professional development courses on AML/CT.

In 2013, the Advanced Training and Professional Development Center for Senior Executives of the State Border Guard Service of Ukraine provided professional development courses on “Organization of Combating the Laundering of Proceeds of Crime” to 27 staff of the units for laundering proceeds of crime of the revenue and duties agencies.

In 2014, the Division of the Advanced Training and Professional Development Center for Senior Executives of the Ministry of Revenue and Duties of Ukraine provided professional development courses on “Organization of Combating the Laundering of Proceeds of Crime” to 22 staff of the units for laundering proceeds of crime of the revenue and duties agencies.

1.7. Threats and Risks

Threat 1. Political instability

Risk 1	Progressing of the political risk and political instability		
Level of consequences	4	Comment	<p>The scale of the political risk in the country is serious. In the most concentrated way it manifests itself in crave for power and aspiration not for power effectiveness, but for its expansion. Rights and privileges outweigh obligations, whereas serving the social needs are viewed predominantly as a way of strengthening the position in power. All of this to a certain degree distorts the government system, orientation of its activities, and social and political role.</p> <p>Mingling of power and business require not just keeping large capital within the boundaries of the law, but taking decisive steps to protect national interests and not the interests of the large business.</p> <p>For these reasons the institute of opposition cannot assert itself, while the boundaries between the political forces remain changeable and uncertain and their unions unstable. In such conditions, the efficiency of the government mechanisms is jeopardized.</p>
Probability level	4	Comment	<p>As evidenced by Fig. 1.1.2, the political stability indicators in Ukraine in the past 10 years have barely reached 50 %.</p> <p>The connection between the political risk and, as a consequence, the country's political stability and economic development is clearly demonstrated by the correlation and regression analysis.</p> <p>In 2005-2013 Ukraine witnessed an inverse relation between the political stability and the economic development; however, depending on a specific political stability indicator, this relation varies from weak to strong, since each of these indicators focuses on different political stability dimensions which affected the economy to a smaller or larger degree.</p> <p>The political risk is directly increased by conflict situations and conflicts related to the parliamentary majority and parliamentary opposition institutes. The relations between these main internal parliamentary groups in the country are characterized by significant disposition towards excessive criticism and a clear-cut victory. After all, the need for a parliamentary opposition is determined not only by criticism of the authorities, but also by a wish to become the authorities.</p>
Overall risk level	16		
Effectiveness of the available measures	2	Comment	<p>The VRU passed the Law of Ukraine "On Changes to Article 87 of the Budget Code of Ukraine" (on the funding of political parties)⁴⁶. Lustration was carried out pursuant to the Law of Ukraine "On Purging of the Authorities"⁴⁷.</p>

⁴⁶ On Changes to Article 87 of the Budget Code of Ukraine" (on the funding of political parties): Law of Ukraine, October 08, 2015 No. 732-VIII: [Electronic resource]. – Access mode: <http://zakon2.rada.gov.ua/laws/show/732-19>

⁴⁷ On Purging of the Authorities: Law of Ukraine, October 16, 2014 No. 1682-VII: [Electronic resource]. – Access mode: <http://zakon0.rada.gov.ua/laws/show/1682-18>

Description of measures	<p>Today, pursuant to the effective legislation, there are agencies, which, on their own initiative, have the right to control or check the activities of the parties: the Ministry of Justice of Ukraine (the competence relates to their compliance with the provisions of the Constitution, Laws “On Political Parties in Ukraine”, “On Civil Associations”⁴⁸ and party statutes), Central Election Commission (parties' compliance with the established procedure for participation in elections) and tax inspections (political parties' compliance with the legislation on reporting on their incomes and expenses, as well as credibility and completeness of the data stated in the reports).</p> <p>Ukraine has developed two influential factors of political reforms: the first of which is an active civil society, and the second one is “soft power” of the EU and international financial organizations.</p>
Net risk level	8
Description of measures proposed to be taken for risk management	<p>With the aim of efficient risk management, the following is proposed:</p> <ol style="list-style-type: none"> 1. Ensure stability of democratic institutions, political and social integration. 2. Increase responsibility for the political decisions made. 3. Develop a strategy to reduce and prevent political risks. 4. Continue the election system reform.

Risk 2	Non-transparent funding of political parties		
Level of consequences	2	Comment	<p>Considering that maintenance of political parties takes a lot of funds, the main sources of party funding are political oligarchs, who, after the party makes it to the Verkhovna Rada of Ukraine, represent their own interests in the Parliament and the interests of their business, and not the interests of the people. Political parties are oligarchs' business projects.</p> <p>This risk results in the use of parties by some representatives of the authorities and politicians to implement narrow-group or individual objectives, ML, and smear campaigns.</p>
Probability level	2	Comment	<p>In Ukraine, parties are not exclusively program- and ideology-based. Most parties are political technology projects that emerged for specific elections, and it is not clear, how long they will exist.</p> <p>The main consequences of a weak financial capabilities of the parties in Ukraine include:</p> <ul style="list-style-type: none"> - active involvement only before the elections; - financial dependence of most parties on financial and industrial groups, individual investors, fusion of business and politics; - shadow funding and political corruption; - faction instability, low level of faction discipline.
Overall risk level	4		
Effectiveness of the	2	Comment	The Law of Ukraine “On Changes to Some Legislative Acts of Ukraine on Preventing and Countering Political Corruption” ⁴⁹

⁴⁸ On Civil Associations: Law of Ukraine, March 22, 2012 No. 4572-VI: [Electronic resource]. – Access mode: <http://zakon2.rada.gov.ua/laws/show/4572-17/page>

⁴⁹ On Changes to Some Legislative Acts of Ukraine on Preventing and Countering Political Corruption: Law of Ukraine, October 08, 2015 No. 731-VIII: [Electronic resource]. – Access mode: <http://zakon3.rada.gov.ua/laws/show/731-19/page>.

available measures		<p>stipulates that the National Agency on Corruption Prevention should effect control over funding of the statutory activities of political parties and legitimacy of using corresponding funds. This control should result in analysis of political parties' quarterly reports.</p> <p>However, since the National Agency on Corruption Prevention is a newly established agency, currently activities are underway to implement the Law of Ukraine "On Political Parties in Ukraine"⁵⁰.</p>
Description of measures	<p>The Law of Ukraine "On Changes to Some Legislative Acts of Ukraine on Preventing and Countering Political Corruption" envisages the following: implement public funding of political parties (political parties' statutory activities and compensation of expenses on the pre-election campaign); determine the amount of natural persons' and legal entities' contributions to parties; elaborate legislative provisions on political parties' financial reports on receiving and using of the funds; ensure public access to the information on the sources of funding of political parties.</p> <p>It is expected that the criminal and administrative punishment for violation of the party funding limits are increased and the limitations on the use of resources and property by political parties are established.</p> <p>The VRU passed the Law of Ukraine "On Changes to Article 87 of the Budget Code of Ukraine" (on the funding of political parties), according to which the expenses from the State Budget of Ukraine will include expenses on the public funding of the political parties' statutory activities unrelated to their participation in the elections, as well as reimbursement of parties' expenses on the pre-election campaign during scheduled and snap elections of Members of Parliament of Ukraine.</p> <p>If implemented, these legislative initiatives may create real conditions for reducing the influence of financial and industrial groups on the political parties' activities, ensuring higher transparency of the party finances, and stimulating institutional development of the party structures.</p>	
Net risk level	4	
Description of measures proposed to be taken for risk management	<p>With the aim of efficient risk management, the following is proposed:</p> <ol style="list-style-type: none"> 1. Implement transparent party funding, thorough control over the parties' use of these funds, and a flexible taxation system in the country. 2. Implement efficient political party reporting on the funding and use of the funds. 3. Develop proposals on drafting a draft law on lobbying. 	

⁵⁰ On Political Parties in Ukraine: Law of Ukraine, April 05, 2001 No. 2365-III: [Electronic resource]. – Access mode: <http://zakon2.rada.gov.ua/laws/show/2365-14/page>.

Threat 2. High corruption level

Risk 1	Inadequate identification and sanctioning of suspicious financial transactions of the national publicly exposed persons		
Level of consequences	4	Comment	<p>Fig. 1.1.3 illustrates the evolution of the corruption perception index in Ukraine. CPI = 0 indicates the highest corruption level in the country, whereas CPI = 100 – absence of corruption. In the past 15 years Ukraine's CPI has been within the lower (25 %) quantile (red line), which evidences a very high probability of corruption occurrence in Ukraine. On the average, Ukraine's CPI was 17 % worse than the world CPI.</p> <p>Main consequences of corruption incidents in Ukraine:</p> <ul style="list-style-type: none"> • inefficient distribution and spending of the state funds and resources; • low efficiency of the capital turnover in terms of the country's economic development; • loss of tax revenues (fiscal agencies appropriate part of the national income in the form of bribes); • loss of time related to creation of artificial bureaucratic hurdles (instead of producing material values, individuals spend time on unproductive search for corrupt revenues); • oppression of the private initiative in the economy; • outflow of qualified personnel, educated youth, and people with entrepreneurial skills to other countries; • reduction in direct investment and slowing down of economic growth; • reduction in the quality of social services; • misuse of the international assistance and inefficiency of such assistance; • growing social inequality; • increasing role of the organized economic crime; • losses for the political legitimacy of the authorities; • deteriorating public morality and general virtues; • increasing reputation and image risks of the country.
Probability level	4	Comment	<p>According to 2015 data (after the new revision of the new Law took effect), about 20% of the amounts, based on the bank PFMS STRs, were related to transactions of the publicly exposed persons (Fig. 3.1.5). In other words, the probability of corrupt actions on the part of the national publicly exposed persons in Ukraine is in the fourth (highest, very probable) distribution quantile under this criterion. Almost 50 % of the predicate crimes in Ukraine are directly related to committing of corrupt actions (Fig. 1.5.2).</p>
Overall risk level	16		
Effectiveness of the available measures	2	Comment	<p>Actions to curb high (political) corruption in Ukraine are characterized by low efficiency. Until 2015, the LEA primarily focused on household corruption. However, on October 14, 2014 Ukraine adopted an anti-corruption legislation package, which led to establishment of such new institutions as the National Anti-Corruption Bureau of Ukraine, National Agency on Corruption Prevention, Specialized Anti-Corruption Prosecutor's Office, and improved criteria for detecting publicly exposed persons' financial transactions on the PFMS level. The said reform should be deemed as an important step towards improvement of the efficiency of anti-corruption measures in Ukraine.</p>

Description of measures	<p>1. In 2014 the required anti-corruption legislation was adopted, and in 2015 three new corruption-combating institutions were launched:</p> <ul style="list-style-type: none"> - National Anti-Corruption Bureau (functions: prevention, detection, stopping, and investigating of corruption crimes); - Specialized Anti-Corruption Prosecutor's Office (functions: procedural supervision of criminal investigations conducted by the National Anti-Corruption Bureau of Ukraine detectives, state prosecution in court); - National Agency on Corruption Prevention (functions: development and implementation of the state anti-corruption policy, checking property declarations of the national publicly exposed persons, and monitoring of the way of life of senior executives to identify false statements in their property declarations and groundless enrichment). <p>As of June 2016, during over 7 months of their activities, the National Anti-Corruption Bureau of Ukraine and the Specialized Anti-Corruption Prosecutor's Office brought 148 criminal cases (on state enterprise managers, prosecutors, judges, Category "A" civil servants, and other officials). 35 suspicion notes were served, indictments on 19 persons were prepared; 15 cases were proved (of which 8 cases relate to judges).</p> <p>2. The electronic procurement system ProZorro, which won an international award in the procurement sphere (https://prozorro.gov.ua/) was introduced in Ukraine starting Feb. 12, 2015 (in operation for 16 months). During the period, the system was used by 5,740 public procurement bidders, submitting 113 712 applications with an expected cost of 37.4 bln UAH. The potential saving is 1.67 bln UAH (or 13.85% under competitive procedures). Starting Aug. 1, 2016 and on, all the public procurements should be done in the ProZorro system. The system meets the requirements of the public procurement agreement with WTO joined by Ukraine in May 2016. The ProZorro system won an international award in the sphere of public procurements (Procurement Leader Award) for development and implementation of an electronic system with a unique architecture. Thanks to ProZorro, Ukraine gained the right to organize a large international forum on public procurement – "Procurement, Integrity, Management and Openness" (PRIMO) – an anti-corruption forum on public procurement (May-June 2017).</p> <p>3. Improvement of the mechanism for identification and establishing of the end beneficiary owner (controller) in the ownership structure of legal entities' clients. Opening of the data on the end beneficiary owners (controllers) in the Unified State Register of Legal Entities, Private Entrepreneurs, and Civil Associations. Ukraine is one of the first countries in Ukraine to have technically established such high transparency standards for the beneficiary ownership data.</p> <p>4. A Unified Portal on Public Spending was established. It provides data on public spending by the government institutions and municipal companies⁵¹. This resource allows any user to control the efficiency of public spending.</p> <p>5. Strengthening bank legislation in the context of increased liability for credit extension to related persons. For example, the NBU Board of Directors Resolution approved a Provision on Submittal of Data on the Bank Ownership Structure, which regulates the procedure for disclosure of the ownership structure⁵². This process aims not at formal disclosure of information, but at disclosure of the real bank controllers. Further, Art. 48 of the Law of Ukraine "On Banks and Banking Activities"⁵³ prohibits risky activities which may jeopardize the interests of the depositors or other bank creditors (hereinafter "risky activities"), punishable under Art. 73 and 77 of the Law of Ukraine "On Banks and Banking Activities".</p>
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⁵¹ Unified Portal on Public Spending: [Electronic resource]. – Access mode: <http://spending.gov.ua>

⁵² On Approving the Provision on Submittal of Data on the Bank Ownership Structure: NBU Board of Directors Resolution, May 21, 2015 No. 328: [Electronic resource]. – Access mode: <http://zakon2.rada.gov.ua/laws/show/v0328500-15>

⁵³ On Banks and Bank Activity: Law of Ukraine, December 07, 2000 No. 2121-III: [Electronic resource]. – Access mode: <http://zakon0.rada.gov.ua/laws/show/2121-14/page>

	Further, the Provision on the Use of Measures of Influence ⁵⁴ by the National Bank of Ukraine provides that the indications of banks' risky activities in the financial monitoring sphere may specifically include a financial transaction with a client who is a publicly exposed person, a person close or related to a publicly exposed person in relation to which the bank has no documentary evidence of the sources of origin of the funds (assets, rights to such assets) sufficient to support his (her) real financial capabilities to effect or initiate effecting of a corresponding financial transaction.
Net risk level	8
Description of measures proposed to be taken for risk management	With the aim of efficient risk management, the following is proposed: 1. Introduce a secure online system for property declaration by the national publicly exposed persons on the National Agency on Corruption Prevention web-site. 2. Ensure rigorous control of timely and complete provision of data by the national publicly exposed persons. 3. Launch criminal cases on each fact of inconsistency between the life style of the national publicly exposed persons and the property declared by them. 4. Extend electronic property declaring to all the public servants of Ukraine and all the local government officials. 5. Strengthen the role of the national FIU in the anti-corruption regime (establish close cooperation of the SFMSU and NABU in the context of required information exchange, improving the corresponding mechanisms and interaction procedures). 6. Ensure efficient functioning of the National Agency for Detection, Search, and Management of Proceeds of Corruption and Other Crimes.

Risk 2		Inefficient measures to identify end beneficiary owners (controllers) and establish control over them	
Level of consequences	4	Comment	Inefficient measures to identify end beneficiary owners (controllers) and establish control over them may result in development of corruption, terrorism, ML, and tax evasion. This risk stimulates the financial flows of international crime and terrorism hidden under a "corporate facade".
Probability level	3	Comment	The information on th end beneficiary owners (controllers) is not provided by: - political parties, creative associations, their territorial divisions, associations of barristers, chambers of commerce and industry, religious organizations, public and communal companies; - legal entities, whose participants include only natural persons, if the end beneficiary owners (controllers) of such legal entities are the same as their participants. In this case, the natural person participants are deemed to be the beneficiary owners (controllers) of such a legal entity; - legal entities which submitted information on their end beneficiary owner(s) to the state registrar, including on the end beneficiary owner(s) of their founder, if such a founder is a legal entity. Currently, there is no procedure for detection of non-provision and verification of credibility of the information on the end beneficiary owners (controllers) provided by legal entities to the state registrars.

⁵⁴ On Approving the Provision on the Use of Measures of Influence by the National Bank of Ukraine: NBU Board of Directors Resolution, Aug. 17, 2012 No. 346: [Electronic resource]. – Access mode: <http://zakon5.rada.gov.ua/laws/show/z1590-12>

			The Unified State Register of Legal Entities, Private Entrepreneurs, and Civil Associations ⁵⁵ contains information only on the economic owners of companies, i.e. stock or share holders, that is everyone who has the right to vote. However, other economic beneficiaries, whose substantial influence on the companies stems not from their legal rights, but from actual circumstances, such as agreements on the right to vote, funding conditions, or family relation, and poses a real risk in the context of masking the incriminated costs, are not taken into account.
Overall risk level	12		
Effectiveness of the available measures	2	Comment	The information on the legal entity's beneficiary owner is included in the Unified State Register of Legal Entities, Private Entrepreneurs, and Civil Associations, which is publicly available and maintained by the Ministry of Justice of Ukraine.
Description of measures	<p>The VRU adopted the Law of Ukraine “On Changes to Some Legislative Acts of Ukraine regarding Identification of End Beneficiaries of Legal Entities and Publicly Exposed Persons”⁵⁶, which envisages disclosure by legal entities of information on the legal entities' end beneficiary owners (beneficiaries).</p> <p>On May 21, 2015 the Law of Ukraine “On Changes to Some Laws of Ukraine Related to Information on the Legal Entity's End Beneficiary Owner (Controller)” was adopted⁵⁷.</p> <p>The Law postponed the deadline for submittal of information on the end beneficiary owner (controller) to the state registrar until Sept. 25, 2015.</p> <p>The Law canceled the requirement to submit the information to the state registrar for legal entities whose participants include only natural persons, where such natural persons are the legal entity's end beneficiary owners (controllers).</p> <p>The Law also provided that in the case of an absent end beneficiary owner (e.g., when none owns more than 25 % of the chartered capital), it is necessary to submit information to the state registrar on the absence of a beneficiary owner.</p> <p>Thus, to meet the legislative requirements on disclosure of the beneficiary owners, the national legal entities have to determine their ownership structure in the context of the legal definition of the end beneficiary owner and select one of three possible options (submit information on the end beneficiary owner (controller), inform of absence of such an owner, or not submit any information to the state registrar).</p>		
Net risk level	8		
Description of measures proposed to be taken for risk management	<p>With the aim of efficient risk management, the following is proposed:</p> <ol style="list-style-type: none"> 1. Develop a procedure for detection of non-provision of information on the end beneficiary owners (controllers) provided by legal entities to the state registrars. 2. Develop tools to verify credibility of information on the end beneficiary owners (controllers) provided by legal entities to the state registrars. 3. Address the issue of failure to submit, untimely submission, or submission of false information on the end beneficiary owners (controllers) during registration procedures. 		

⁵⁵ Unified State Register of Legal Entities, Private Entrepreneurs, and Civil Associations: [Electronic resource]. – Access mode: <https://usr.minjust.gov.ua/>

⁵⁶ On Changes to Some Legislative Acts of Ukraine regarding Identification of End Beneficiaries of Legal Entities and Publicly Exposed Persons: Law of Ukraine, October 14, 2014 No. 1701-VII: [Electronic resource]. – Access mode: <http://zakon2.rada.gov.ua/laws/show/1701-18>

⁵⁷ On Changes to Some Laws of Ukraine Related to Information on the Legal Entity's End Beneficiary Owner (Controller): Law of Ukraine, May 21, 2015 No. 475-VIII: [Electronic resource]. – Access mode: <http://zakon0.rada.gov.ua/laws/show/475-19>

Threat 3. High level of the shadow financial system

Risk 1	Inappropriate identification and inappropriate elimination of the factors which contribute to the growing size of the shadow and off-shore financial system		
Level of consequences	4	Comment	<p>The main consequences of the increasing size of the shadow financial system in Ukraine include:</p> <ul style="list-style-type: none"> - informal employment and a growing size of shadow salaries adversely affect the size of insurance premiums to the Pension Fund of Ukraine, social insurance funds, and budget revenues, which negatively affects the stability of the state financial and pay-as-you-go pension system, hinder accumulation of funds in the contributory pension system and development of its investment potential; - a high level of shadow financial flows threatens state budget stabilization and reduces the potential of the financial system reformation; - insufficient reliability of the national stock market and insurance institutes caused by their integration in shadow schemes poses a risk for implementing Level II of the pension system and transfer to the insurance model of health care; - manipulation with the amounts of the official income allow those employed illegally or those getting a part of their salaries “in envelopes” to receive unjustified social support from the government, which may adversely impact the effectiveness of the reform of the social assistance system; - the increasing size of the shadow land relations prevents development of efficient mechanisms of the land market management in the context of the land reform, whereas implementation of the land reform without appropriate inventory taking, accounting, evaluation, and control over the use of lands will increase the size of the shadow land market and create conditions for legalization of violations; - distortion of competition mechanisms due to significant size of economic entities' shadow activities and insufficient reliability of the national financial market due to a large size of the shadow financial flows adversely impact the effectiveness of the reforms aimed at improving the business climate and attracting investment. <p>Offshore jurisdictions can be used for financing of terrorism, tax evasion, and other unlawful transactions.</p>
Probability level	4	Comment	<p>The scale of shadow economic relations in Ukraine remains close to the critical level, which, according to the MEDTU and evaluations based on extrapolation of data on the size of the national shadow economy, is 40 % (740 bln UAH in the 2015 prices or 31 bln USD). Additional evaluations of the probability of the national economy shadow level growth are shown in Fig. 1.3.3.</p> <p>The probability level of the subsequent national economy shadow level growth depends on the efficiency of eliminating the following factors:</p> <ol style="list-style-type: none"> 1) significant gap between the cost of labor for the employer and the actual amount received by the employee for his/her labor;

			<p>2) tolerant attitude of the employees to payment of unofficial salaries and, consequently, their deprivation of pension and social insurance guarantees;</p> <p>3) the feeling of inconsistency between the taxes and contributions paid and the quality of the state services, which leads to the need of significant additional expenses on the part of population to get these services on an appropriate level;</p> <p>4) feeling of injustice in the pension distribution system related to a large number of targeted, professional, special, and preferential pension regimes;</p> <p>5) existence of the mechanisms which allow easy withdrawal of the company funds to the illegal sector of economy with the purpose of paying shadow salaries;</p> <p>6) actual impunity of violations in the labor remuneration sphere;</p> <p>7) absence of an efficient land accounting system;</p> <p>8) imperfection of the procedure for free-of-charge transfer, sale, and rent of public and community lands to natural persons and legal entities;</p> <p>9) prohibition of agricultural land alienation (according to the State Service of Ukraine for Geodesy, Cartography & Cadastre, 98 % of the shadow schemes of land relations have to do with failure to comply with this prohibition);</p> <p>10) ineffective mechanisms of buying and renting the lands under the privatized estate;</p> <p>11) ineffective mechanisms of the land use control.</p> <p>According to the MEDTU calculations, in 2013 the shadow economy level in Ukraine was 35 % of the official GDP, and in 2014 – 41% of the official GDP. At the same time, the EU average shadow economy level in 2014 was 18.6 % of GDP, 10.8 % in France, 12.2 % in Germany, and 23.5 % in Poland respectively.</p> <p>According to proven data, about 90% of the Ukrainian capital were withdrawn to Cyprus at different times. Experts explain attractiveness of this offshore by the agreement on avoidance of double taxation signed between Ukraine and Cyprus. Experts note that today Cyprus officially remains one of the largest investors in Ukraine's economy. A significant fraction of the funds from Cyprus, however, should be viewed as direct investment of Ukrainian origin. Analysts believe that the Ukrainian business actively uses Cyprus as a “safe tax harbor”.</p> <p>According to different data, about 170 bln USD were withdrawn from Ukraine in the past 15 years. Cyprus is used by Ukrainian-origin companies or Ukrainian residents to store over 30 bln USD earned in Ukraine.</p>
Overall risk level	16		
Effectiveness of the available measures	2	Comment	<p>The current measures to curb the escape of different sectors of the national economy into the shadow are characterized by low efficiency and predominantly are of declarative nature. To minimize the risks of money withdrawal:</p>

		<p>a) President of Ukraine signed a Decree “On Measures to Counter Tax Base Reduction and Transfer of Revenues Abroad”⁵⁸;</p> <p>b) the VRU passed the Law of Ukraine “On Amending Some Legislative Acts of Ukraine regarding Liability of Persons Associated with the Bank”⁵⁹;</p> <p>c) the NBU Board of Directors adopted a Resolution “On Approving the Provision on Submittal of Data on the Bank Ownership Structure”⁶⁰:</p> <p>To eliminate administrative and regulatory hurdles which restrict business entities' activities, the state authorities took the following measures in 2015:</p> <ul style="list-style-type: none"> - simplification of business entities' activities, deregulation of entrepreneurial activities; - enhancing the efficiency of using financial resources in the energy sphere; - combating corruption and purging of the authorities.
Description of measures		<p>1. The Tax Code of Ukraine⁶¹ provides for a reduced tax burden on the business environment, simplified administrative procedures and improved tax administering procedures, transfer to a system of general taxation of the insurers' income, which will help reduce large-scale “scheme-based” insurance.</p> <p>2. An anti-corruption reform package was approved.</p> <p>3. Actions have been taken to simplify the approval-issuing system and the licensing procedure; specifically, an exhaustive list of the approval documents has been legislatively established; transfer from “one-stop office” to “one-stop window” principle for issuing of approvals has been ensured; the approval procedures in construction have been simplified; the list of activities subject to licensing has been reduced, etc.</p> <p>4. The AML/CFT legislation was harmonized with the FATF Recommendations; Ukraine is not on any FATF sanction lists.</p> <p>5. The NSSMC has approved a program to prevent issuing and circulation of the securities that can be used for unproductive capital outflow, tax evasion, and ML, which allowed monitoring the issuers of the securities with indications of fictitiousness, persons related to issuing and circulation of fictitious securities, and stock market participants who carry out transactions with them, as well as stopping circulation and canceling registration of the securities with indications of fictitiousness.</p> <p>6. The NBU pursues a consistent policy to reduce cash payments in the national economy. On June 6, 2013, the NBU Board of Directors Resolution “On Establishing the Limiting Amount of Cash Payments” was approved⁶² (natural persons are allowed to make daily cash payments to the amount not exceeding 150,000 UAH</p>

⁵⁸ On Measures to Counter Tax Base Reduction and Transfer of Revenues Abroad: President of Ukraine Decree, June 28, 2016 No. 180/2016: [Electronic resource]. – Access mode: <http://zakon3.rada.gov.ua/laws/show/180/2016>

⁵⁹ On Amending Some Legislative Acts of Ukraine regarding Liability of Persons Associated with the Bank: Law of Ukraine, March 02, 2015 No. 218-VIII: [Electronic resource]. – Access mode: <http://zakon2.rada.gov.ua/laws/show/218-19>

⁶⁰ On Approving the Provision on Submittal of Data on the Bank Ownership Structure: NBU Board of Directors Resolution, May 21, 2015 No. 328 [Electronic resource]. – Access mode: <http://zakon5.rada.gov.ua/laws/show/v0328500-15/paran7#n7>

⁶¹ Tax Code of Ukraine: Law of Ukraine, December 02, 2010 No. 2755-IV: [Electronic resource]. – Access mode: <http://zakon3.rada.gov.ua/laws/show/2755-17>

⁶² On Establishing the Limiting Amount of Cash Payments: NBU Board of Directors Resolution, June 06, 2013 No. 210: [Electronic resource]. – Access mode: <http://zakon3.rada.gov.ua/laws/show/z1109-13>

	<p>(6,000 USD)). The Comprehensive Development Program for the Financial Sector of Ukraine until 2020⁶³ provides for an additional number of reforms.</p> <p>Further, Art. 48 of the Law of Ukraine “On Banks and Banking Activities” prohibits risky activities which may jeopardize the interests of the depositors or other bank creditors, punishable under Art. 73 and 77 of the Law.</p> <p>Further, the Provision on the Use of Measures of Influence by the NBU envisages possible indicators of banks' risky activities in the financial monitoring sphere.</p> <p>7. President of Ukraine Decree “On Measures to Counter Tax Base Reduction and Transfer of Revenues Abroad”⁶⁴ established a working group to prepare draft laws on countering tax base reduction and transfer of revenues abroad.</p>
Net risk level	8
Description of measures proposed to be taken for risk management	<p>With the aim of efficient risk management, the following is proposed:</p> <ol style="list-style-type: none"> 1. Establish, based on the information contained in the registers of promisors, a unified state register of promissory notes drawn and ensure the government authorities' access to it (for reference: pursuant to the effective legislation, each promisor shall maintain a register of the promissory notes drawn). 2. Amend the effective insurance legislation to limit transactions of the promissory note buying/selling by insurers given the practices of using promissory note buying/selling transactions by insurers in shadow schemes. 3. Amend legislative acts to step up requirements for securities issuers, specifically to: reduce the maximum amount of company bonds that can be issued; identify the indicators of fictitiousness of securities issuers; stop the circulation of the securities and derivatives of the issuer that meets fictitiousness indicators; verify the credibility of the data provided by the issuer during issue prospectus registration; conduct an additional audit and independent property assessment; obtain additional rating for the issuer when in doubt of the credibility of the issuer's data contained in the documents submitted for issue and securities issue prospectus registration. 4. Increase liability for tax and insurance premium evasion and improve their administering (specifically, amend legislation to increase fines for evasion of employment contracts between the employee and the employer, increase liability of the employer's competent officials for failure to have an employment contract with the employee). 5. Address the issue of lifting the moratorium on the sale of agricultural lands (provided the land inventory development and the cadastre and registration system have been completed) to reduce the motivation of a significant number of business entities to use shadow and corrupt schemes for transferring agricultural lands to other land categories. 6. Ensure transparency in the activities of public authorities and local governments on making decisions to transfer public and community lands to private property or rent them out, free access of natural persons and legal entities to the information on free lands and master plans of localities, which will help involve a broader number of participants in land auctions. 7. Simplify the procedures for transfer to private property or renting of industrial lands which have objects of estate owned by natural persons or legal entities. 8. Step up the activities of the working group to prepare draft laws on countering tax base reduction and transfer of revenues abroad.

⁶³ Comprehensive Development Program for the Financial Sector of Ukraine until 2020: NBU Board of Directors Resolution, June 18, 2015 No. 391: [Electronic resource]. – Access mode: <http://zakon3.rada.gov.ua/laws/show/v0391500-15>

⁶⁴ On Measures to Counter Tax Base Reduction and Transfer of Revenues Abroad: President of Ukraine Decree, Apr. 28, 2016 No. 180/2016: [Electronic resource]. – Access mode: <http://zakon5.rada.gov.ua/laws/show/180/2016>

- 9. Intensify cooperation with the OECD with the aim of subsequent accession to the organization and ensure active participation on the Global Forum on Transparency and Exchange of Information.
- 10. Ensure periodic updating of the Ukrainian offshore lists based on the Global Forum and OECD data.
- 11. Ensure conclusion of agreements for automatic exchange of data on non-residents' accounts.
- 12. Tighten the transfer pricing rules, implement special rules for cross-border e-commerce.
- 13. Take actions to create favorable conditions for intensification of economic activity by business entities in the legal economy through improved investment and entrepreneurial climate in the country.
- 14. Continue the practice of reducing regulatory and tax pressure on the private sector.

Risk 2		Low level of population income	
Level of consequences	4	Comment	<p>Poverty hinders stability and further development of the society. People who have remained poor for a long time degrade significantly and turn into criminals who pose a threat to the good citizens. Poverty results in a low birth rate, deteriorated health, impossibility to receive high-quality education, and mass emigration of the economically active population abroad.</p>
Probability level	4	Comment	<p>Ukraine has one of the lowest minimum salaries in the world. Social guarantees in 2015 in Ukraine remained on the level of 2014 (the minimum salary, according to the Law of Ukraine “On the State Budget of Ukraine for 2015”, remained unchanged). The latest minimum salary increase within the reviewed period (Dec. 31, 2015) occurred on Sept. 1, 2015 to 1,378 UAH (57 USD):</p> <p>The remuneration received by employees in Ukraine for their labor is measured in UAH which (considering depreciation and inflation) has an ever dropping purchasing power. The actual minimum and nominal salary differ significantly.</p> <p>The cost of the Ukrainian currency (UAH to USD exchange rate) significantly affects the actual salary in Ukraine, given a large share of imported commodities consumed.</p> <p>Early in 2015, all the accomplishments of the previous years were thwarted, which was caused by the unchanging level of the minimum salary in 2015 and a virtually double increase in the USD to UAH exchange rate – 15.77 from 7.99. In the first months of 2015 the UAH continued depreciation, and as of early 2016 the minimum salary (1,378 UAH) translated to \$57 at the UAH/USD exchange rate of 24.3.</p> <p>Today one can observe a dramatic poverty rate increase in Ukraine, which, combined with a concentration of the shadow capital and corrupt revenues of a small fraction of population, breeds very high risks of social, psychological, and economic nature (further drop in the levels of production, consumption, business activities, savings, employment in legal economy, liquidity of the financial sector, its financial stability, tax evasion, etc.), which allow stating the highest</p>

			<p>level of social and economic destabilization risk in Ukraine with indeterminate prospects of its reduction.</p> <p>A low population income level is observed on the backdrop of regular increasing utilities prices and a dramatic drop in GDP and accelerated inflation rate.</p>
Overall risk level			16
Effectiveness of the available measures	4	Comment	<p>According to the State Statistics Committee, 2,747.9 thous households applied for subsidies as reimbursement of the utilities expenses in January-May 2016, which is twice more than in January-May 2015.</p> <p>A positive step is the Cabinet of Ministers of Ukraine approval of the “Poverty Reduction Strategy”⁶⁵ and a “Procedure for Providing Benefits to Some Categories of Citizens Based on the Average Monthly Aggregate Family Income”⁶⁶.</p> <p>The VRU passed:</p> <ul style="list-style-type: none"> - the Law of Ukraine “On Amending Some Legislative Acts of Ukraine regarding Reforming of the Mandatory General State Social Insurance and Legalization of the Labor Compensation Fund”⁶⁷. - the Law of Ukraine “On Amending Article 5 of the Law of Ukraine “On Social Assistance to Needy Families” regarding Social Protection of Children”⁶⁸. <p>The Law of Ukraine “On Amending Some Legislative Acts of Ukraine regarding Reforming of the Mandatory General State Social Insurance and Legalization of the Labor Compensation Fund” (took effect on Jan. 1, 2015) increased the liability of employers for violations of labor legislation⁶⁹.</p>
Description of measures			<ol style="list-style-type: none"> 1. The subsidy system has been reformed: their paperwork has been simplified, unfair restrictions and artificial criteria have been eliminated. 2. Employers' liability for violation of the labor legislation has been increased. 3. Timely payment of pensions and other social benefits has been ensured. 4. Pursuant to the Government-approved Poverty Reduction Strategy, this goal will be achieved through implementation of strategic areas regarding: increasing access to productive employment, facilitation of population income growth from employment and payments in the state social insurance system to provide for decent work conditions; ensure population access to social services regardless of their place of residence, minimization of social exclusion risks for rural population; countering social exclusion and minimization of poverty risks for the most vulnerable population

⁶⁵ On Approving the Poverty Reduction Strategy: Cabinet of Ministers of Ukraine Ordinance, March. 1, 2016 No. 161-r: [Electronic resource]. – Access mode: <http://zakon2.rada.gov.ua/laws/show/161-2016-%D1%80>

⁶⁶ On Approving the Procedure for Providing Benefits to Some Categories of Citizens Based on the Average Monthly Aggregate Family Income: Cabinet of Ministers of Ukraine Resolution, June 04, 2015 No. 389: [Electronic resource]. – Access mode: <http://zakon0.rada.gov.ua/laws/show/389-2015-%D0%BF>

⁶⁷ On Amending Some Legislative Acts of Ukraine regarding Reforming of the Mandatory General State Social Insurance and Legalization of the Labor Compensation Fund: Law of Ukraine, December 28, 2014 No. 77-VIII: [Electronic resource]. – Access mode: <http://zakon5.rada.gov.ua/laws/show/77-19>

⁶⁸ On Amending Article 5 of the Law of Ukraine “On Social Assistance to Needy Families” regarding Social Protection of Children: Law of Ukraine, March 02, 2015 No. 221-VIII: [Electronic resource]. – Access mode: <http://zakon0.rada.gov.ua/laws/show/221-19>

⁶⁹ On Amending Some Legislative Acts of Ukraine regarding Reforming of the Mandatory General State Social Insurance and Legalization of the Labor Compensation Fund: Law of Ukraine, December 28, 2014 No. 77-VIII: [Electronic resource]. – Access mode: <http://zakon2.rada.gov.ua/laws/show/77-19>

	categories; preventing poverty and precluding pockets of chronic poverty and social exclusion among internally displaced persons.
Net risk level	16
Description of measures proposed to be taken for risk management	<p>With the aim of efficient risk management, the following is proposed:</p> <ol style="list-style-type: none"> 1. Take actions to stabilize the national currency. 2. Balance the population income level and prices. 3. Implement a comprehensive job creation program. 4. Improve the social legislation system. 5. Implement the program for attracting international investments and grants for social development and events. 6. Monitor the implementation of the strategic areas of poverty reduction. 7. Take the required measures to implement the Poverty Reduction Strategy.

Risk 3	Low level of confidence in the financial system		
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Level of consequences	4	Comment	<p>Lack of confidence of natural persons and legal entities in the countries financial system in general and bank institutions in particular, which are the system-making institutes of the national financial system, causes the population savings and the legal entities' financial resources to be moved to the shadow sector and triggers capital outflow abroad.</p> <p>The information asymmetry on the financial market, which is a key reason for the extremely low level of confidence in the financial institutions, leads to development and entrenchment in the Ukrainian social and institutional environment in general and bank sector in particular of a “forced consumerism” and “adverse selection” syndrome, characterized by inefficient operation of the financial market and inefficient distribution of resources on it.</p>
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Probability level	4	Comment	<p>The occurrence probability of this risk, unless the situation changes dramatically, is very high, about 70-80 %. This is caused by the following factors.</p> <p>Firstly, on the Ukrainian financial market, where a small number of investors directly control the financial flows of their own financial institutions, the level of informational transparency is established through “mandatory volunteerism” under harsh pressure of the NBU, NSSMC, and SCRFSMU. The world famous rating agency Standard&Poor's notes a reduction in the transparency index of the Ukrainian financial institutions for foreign investors. Researchers state a sad fact – a number of Ukrainian financial institutions have lagged even more behind international standards of information disclosure and information transparency. This is because when the national financial institutions felt interest to them on the part of foreign investors (before the financial crisis), they took active effort to be more open.</p> <p>Secondly, low quality of assessments made by the national rating agencies. Ukraine has 12 rating agencies, and only six of them have the status of authorized rating agencies.</p> <p>Thirdly, because of underdeveloped financial markets, Ukrainians take little interest in the news from the financial sector. The three “money” issues monitored by the majority of the population are the</p>
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			<p>inflation index (20 %), changes in the pension level (10 %), and changes in the real estate prices (10 %).</p> <p>Fourthly, the behavior of an average Ukrainian consumer of financial services is not independent, prompted by a traditionally narrow confidence margin, often irrational in the conditions of continuously recreated market informational and operational asymmetry. This asymmetry is especially reinforced by consumers' substantially distorted perceptions of financial services not only due to lack of relevant information, but also due to excessive advertisement, which is misleading in selection of the required service and counteragent (it is important to note that excessive information during provision of financial services is deemed to be as undesirable as its lack and is clearly regulated in the international practice as a component of the information asymmetry).</p> <p>Fifthly, only 11 % of Ukrainians have a savings deposit in a bank; this service ranks eighth among the most common bank products. Almost a third of the country's population, 39 %, do not participate in the official financial system and do not have a bank account altogether. At the same time, in terms of demand for additional information on financial services, deposits rank second, trailing only behind loans. Comparison of these contradictions offers every reason to claim that low population activity in terms of bank depositing is caused by lack of accessible, needed, and reliable information. If depositors had better awareness of the deposit products and services, and the information available to them was highly reliable and accurate, bank deposits would take top positions by popularity and use.</p> <p>Sixthly, the world financial crisis helped reveal problems related to establishing and using of "non-transparency hubs" in Ukraine's bank system. According to the Commercial Value Institute (US) survey, over one third of Ukrainians hope that possible changes in the legislation in the next five years will primarily relate to improving the transparency and openness of financial institutions.</p>
Overall risk level	16		
Effectiveness of the available measures	3	Comment	<p>The pre-crisis level of population confidence in banks has been implemented. The level non-confidence in banks in 2015 was almost 80%. 20 financial institutions account for almost 75 % of all the Ukrainians' deposits. Almost a quarter of all the natural persons' deposits is accounted for by one bank institution. In general, 35.4 % of the consumers do not trust banks at all; 33.2 % mostly do not trust; 15.3 % cannot answer; 16 % mostly trust; and only 1,1 % trust completely.</p>
Description of measures	<p>Increased requirements on the part of the financial market regulators in relation to disclosure of information on the financial institutions' official web-sites.</p> <p>Increased transparency of the Deposit Guarantee Fund operation.</p> <p>In-depth verifications and withdrawal from the market of the bank and other financial institutions that fail to meet the legislative requirements.</p> <p>Development of a concept to implement a new system for insuring natural persons' deposits.</p>		

	NBU structural reorganization (related to supervision of bank activities and support to their financial stability), and reforming of its other functions in line with the best international practices.
Net risk level	12
Description of measures proposed to be taken for risk management	<p>With the aim of efficient risk management, the following is proposed:</p> <p>Take a number of actions to reduce the information asymmetry through development of market specialized participants, such as a financial observer and financial ombudsman, consultants and others.</p> <p>Take actions to stimulate the market discipline, which should include not only requirements on disclosure of additional data by banks, but also a number of actions to improve the mechanisms for transfer of the required information to the market participants, increase its accessibility and ease of interpreting. Resolving of this issue requires a unified information space and information standards, which will provide investors with a possibility of getting the required data. As opposed to expansion of the list of indicators to be disclosed by financial institutions, preference should be given to measures aimed at improving information reliability and accessibility.</p> <p>Pursue adaptation of the Ukrainian bank legislation to the norms and standard of the EU bank law (acquis communautaire), which envisages a gradual harmonization of the NBU legislative and regulatory acts with the European standards.</p> <p>Determine the sequence and priority of changes in bank regulation pursuant to the new international capital agreement (Basel III) based on the principles of dynamic provisioning, increase requirements for the qualitative and quantitative level of common equity, and determine criteria for the systemic importance of banks.</p> <p>Develop a system for early diagnostics of potential negative effects caused by individual bank institutions' activities on stable and efficient development of Ukraine's bank system.</p> <p>Enhance the level of coordination of the goals and actions of the state financial system supervisory agencies.</p>

Risk 4		High level of cash circulation	
Level of consequences	4	Comment	<p>Increased amounts of extra-bank cash circulation both in the national and foreign currency has the following negative consequences:</p> <ol style="list-style-type: none"> 1) the supply of foreign currency on the internal interbank currency market is reduced, which prevents establishing of a real UAH exchange rate to foreign currencies and causes significant UAH rate fluctuations; 2) the possibilities of increasing the country's currency reserves are reduced, which decreases sustainability of the national currency; 3) the country's investment and credit resources are significantly reduced, which creates artificial demand for foreign loans and increases the external public debt and legal entities' debts; 4) the tax basis is reduced due to shadow cash circulation; 5) increased amounts of extra-bank circulation further promotes the shadow economy, which it predominantly serves; 6) significant amounts of extra-bank cash are a substantial source of currency outflow abroad.
Probability level	4	Comment	Despite all the restrictions applied by the National Bank of Ukraine, continuous withdrawal of UAH deposits went on from January 2014

			<p>through September 2015 and reached 31 % in relative terms and 80.4 bln UAH in absolute terms.</p> <p>The data provided in Fig. 1.3.15 shows the evolution of household UAH deposit withdrawal from the bank system, both in the UAH and the USD. The latter indicator was received through calculations, based on the average monthly official NBU exchange rate for the pair USD/UAH. The calculations made allow a conclusion that during the two crisis years the population withdrew a significant amount of UAH deposits from the bank system, the USD equivalent of which is 24.5 bln USD.</p> <p>Thus, in 2014-2015 the equivalent of 37 bln USD worth of deposits was withdrawn from the bank system of Ukraine.</p> <p>Fig. 3.1 shows the evolution of a significant reduction in the number of banks in the bank system of Ukraine in 2013-2015, which prompted a critically low population trust in the bank system and in keeping savings in cash.</p> <p>The depreciation spike at the beginning of 2014 and the panic on the currency market, a triple devaluation of the UAH in relation to the USD in 2014-2015 significantly destabilized the population expectations and precipitated an abrupt growth in the foreign currency demand first on the official, and after introduction of administrative restrictions – the main demand for the currency was concentrated in the shadow – on the “black” currency market.</p>
Overall risk level	16		
Effectiveness of the available measures	2	Comment	<p>Development of cashless settlements reduces a transaction demand for cash in Ukraine for legal payments. The volume of cashless payments using payment cards on the average doubled every two years, which caused replacement of cash in circulation with payment cards.</p>
Description of measures	<p>1. The NBU, in order to ensure compliance of the bank system with the requirements of Ukraine's legislation, its stability and security, including in the context of depositors' and bank creditors' interest protection, puts effort in preventing banks from effecting transactions which are risky in terms of financial monitoring of financial transactions.</p> <p>For instance, starting 2014, the NBU stepped up its activities to prevent the use of the bank system for ML and to preclude bank clients from effecting financial transactions with significant cash amounts which may point to illegal activities. To this end, individual banks have been audited resulting in identified and recorded facts of financial transactions effected by the bank clients with significant cash amounts. Individual banks provided information on such financial transaction to the SFMSU, but some banks did not take these measures. At the same time, in pursuance of the NBU recommendations, such banks provided information on all the cash transactions to the SFMSU.</p> <p>Based on the violations identified, the NBU made the following decisions in relation to the relevant banks in 2013-2014:</p> <ul style="list-style-type: none"> - suspension of some bank transactions covered by the bank license; - temporary suspension of the Board of Directors chairpersons; - imposing fines on banks. 		

	<p>During September 2014 – January 2015, the NBU decided on the insolvency of six banks which were pursuing risky activities in terms of financial monitoring. Currently, the bank license of these banks has been terminated and their liquidation procedure is in progress.</p> <p>Further, in April 2015, one bank was categorized as a troubled one for persistent violation of the legislation regulating the financial monitoring sphere (currently the bank is categorized as insolvent).</p> <p>It should be noted that based on the analysis of cash transactions carried out during bank audits performed by the NBU and based on the typologies developed by the AML/CFT international organizations and the SFMSU, the NBU identified the indicators of risky cash transactions and submitted them to the banks in order to enhance the efficiency of the bank risk management system related to using bank services for ML/FT.</p> <p>2. The NBU Board of Directors adopted Resolution “On Establishing the Limiting Amount of Cash Payments”⁷⁰, which establishes the following limiting amounts for cash payments:</p> <p>10 thous UAH – between companies within one day; 150 thous UAH – between natural persons and companies (entrepreneurs) within one day for goods (work, services); 150 thous UAH – between natural persons under buying/selling contracts subject to notary certification.</p>
Net risk level	8
Description of measures proposed to be taken for risk management	<p>With the aim of efficient risk management, the following is proposed:</p> <ol style="list-style-type: none"> 1. Raise the population financial awareness level about payment cards. 2. Improve the convenience of payments for the utilities, state agency services, taxes and other periodic payments with payment cards. 3. Increase the population level of confidence in the bank system of Ukraine. 4. Review the limits for cash transactions.

Risk 5		Outflow of the financial capital from the country	
Level of consequences	4	Comment	<p>The capital outflow abroad is one of the significant threats to the economic security of the country. The capital outflow causes a number of negative consequences, which, inter alia, include:</p> <p>reduced tax revenues to the state budget, because legal export of capital and its registration yield mandatory payments to the budget; reduced foreign exchange reserves and sources of foreign debt settlement; significant weakening of the payment balance resources by consumption of the positive trade balance; reduced manufacturing; slow-down in the GDP growth.</p>
Probability level	4	Comment	<p>The capital outflow usually occurs in the monetary form and is accomplished by two main methods:</p> <p>by illegal movement of funds from a country to another country; illegally, i.e. in violation of the national currency and foreign trade legislation.</p>

⁷⁰ On Establishing the Limiting Amount of Cash Payments: NBU Board of Directors Resolution, June 06, 2013 No. 210: [Electronic resource]. – Access mode: <http://zakon3.rada.gov.ua/laws/show/z1109-13>

			<p>The capital outflow from Ukraine is caused by the following:</p> <ul style="list-style-type: none"> global nature of accelerated transformation of the economic and political system; low level of investor confidence in the national currency; absence of a favorable investment climate in Ukraine and the mechanism for protection of the property rights; slow maturing of entrepreneurship – the main factor which shapes market relations; “dollarization” of the economy, which determines the behavior motivation and priorities in the system of population savings; insufficient level of legislative regulation of capital export transactions and low efficiency of the currency and export control; imperfect protection system of the state border of Ukraine, which complicates efficient customs control. <p>The evolution of illegal financial flows from Ukraine (Fig. 1.3.21 and Fig. 1.3.22) suggests that the prevalent mechanism of illegal withdrawal of financial resources from Ukraine is manipulation of agreement terms or incorrect issuing of foreign trade flow invoices. The most common schemes for laundering the money of the above origin include: pseudo-export/pseudo-import, export and/or import at overestimated and/or underestimated prices.</p>
Overall risk level	16		
Effectiveness of the available measures	2	Comment	Starting the end of 2014, the NBU took action to prevent inefficient capital withdrawal from Ukraine. To this end, the NBU Board of Directors Resolution “On Approving the Instruction on the Procedure of Register Compiling by Authorized Banks and Amending Some Regulatory Acts of the National Bank of Ukraine on the Issues of Register Compiling by Authorized Banks” was approved ⁷¹ .
Description of measures	<p>The NBU stepped up measures to prevent capital outflow from Ukraine abroad under suspicious transactions. To this end, the NBU Board of Directors approved Resolution “On Approving the Instruction on the Procedure of Register Compiling by Authorized Banks and Amending Some Regulatory Acts of the National Bank of Ukraine on the Issues of Register Compiling by Authorized Banks”.</p> <p>The authorized banks, which received general licenses for foreign currency financial transactions, have to include information on the following financial transactions in the registers:</p> <ul style="list-style-type: none"> - buying foreign currency; - transfer of foreign currency outside Ukraine; - transfer of UAH in favor of non-residents through correspondent UAH accounts of non-resident banks opened with the authorized banks; - transfer of funds in favor of non-residents through authorized banks' subsidiaries opened in other countries. <p>Before adopting the corresponding regulatory legal act, the requirements for compiling of such registers were established in an NBU letter.</p>		

⁷¹ On Approving the Instruction on the Procedure of Register Compiling by Authorized Banks and Amending Some Regulatory Acts of the National Bank of Ukraine on the Issues of Register Compiling by Authorized Banks: NBU Board of Directors Resolution, Apr. 7, 2016 No. 247: [Electronic resource]. – Access mode: <http://zakon3.rada.gov.ua/laws/show/v0247500-16>

	<p>The Resolution also expands the NBU possibilities to block suspicious financial transactions, which will help prevent unproductive capital outflow abroad. Relevant changes are also made to the NBU Board of Directors Resolution of March 3, 2016, No. 140 “On Regulation of the Situation on the Monetary and Currency Market”. These changes to Resolution 140 remain effective through June 8, 2016⁷².</p>
Net risk level	8
Description of measures proposed to be taken for risk management	<p>With the aim of efficient risk management, the following is proposed:</p> <ol style="list-style-type: none"> 1. Implement real mechanisms (including fiscal) to stimulate small innovative entrepreneurship. 2. Enhance customs, currency, and bank control, specifically through: <ul style="list-style-type: none"> strengthening confidence in the bank system and guarantees of safekeeping the population deposits; expanding the National Bank of Ukraine and lead commercial banks consultations with the relevant foreign institutions regarding the channels and mechanisms of the “capital outflow”, the methodology of its assessment, etc.; expanding and improving the legal framework on regulation of cash export. 3. Take action to improve the investment climate in Ukraine, specifically through: <ul style="list-style-type: none"> pursuing of the monetary, tax, and budgetary policy aimed at reducing inflation; improving the legislative framework aimed at ensuring standard international conditions for investor activities; transfer of the accounting and reporting of companies and credit organizations to international standards, which will help increase the “transparency” of Ukraine's companies for investors; restructuring of the bank system and reducing the loan interest rates, etc. 4. Gradually implement harsh administrative restrictions in the sphere of currency regulation. In global experience, the Italian legislation is viewed among the most efficient one to counter ML and was recommended by the EU as a sample for unification of national legislations in the sphere of currency and currency control regulation. The Italian legislation established 150 indicators which characterize a possible criminality of a transaction. 5. Develop and implement a dedicated program for immediate actions to identify illegal “capital outflow” and return of previously exported funds. 6. Develop proposals to improve the state statistics and scientifically substantiated monitoring methodology for assessment of the magnitude of the capital exported from the country and to provide a more detailed presentation of the indicators reflecting the “capital outflow” abroad in Ukraine's balance of payment.

⁷² Source: according to NBU information: [Electronic resource]. – Access mode: http://www.bank.gov.ua/control/uk/publish/article?art_id=29860061

Threat 4. Insufficient regulatory and legal support of the financial monitoring system

Risk 1	Incomplete implementation in the national legislation of the provisions of Directive EU 2015/849 of the European Parliament and of the Council on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing		
Level of consequences	4	Comment	Ukraine has signed the EU association agreement. In view of this, the national AML/CFT legislation should be gradually brought in line with the European one. Non-compliance of Ukraine's legislation with the EU legislation on AML/CFT may adversely affect the overall process of Ukraine's accession to the EU.
Probability level	1	Comment	The probability of the relevant risk occurrence exists (given the multi-stage legislative process), but not to a significant degree. Implementation of the provisions of Directive EU 2015/849 of the European Parliament and of the Council on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing requires technical procedures to develop and support the relevant draft law.
Overall risk level	4		
Effectiveness of the available measures	1	Comment	The Government adopted an Action Plan on Preventing and Countering Legalization (Laundering) of Proceeds of Crime, Financing of Terrorism, and Financing of Proliferation of Weapons of Mass Destruction for 2016 and a Strategy of Development of the System for Preventing and Countering Legalization (Laundering) of Proceeds of Crime or Financing of Terrorism until 2020, which, inter alia, provide for further implementation of international (European) standards in Ukraine's legislation.
Description of measures	<p>The SFMSU and other state authorities continuously take actions to implement international standards in the national AML/CFT legislation.</p> <p>Currently, coordination of the relevant draft law on implementation of the provisions of Directive EU 2015/849 of the European Parliament and of the Council on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing is in progress.</p> <p>To meet the Law requirements, the SFMSU amends its AML/CFT-related regulatory-legal acts.</p>		
Net risk level	2		
Description of measures proposed to be taken for risk management	<p>With the aim of efficient risk management, the following is proposed:</p> <ol style="list-style-type: none"> 1. Prepare a draft law to implement the provisions of the Directive EU 2015/849 of the European Parliament and of the Council on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing and ensure its support until adoption. 2. Bring Ukraine's legislation in line with the FATF recommendations in the case of changes to them. 		

Threat 5. Unstable security situation in the country

Risk 1		Growing organized crime	
Level of consequences	3	Comment	Organized crime is a substantial factor, which increases social tension and destabilizes social relations, causes deformation in the economic management, and slows down the country's economic development.
Probability level	3	Comment	Organized crime is facilitated by global social and economic processes: urbanization, interstate and interregional migration, shaping of the global informational and cultural space.
Overall risk level	9		
Effectiveness of the available measures	2	Comment	Pursuant to Art. 2 of the President of Ukraine Decree "On the State Policy Concept in the Sphere of Combating Organized Crime" ⁷³ , CMU Resolution of Jan. 25, 2012, No. 52-r "On Approving the Action Plan to Implement the State Policy Concept in the Sphere of Combating Organized Crime", the SBU takes measures to detect and stop OCGs, whose illegal activities are related to embezzlement of budget funds, ML, organization of the drug business, illegal migration, etc.
Description of measures	In 2013-2014, the staff of the organized crime combating units at the MIA detected 25 and 17 ML-related criminal offenses respectively, the material damages of which start at 100,000 UAH. 123 OCGs were detected in 2015. SBU also pursues combating of organized crime (Fig. 1.5.1).		
Net risk level	6		
Description of measures proposed to be taken for risk management	With the aim of efficient risk management, the following is proposed: 1. Arrange regular meetings and training for LEA on detection and stopping OCG activities. 2. Enhance the efficiency of LEA interaction on combating organized crime, specifically cooperation with the newly established (including anti-corruption) LEA. 3. Continue focusing on the need to take action on combating organized crime in the annual AML/CFT action plans.		
Risk 2		Acts of terrorism and separatism	
Level of consequences	4	Comment	Illegal terrorist groups, the so-called "LNR" and "DNR", act in Eastern Ukraine. This caused the ATO in the East of Ukraine. Further presence of terrorist and separatist threats breeds instability in the rest of Ukraine and is apparently accompanied by unlawful financing of the relevant processes.
Probability level	4	Comment	In 2013, 2014, and 2015, the SFMSU received 6, 1, and 2 reports respectively related to financial transactions with natural persons, whose data coincide with the data of persons on the List of Persons

⁷³ On the State Policy Concept in the Sphere of Combating Organized Crime: President of Ukraine Decree, Oct. 21, 2011 No. 1000/2011: [Electronic resource]. – Access mode: <http://zakon0.rada.gov.ua/laws/show/1000/2011>

			<p>related to Terrorist Activities or Subjected to International Sanctions. All the reports with the “financing of terrorism” indicator came from banks and were registered.</p> <p>In 2013, the materials of the SBU operational departments were used to bring 4 criminal cases under CCU Art. 258 “Terrorist Act” and 258-5 “Financing of Terrorism”, and 77 in 2014 (a 19-time increase in 2014 over 2013).</p> <p>In 2015, 916 cases were brought against 129 persons under CCU Art. 258 (of which the court reviewed 3 cases against 4 persons) and 210 cases against 23 persons under CCU Art. 258-5 (of which 6 cases against 7 persons were reviewed) – (a 14.6-time increase in 2015 over 2014).</p> <p>Pursuant to the Procedure for Compiling of the List of Persons Related to Terrorist Activities or Subjected to International Sanctions⁷⁴, the SFMSU shall include a legal entity or natural person on the List based on the information received from SBU and MFA, namely: a court verdict that has took effect on finding a natural person guilty of the crimes under CCU Art. 258-2585, 439, and 440, a court decision on finding an organization, legal entity or natural person to be related to pursuit of terrorist activities or proliferation of weapons of mass destruction, court verdicts (decisions), decisions of other competent foreign agencies regarding organizations, legal entities or natural persons related to pursuit of terrorist activities or proliferation of weapons of mass destruction which are recognized in Ukraine under international agreements of Ukraine.</p> <p>According to the official State Court Administration statistics for 2014-2015⁷⁵, courts reviewed 3 cases under CCU Art. 258-2583 with a verdict in 2014 and convicted 3 persons, and 69 cases and 52 convicted in 2015. However, the MFA and SBU in 2014-2015 did not inform the SFMSU of including the convicted persons on the said List.</p> <p>It means that in fact the SFMSU compiles the List using the information produced by international organizations or their authorized bodies on organizations, legal entities and natural persons related to terrorist organizations or terrorists and on persons subjected to international sanctions and received by the SFMSU from the official UN web-site, as well as using court rulings independently received by the SFMSU.</p> <p>This explains the reasons for not including national terrorists on the List.</p>
Overall risk level	16		
Effectiveness of the available measures	3	Comment	Ukraine adopts regulatory legal acts focused on actions to prevent and counter terrorism and separatism (the Law, President of Ukraine decrees adopted, etc.).

⁷⁴ On Approving the Procedure for Compiling of the List of Persons Related to Terrorist Activities or Subjected to International Sanctions: Cabinet of Ministers of Ukraine Resolution, October 25, 2015 No. 966: [Electronic resource]. – Access mode: <http://zakon0.rada.gov.ua/laws/show/966-2015-%D0%BF>

⁷⁵ Form 1-1. “Court of First Instance Report on Review of Criminal Case Materials”: [Electronic resource]. – Access mode: http://court.gov.ua/sudova_statystyka/.

		To detect persons who facilitate terrorism and anti-State actions in Ukraine, in 2015 the State Border Guard Service of Ukraine developed national risk profiles.
Description of measures	<p>The President of Ukraine Decree gave effect to the National Security and Defense Council of Ukraine Decision of May 6, 2015 “On the National Security Strategy of Ukraine”⁷⁶.</p> <p>Further, the President of Ukraine Decree gave effect to the National Security and Defense Council of Ukraine Decision “On the New Revision of the Military Doctrine of Ukraine”⁷⁷.</p> <p>One of the SFMSU priority areas is the activities aimed at detecting persons and their financial transactions which may be related to FT or effected with participation of persons who publicly call to a violent change or overturn of the constitutional order or a change in the boundaries of the territory or state border of Ukraine.</p> <p>In 2014 the detected and blocked funds on the accounts of persons suspected of financing of terrorism and separatism amounted to 864.94 thous USD, 54.65 thous EUR, 130,082.49 thous RUB, and 36,991.80 thous UAH.</p> <p>In 2015 the detected and blocked funds on the accounts of persons suspected of financing of terrorism and separatism amounted to 0.715 mln USD, 0.207 mln EUR, 3 mln RUB, and 110 mln UAH.</p> <p>Results of the SBGSU application of the national risk profiles during 11 months of 2015:</p> <ul style="list-style-type: none"> - Russian Federation citizens refused entry, who, based on the sum total of indicators, may be involved in disruption of the situation in Ukraine or be related to provocative actions and mass unrest in Ukraine – 932; - identified persons related to extremist actions in Ukraine – 43; - identified journalists of the Russian mass media related to anti-Ukrainian information activities – 4. 	
Net risk level	12	
Description of measures proposed to be taken for risk management	<p>With the aim of efficient risk management, the following is proposed:</p> <ol style="list-style-type: none"> 1. Continue imposing and using severe sanctions to prevent financial and technical support of the so called “LNR” and “DNR”. 2. Ensure timely identification and neutralization of the persons who facilitate terrorist activities and publicly call to a violent change or overturn of the constitutional order or a change in the boundaries of the territory or state border of Ukraine. 3. Pursue a comprehensive state patriotic awareness policy. 4. Step up SBU and MFA activities to provide information to the SFMSU on a timely basis for compiling of the list of persons related to terrorist activities or subjected to international sanctions. 	

⁷⁶ On the National Security and Defense Council of Ukraine Decision of May 6, 2015 “On the National Security Strategy of Ukraine”: President of Ukraine Decree, May 26, 2015 No. 287/2015: [Electronic resource]. – Access mode: <http://zakon5.rada.gov.ua/laws/show/287/2015/paran7#n7>

⁷⁷ On the National Security and Defense Council of Ukraine Decision of Sept. 2, 2015 “On the New Revision of the Military Doctrine of Ukraine”: President of Ukraine Decree, Sept. 24, 2015 No. 555/2015: [Electronic resource]. – Access mode: <http://zakon0.rada.gov.ua/laws/show/555/2015>

Risk 3	Inefficiently efficient actions by competent authorities to counter financing of terrorism and separatism		
Level of consequences	4	Comment	Financing of terrorism and separatism create conditions for existence and efficient activities of terrorists and separatists, facilitates their committing of terrorist acts and other terrorist crimes. The main immediate objects of these crimes include public security and encroaching on the boundaries of the territory of the country.
Probability level	4	Comment	A high level of terrorist and separatist activities (and thus financing of such activities) in Ukraine is an undisputed fact that transformed into the threat of a protracted military conflict. It is most difficult to perceive, because until recently Ukraine did not suffer from internal terrorist incidents and the analysis of criminal cases investigated by the LEA demonstrated that they were unrelated to terrorist activities and did not reveal any indicators pointing to participation of natural persons or legal entities in Ukraine or abroad in the FT.
Overall risk level	16		
Effectiveness of the available measures	2	Comment	One of the efficient measures to counter financing of terrorism and separatism is provision of methodological, procedural, and other assistance in the AML/CFT area. Such measures are not exhaustive and require continuous initiative on the part of the SFMSU. Further, in some cases the SFMSU and LEA activities to counter financing of terrorism and separatism are productive and coordinated
Description of measures	<p>In 2014, the SFMSU, jointly with the State Financial Monitoring Subjects, as well as government authorities, including LEA prepared a typological research about the “Current Methods, Approaches, and Financial Tools for Financing Terrorism and Separatism”⁷⁸.</p> <p>The NBU provided recommendations to banks on taking actions regarding:</p> <ul style="list-style-type: none"> - persons related to exacerbation of the political and economic crisis in Ukraine and exposed to international sanctions; - analysis of financial transactions to identify cases which may testify to the use of bank services by clients to finance illegal activities. <p>The PFMS use mechanisms to counter financing of terrorism and separatism stipulated in the AML/CFT legislation and internal documents on the financial monitoring, taking into account recommendations by the State Financial Monitoring Subjects.</p> <p>In this context, the SFMSU prepares and submits SM and ASM to the LEA on the financial transactions which may be related to FT or effected with participation of persons who publicly call to a violent change or overturn of the constitutional order or a change in the boundaries of the territory or state border of Ukraine.</p> <p>In 2014, the SFMSU prepared and submitted 73 materials to the LEA (of which 55 SM and 18 ASM).</p> <p>In 2015, the SFMSU prepared and submitted 48 materials (of which 39 SM and 9 ASM): PGOU – 2 SM; MIA– 3 SM; SBU – 33 SM and 9 ASM; FIS – 1 SM. In 2015,</p>		

⁷⁸ Current Methods, Approaches, and Financial Tools for Financing Terrorism and Separatism: SFMSU Order, Dec. 25, 2014 No. 170: [Electronic resource]. – Access mode: www.sdfm.gov.ua/index.php?cat=114&lang=uk

	<p>out of these, 45 materials were prepared with the SBU and MIA information provided in 127 letters on the issues of countering financing of terrorism and separatism in Ukraine and participation of the national and local state authorities and local government officials in illegal activities.</p> <p>Based on the measures taken, the SFMSU during the said period detected and blocked funds of financial transactions related to FT and actions aimed at a violent change or overturn of the constitutional order or a change in the boundaries of the territory or state border of Ukraine to the total amount of 110 mln UAH, 715.1 thous USD, 206.6 thous EUR, 3.0 mln RUB.</p> <p>In its turn, SBU in 2014-2016 submitted 208 items of information to the SFMSU on financial transactions regarding which there are suspicions that they relate to or are intended for FT.</p> <p>In the said period there were registered 302 criminal cases on the indications of crimes under CCU Art. 285-5 ("Financing of terrorism"). In relation to 13 persons the court passed guilty verdicts for FT and sentenced them to 5 years of imprisonment and 10 persons were served a suspicion note. Under CCU Art. 258-4 ("Facilitating the commission of a terrorist act") 26 criminal cases were investigated during the said time, of which five indictments in relation to five persons were submitted to court and three were sentenced to imprisonment.</p>
<p>Net risk level</p>	<p>8</p>
<p>Description of measures proposed to be taken for risk management</p>	<p>With the aim of efficient risk management, the following is proposed:</p> <ol style="list-style-type: none"> 1. Increase control of the payment systems. 2. Impose harsh restrictions on the currency circulation, e.g., through: <ul style="list-style-type: none"> - establishing strict limits on the accounts in terms of cash withdrawal; - increased limits of cash removal only based on the documents which confirm the sources of origin of the funds and the purpose of the funds. 3. Monitor of information from the Internet by bank employees to identify the clients who use their accounts to raise charity and assist terrorist and separatist groups and impose limitations on the accounts of persons related to financial of separatism (limitation of the possibility to transfer funds from the account or to withdraw cash). 4. Strengthen state regulation over non-profit organizations. 5. Step up interagency cooperation between the State Financial Monitoring Subjects, PFMS, SFMSU, and LEA. 6. Step up international cooperation on countering terrorist and separatist activities.

Threat 6. Insufficient level of training of the AML/CFT system participants

Risk 1	Non-compliance of the SFMSU Training and Methodical Center organizational and legal form with the requirements of the Law		
Level of consequences	4	Comment	<p>Inefficient training and professional development of the AML/CFT system participants may entail catastrophic implications, namely:</p> <ul style="list-style-type: none"> - lack of understanding and failure of the LEA to perform their functions related to investigation of the ML/FT crimes; - lack of awareness among the PFMS representatives, which will lead to their failure to detect suspicious financial transactions; - absence of effective control over the PFMS on the part of the State Financial Monitoring Subjects; - insufficient skills among judges on review of ML/FT criminal cases. <p>These consequences can be avoided by reorganizing the SFMSU Training and Methodical Center, established in 2004, into a new organizational and legal form – that of an Academy.</p>
Probability level	2	Comment	<p>The SFMSU Training and Methodological Center continuously trains AML/CFT specialists on financial monitoring.</p> <p>According to the amended legislation, professional development is a component of the post-graduate education received, inter alia, at academies. Therefore, to make the SFMSU Training and Methodological Center compliant with the requirements of the Law and legislation on education, measures have to be taken to reorganize the Training and Methodological Center by transforming it into a Financial Monitoring Academy. Establishing of the Academy will help develop, upgrade, and enhance the quality of post-graduate education in the AML/CFT area at the Financial Monitoring Academy under the SFMSU management, and facilitate improved competitiveness of the Financial Monitoring Academy on the international level and reduce the risks of using PFMS for ML, FT, and FPWMD.</p>
Overall risk level	8		
Effectiveness of the available measures	3	Comment	<p>The Law stipulates that the SFMSU shall ensure, based on the CMU determined procedure, organization and coordination of the work on advanced training and professional development of the state agencies' specialists on financial monitoring and PFMS responsible employees, as well as the employees involved in AML/CFT financial monitoring at the relevant training institution – the academy, which belongs to the SFMSU sphere.</p> <p>The procedure for organization and coordination of work on advanced training and professional development of specialists on financial monitoring⁷⁹ stipulates the following:</p> <ul style="list-style-type: none"> - advanced training and professional development of the state authorities specialists on financial monitoring are carried out pursuant to the government order at the expense of the state budget at the academy which belongs to the SFMSU management sphere (hereinafter “the

⁷⁹ On Approving the Procedure for Organization and Coordination of Work on Advanced Training and Professional Development of Specialists on Financial Monitoring: Cabinet of Ministers of Ukraine Resolution, August 19, 2015 No. 610: [Electronic resource]. – Access mode: <http://www.kmu.gov.ua/control/uk/cardnpd?docid=248425178>

			academy”) using the educational programs developed in line with the legislation, approved by the academy, and concurred by the SFMSU. - the responsible employees and the employees involved in financial monitoring take advance training and professional development pursuant to the legislation under educational programs developed pursuant to the legislation, approved by the educational institutions, and concurred by the relevant State Financial Monitoring Subjects and SFMSU.
Description of measures	Table 1.6.1 provides information on AML/CFT training of specialists at the SFMSU Training and Methodological Center in 2013-2015. The SFMSU several times prepared a draft Government act on reorganization of the SFMSU Training and Methodological Center into a Financial Monitoring Academy, however the draft has never been concurred by the Ministry of Finance due to money shortage in the State Budget of Ukraine.		
Net risk level	9		
Description of measures proposed to be taken for risk management	With the aim of efficient risk management, the following is proposed: 1. Take actions to reorganize the SFMSU Training and Methodological Center into a Financial Monitoring Academy. 2. Provide advanced training and professional development of the SFMSU divisions' staff and managers responsible for financial monitoring, as well as state authorities specialists in the AML/CFT sphere using modern methodologies and technologies. 3. Intensify transition from theoretical to practical training in the AML/CFT sphere.		

Risk 2		Insufficient level of training of the AML/CFT system participants	
Level of consequences	4	Comment	Insufficient level of training of the staff involved in financial monitoring may lead to using the PFMS for ML/FT. A low preparation level of the LEA on investigating ML/FT crimes leads to inefficient and incomplete collection of evidence on the relevant category of crimes, due to which the persons who committed these crimes remain unpunished. This leads to repeated committing of ML/FT crimes, which threatens the country security. Lack of understanding among the judges of the ML crime results in re-qualification of crimes under CCU Art. 209 to other criminal articles during review of the ML cases. This leads to convicting people under other CCU articles and imposing a lower punishment on the offenders for the committed serious crime.
Probability level	1	Comment	Ukraine's AML/CFT legislation obliges the PFMS to take action, in line with the legislation, to ensure that the responsible employee takes AML/CFT training within three months of his/her appointment and undergoes professional development at least once every three years at the SFMSU Training and Methodological Center and at other training facilities agreed by the SFMSU. Further, the PFMS internal documents envisage periodic training of the PFMS employees involved in financial monitoring.

			<p>According to information contained in the Trial Court Report on Review of the Crimes under CCU Articles 209, 209-1, 306 under Form 1-L⁸⁰:</p> <ul style="list-style-type: none"> - in 2013 the courts had 635 criminal cases in review under CCU Art. 209 ad 209-1. During the year, out of these there were reviewed 283 criminal cases (45 %), of which 150 criminal cases with a verdict (53 %). 55 criminal cases (9 % of the cases in review) were re-qualified from CCU Art. 209, 209-1 to other CCU articles; - in 2014 the courts had 434 criminal cases in review under CCU Art. 209 ad 209-1. During the year, out of these there were reviewed 180 criminal cases (42 %), of which 91 criminal cases with a verdict (51 %). 25 criminal cases (6 % of the cases in review) were re-qualified from CCU Art. 209, 209-1 to other CCU articles; - in 2015 the courts had 324 criminal cases in review under CCU Art. 209 ad 209-1. During the year, out of these there were reviewed 103 criminal cases (32 %), of which 45 criminal cases with a verdict (44 %). 17 criminal cases (5 % of the cases in review) were re-qualified from CCU Art. 209, 209-1 to other CCU articles. <p>The above data evidences low efficiency of courts in reviewing criminal cases under Art. 209, 209-1 in 2013-2015. On the annual average, 39 % of criminal cases of the total number of cases submitted to courts were reviewed.</p> <p>The facts of re-qualified indictments from CCU Art. 209, 209-1 to other CCU articles (2013 – 9 % of cases, 2014 – 6% of cases, 2015 – 5% of cases) may evidence insufficient understanding by judges of the essence of Art. 209 and 209-1.</p>
Overall risk level			4
Effectiveness of the available measures	2	Comment	<p>Advanced training and professional development of the SFMSU responsible employees and employees involved in financial monitoring on the issues of financial monitoring are provided by the SFMSU Training and Methodological Center, State Education and Research Institution “Academy of Financial Management”, and other training institutions that entered into a cooperation agreement with the SFMSU.</p> <p>All the bank institutions arrange internal AML/CFT training on a continuous basis. The internal AML/CFT training is usually conducted according to the approved Training Plan for the current year. Further, bank employees take part in the trainings provided by the SFMSU and/or NBU.</p> <p>Training of LEA specialists on financial monitoring in the AML/CFT area is provided by:</p> <ul style="list-style-type: none"> - SFMSU Training and Methodical Center; - training institutions at the LEA. <p>Further, LEA representatives take part in international workshops on the AML/CFT subjects.</p> <p>Good practice is development of methodological recommendations (with regards to publicly exposed persons). The 2015 publication of the article-specific scientific and practical comments to the Law was very important.</p>

⁸⁰ Source: information from the Judiciary of Ukraine official web-portal. [Electronic resource]. – Access mode: http://court.gov.ua/sudova_statystyka/

<p>Description of measures</p>	<p>Table 1.6.1 provides information on training of specialists on financial monitoring in the AML/CFT sphere at the SFMSU Training and Methodological Center in 2013-2015. In 2013-2015, there were conducted 139 training events and seminars for 2,447 representatives of the PFMS, 17 training events for 262 representatives of the State Financial Monitoring Subjects, 44 training events for 1,422 representatives of the LEA, courts, and other agencies.</p> <p>In 2015, 43 PGOU employees participated in trainings on financial investigations organized by the International Center for Asset Recovery (ICAR) of the Basel Institute on Governance.</p> <p>In 2014, the Juridical Personnel Training Institute for the Security Service of Ukraine of the National University “Yaroslav Mudryi Law Academy of Ukraine” and the National Academy of the Security Service of Ukraine organized and conducted nine streams of professional development for the SBU operational and managerial staff, where 67 SBU took their professional development courses on AML/CT.</p> <p>Further, the National SBU Academy provided instruction on: “Organization and Regulatory Framework of Interaction between the Law Enforcement Agencies and the designated financial monitoring agency of Ukraine” for three professional development streams of SBU staff.</p> <p>In 2013, the Advanced Training and Professional Development Center for Senior Executives of the State Border Guard Service of Ukraine provided professional development courses on “Organization of Combating the Laundering of Proceeds of Crime” to 27 staff of the units for laundering proceeds of crime of the revenue and duties agencies.</p> <p>In 2014, the Division of the Advanced Training and Professional Development Center for Senior Executives of the Ministry of Revenue and Duties of Ukraine provided professional development courses on “Organization of Combating the Laundering of Proceeds of Crime” to 22 staff of the units for laundering proceeds of crime of the revenue and duties agencies.</p> <p>In 2013-2015, the SFMSU Training and Methodological Center provided training to 584 representatives of the judicial authorities.</p>
<p>Net risk level</p>	<p>4</p>
<p>Description of measures proposed to be taken for risk management</p>	<p>With the aim of efficient risk management, the following is proposed:</p> <ol style="list-style-type: none"> 1. Ensure timely taking of trainings by the PFMS responsible employees. 2. Ensure regular internal AML/CFT training of the PFMS employees involved in financial monitoring. 3. Draw PFMS attention to the need of analyzing typological research performed by the SFMSU and other institutions. 4. Continue the practice of developing study guides, comments, and methodological recommendations for the AML/CFT system participants (including analyses and collections of regulatory legal acts, explanatory dictionaries on the AML/CFT system). 5. Continue the practice of participation of court representatives in AML/CFT-related interagency meetings, workshops, and conferences. <p>Improve the curricula and syllabuses for LEA not only to study the theory of countering ML/FT, but also to build up skills on detection and investigation of ML/FT-related cases, including evidence gathering.</p> <ol style="list-style-type: none"> 6. Organize joint training for different LEA to exchange experience on investigation of ML/FT cases. 7. Ensure conducting interagency meetings between representatives of the law enforcement and intelligence agencies to ensure productive and efficient cooperation on investigation of the ML/FT crimes.



**GOVERNMENT
COMPONENT**

2.1. Financial Intelligence Unit

Pursuant to FATF Recommendation 29 and Art. 12 of the Council of Europe Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime and on the Financing of Terrorism, countries should establish a financial intelligence unit (FIU) that serves as a national center for the receipt and analysis of STRs and other information relevant to ML, associated with predicate offenses and FT, and for the dissemination of the results of that analysis.

According to the Law of Ukraine “On Ratification of the Council of Europe Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime and on the Financing of Terrorism”⁸¹, the agency authorized by Ukraine to perform the FIU functions is the SFMSU.

Pursuant to the Law, Ukraine has a central executive agency implementing the state policy on preventing and countering legalization (laundering) of proceeds of crime, financing of terrorism, and financing of proliferation of weapons of mass destruction and is a key element of the system. Initially, in 2002, this agency functioned as a State Department within the Ministry of Finance of Ukraine, then as a separate central executive agency – State Financial Monitoring Committee of Ukraine, and then, starting 2010, as the State Financial Monitoring Service of Ukraine.

The SFMSU activities are directed and coordinated by the CMU through the Minister of Finance of Ukraine.

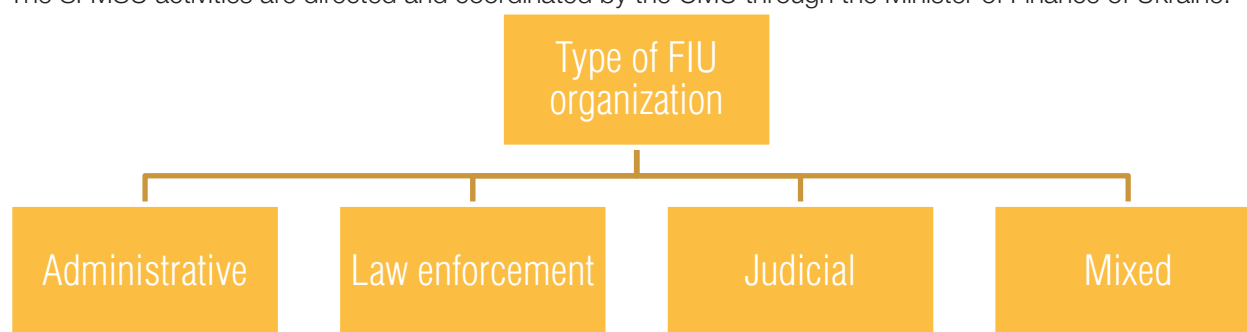


Fig. 2.1.1. Type of FIU organization

In Ukraine, like in most other post-Soviet countries, the SFMSU acts as an administrative type FIU, which is operationally independent.

The administrative type FIU does not have a “complete production cycle” on detecting the facts of money laundering, since it performs only some of the main anti-ML stages, which include: (a) initial detection and registration of suspicious information; (b) information analysis; (c) case investigation.

Of the above components of the “complete production cycle” of financial intelligence, the FIU of Ukraine is in charge of the analysis and summarizing of the analyzed information on the STRs received from other subjects in the national AML/CFT system.

⁸¹ On Ratification of the Council of Europe Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime and on the Financing of Terrorism: Law of Ukraine, November 17, 2010 No. 2698-VI: [Electronic resource]. – Access mode: <http://zakon3.rada.gov.ua/laws/show/2698-17>

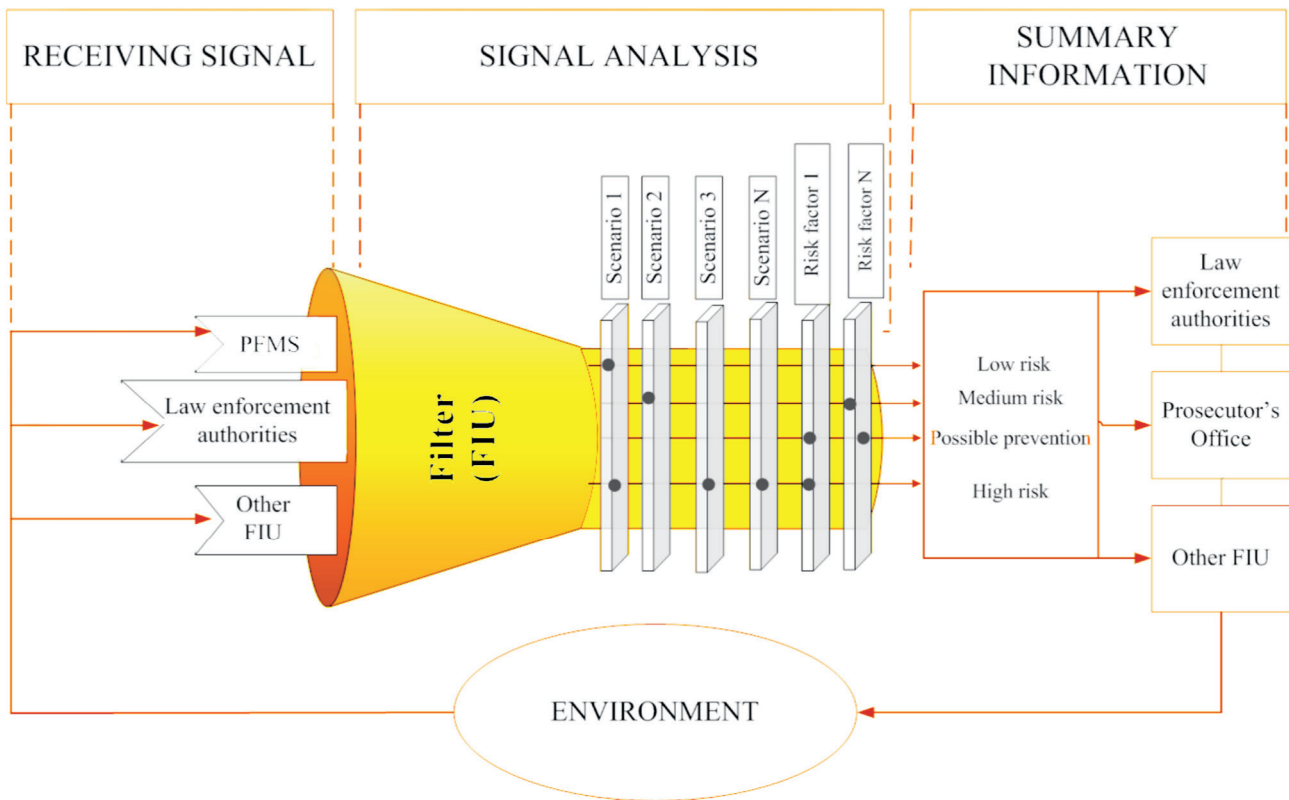


Fig. 2.1.2. The Functioning Model of the Institute of Anti-Legalization Financial Monitoring in Ukraine on the Macrolevel

The main sources of input (primary) information flows for the national FIU include PFMS (banks), the Ukraine's LEA, and foreign FIUs. The elements of the national AML/CFT system, which receive the processed and national FIU-provided information in the form of summarized materials as a stimulus for taking relevant criminal and procedural actions and/or administrative and regulatory actions, are composed of the sum total of the LEA, State Financial Monitoring Subjects (agencies that supervise the PFMS activities in the AML/CFT area), and foreign FIUs.

The microlevel functioning model of the institute of anti-legalization financial monitoring of Ukraine is fractal to the macrolevel one, considering that the “filter” function (initial detection and registration of an STR) in it is performed by the PFMS, and the main source of the data inputs on the microlevel is information on the clients and their transactions (Fig. 2.1.3):

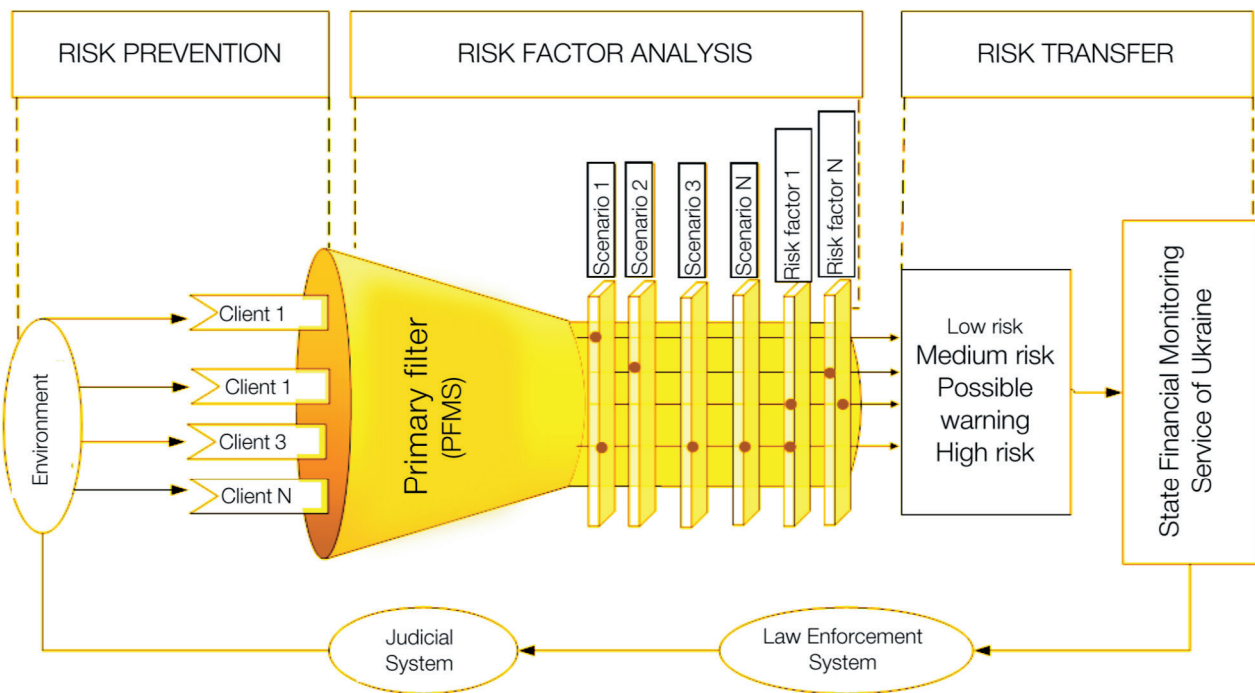


Fig. 2.1.3. The functioning model of the of anti-legalization financial monitoring institute in Ukraine on the microlevel

Fig. 2.1.4 shows absolute and relative characteristics of the PFMS registered with the SFMSU as of Jan. 1, 2016, by their types (without taking into consideration separated divisions).

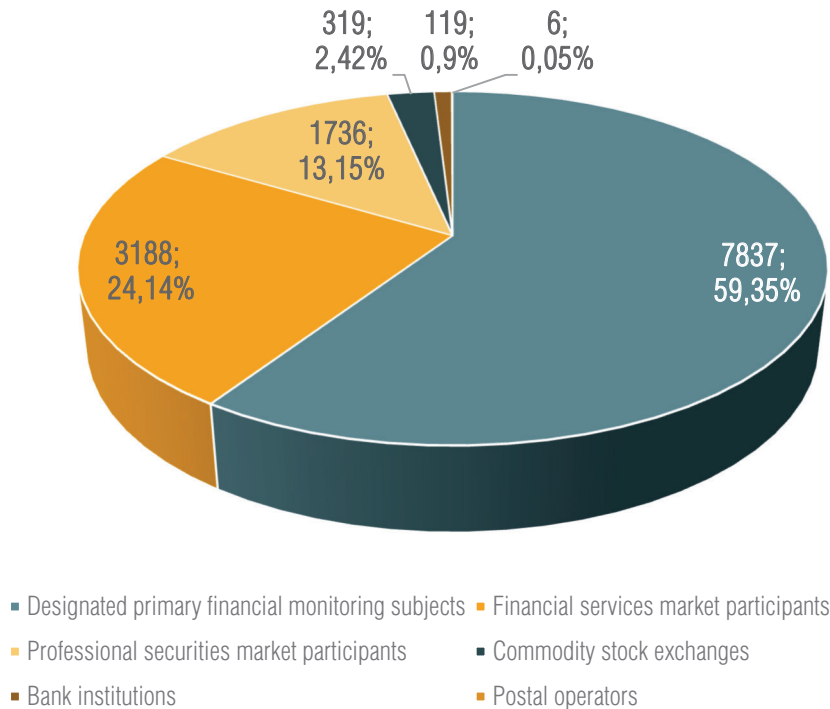


Fig. 2.1.4. Absolute and relative characteristics of the PFMS registered with the SFMSU as of Jan. 1, 2016⁸²

The main source of the incoming data flow is information on the clients' financial transactions.

Fig. 2.1.5 demonstrates the evolution of the total number of the STRs submitted to the SFMSU from all the PFMS, showing the average and cumulative characteristics of the process.

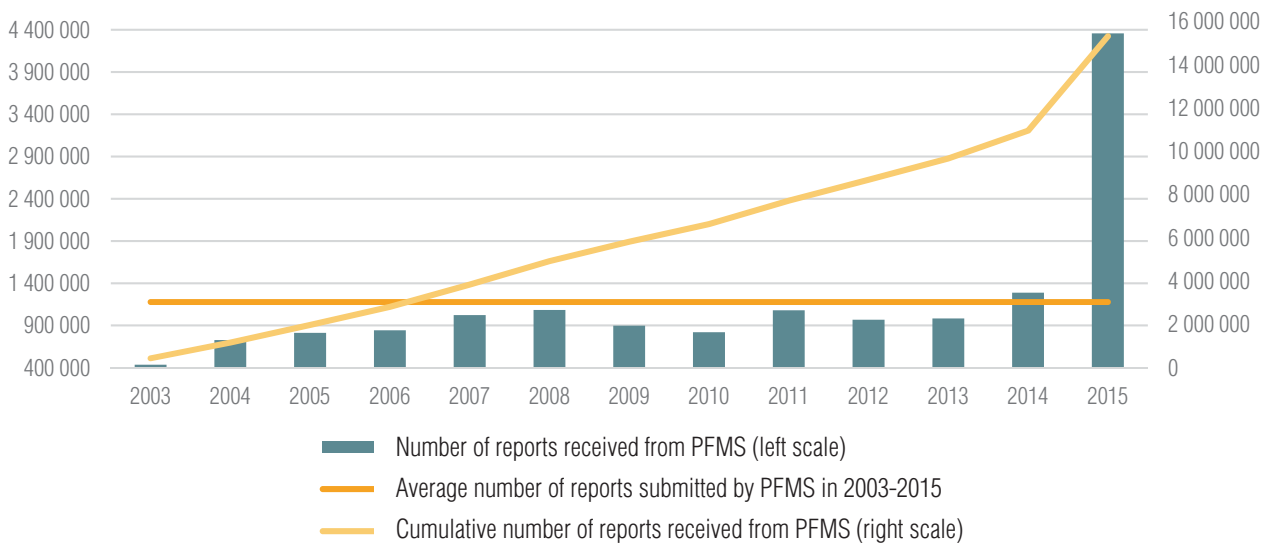


Fig. 2.1.5. Evolution of total, average, and cumulative number of STRs submitted to the SFMSU⁸³

Thus, in 2003-2015, the PFMS annually submitted on the average 1,177,830 reports to the SFMSU. The cumulative (accrued) number of the STRs received from the primary financial monitoring subjects with indications of the mandatory and internal monitoring as of 01.01.2016 was 15,311,784.

⁸² Source: based on the SFMSU data.

⁸³ Source: based on the SFMSU data.

The number of STRs from the PFMS in 2015 increased 3.8 times over 2014 and reached almost 4.4 mln, which is explained by a new revision of the Law taking effect and expanding the list of financial transactions mandatory for submittal to the SFMSU.

Analyzing the amounts of the financial transactions received from the PFMS in 2010-2015, it should be noted that the main growth was observed in 2015. At the same time, the average amount of one report received from the PFMS in 2010-2015 did not change significantly and ranges between 9.94 mln UAH and 1.33 mln UAH.

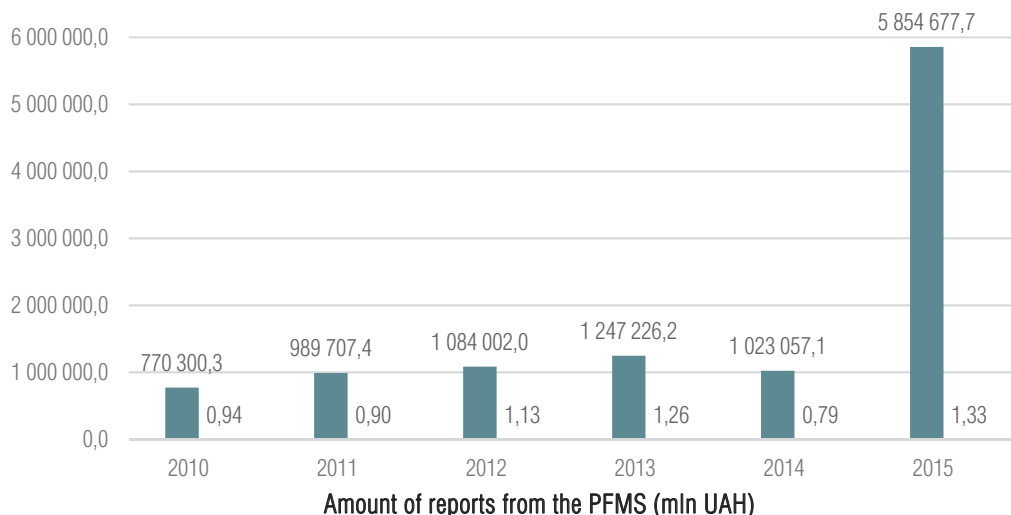


Fig. 2.1.6. Evolution of the total amount of STRs submitted to the SFMSU and the average amount of one STR⁸⁴

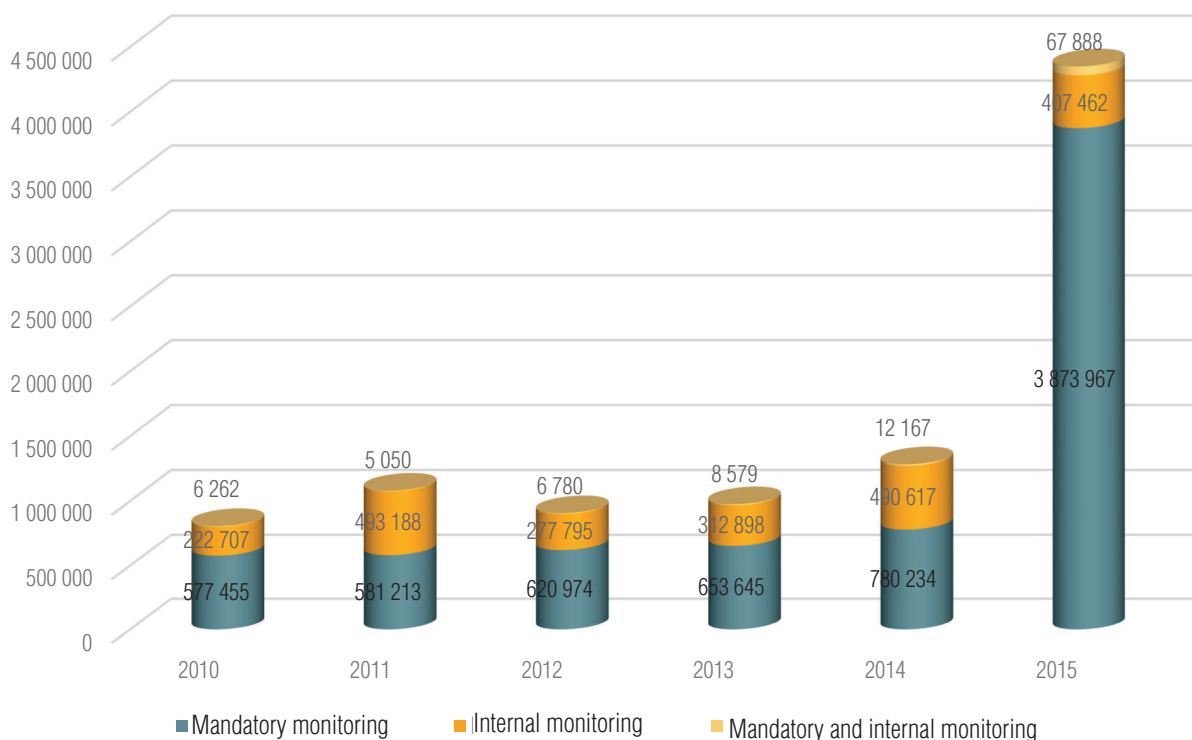


Fig. 2.1.7. Number of STRs registered by the SFMSU in 2010-2015 by the financial monitoring indicators⁸⁵

⁸⁶ Source: based on the SFMSU data.

⁸⁷ Source: based on the SFMSU data.

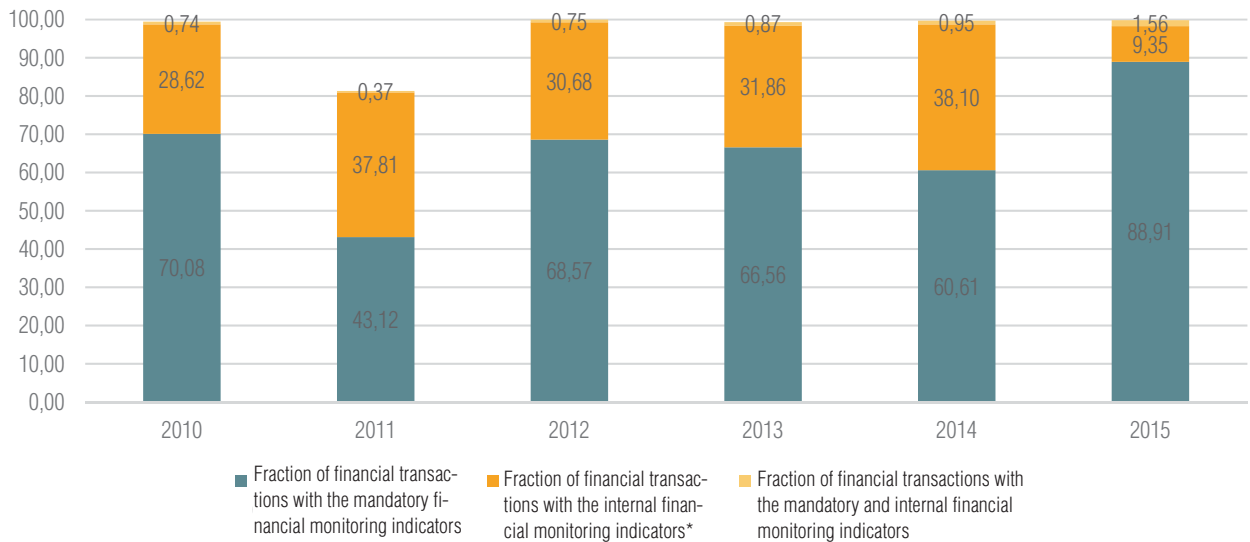


Fig. 2.1.8. Fraction of STRs registered by the SFMSU in 2010-2015 by the financial monitoring indicators

The lion share of such reports in 2010 came from the bank sector PFMS and amounted to 97-99 %.

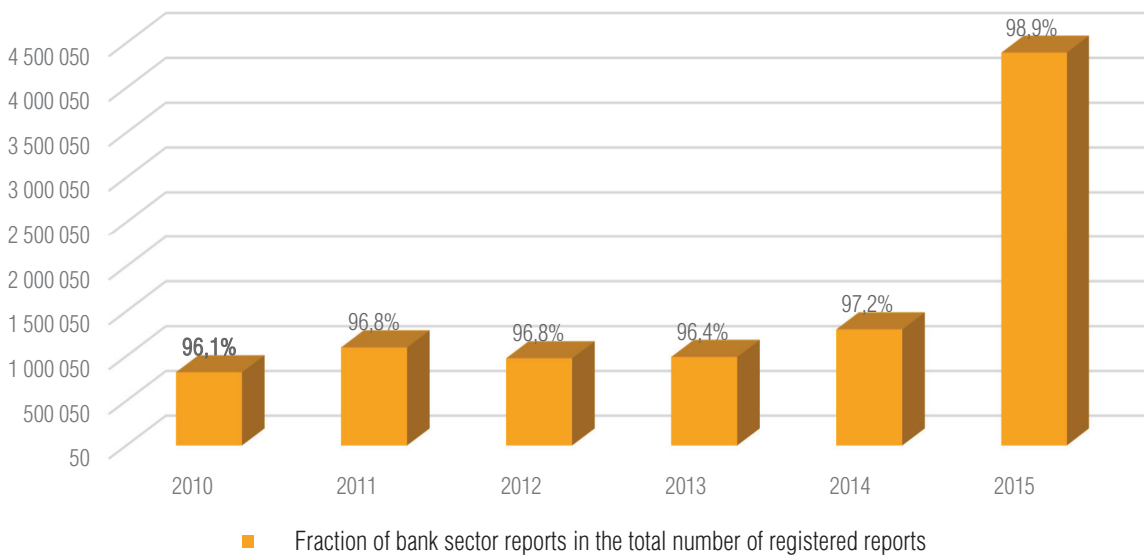


Fig. 2.1.9. Fraction of bank sector STRs in the total registered amount

An overview of the above data evidences that the primary financial monitoring system in Ukraine is bank-centered, since it is banks that make the main PFMS category which in 2010-2014 submitted 97 % and in 2015 – 99 % of all the suspicious financial transactions effected in Ukraine and contain indications testifying to effecting of these transactions with the ML purpose.

Therefore, ensuring an efficient functioning of the system of preventing the use of the bank system of Ukraine for suspicious financial transactions is a primary task in the context of improving the state and primary financial monitoring measures.

Among the PFMS of the non-bank sector, the most active are insurance institutions, credit unions, leasing institutions, stock market professional participants, business entities involved in conducting lotteries, and postal operators.

The statistics on the number of STRs received from the non-bank sector PFMS and registered by the SFMSU in 2010-2015 is provided below.

PFMS name	Number of registered STRs received from PFMS					
	2010	2011	2012	2013	2014	2015
Non-government pension fund administrator	1	0	0	0	0	4
Credit union	16	153	519	614	612	780
Another credit institution	12	40	82	105	309	498
Pawnbroker's shop	60	57	47	34	12	11
Insurance broker – legal entity	429	424	475	454	467	821
Insurer, reinsurer	20,542	20,366	19,052	23,321	23,189	25,237
Institution providing financial leasing services	53	150	223	336	488	635
Institution providing factoring services	0	37	13	1	0	23
Other legal entities that under their legal status are not financial institutions but provide individual financial services	6	12	10	9	0	320
Subsidiaries or offices of foreign businesses providing financial services in Ukraine	-	-	-	108	124	231
Financial company	409	546	530	140	44	108
Asset management company	815	2,716	3,669	3,464	4,143	6,270
Professional securities market participant	2	0	3	3	0	67
Registrar	2	4	0	1	9	1
Registrar-depository	0	1	3	3	2	6
Securities trader	431	297	252	114	48	1,518
Trader-depository	642	688	668	909	1,039	2,487
Trader-depository-registrar	3	17	0	3	1	0
Legal entities that effect financial transactions with commodities for cash	3	208	130	3	0	0
Economic entities involved in cash trade in precious metals and stones and goods made thereof	0	0	0	0	0	12
Economic entities involved in conducting lotteries	366	379	210	392	258	300
Postal operators	30	21	37	36	30	184
Notaries	17	417	269	57	24	31

Table 2.1.1. Number of STRs received from the non-bank sector PFMS and registered by the SFMSU in 2010-2015⁸⁶

All the STRs received are categorized by the level of risk and subject to thorough analysis with due account for all the available information. The analysis results are combined into a brief for financial investigation. Each financial transaction from the brief is analyzed for reasons to believe that the financial transaction may be related to ML/FT or FPWMD, or related to another act stipulated in the CCU.

The SFMSU applies the financial transaction analysis based on a risk-oriented approach taking into account international experience of combating ML/FT.

The statistics on the STRs and started briefs selected for active work in 2010-2015 is provided below.

⁸⁶ Source: based on the SFMSU data.

Year	Number of STR	Number of SFMSU briefs
2010	188,857	1,706
2011	205,543	1,841
2012	100,912	1,896
2013	117,976	1,999
2014	200,824	1,970
2015	280,525	1,951

Table 2.1.2. Number of selected STRs and briefs started by the SFMSU in 2010-2015⁸⁷

The PFMS-submitted STRs with indicators of mandatory or internal financial monitoring are selected according to the designated SFMSU criteria are analyzed and, if there are grounds, submitted to the LEA or IA of Ukraine as part of the SM/ASM. The received STRs are analyzed with due account for additional information received in response to the SFMSU requests.

Regardless of the automation level at the early stages of receiving (bank) reports, the tools for verification, initial analysis and determining the priorities relied on by the SFMSU analysts for further analysis and development of SM are mostly non-automated. These processes are based on: uploading the financial transaction data to Excel spreadsheets, development of i2 diagrams on their basis to visualize the relations, and development of reports using Microsoft Word.

The process of transferring data from one system to another, their analysis with subsequent export of partly analyzed data and loading them into another system, and so on until the materials are finally developed, requires significant time, resources, and with a high probability may cause human-related errors. It also means that a large number of different systems needs to be supported, periodically upgraded, and their licenses paid.

SM is an SFMSU product which is developed through analysis of information on financial transactions and their participants and additional information, and which raised the SFMSU suspicions. SM are submitted to the law enforcement or intelligence agencies for further investigations of the facts stated therein in relation to ML/FT or in relation to a committed ML predicate crime, committing of another crime.

ASM is an integral part of the SM and is developed in addition to the already submitted SM based on the analysis of additionally received information.

SM is a report on a committed criminal offense and can become the basis for taking investigative and counter-intelligence activities by the law-enforcement and intelligence agencies of Ukraine.

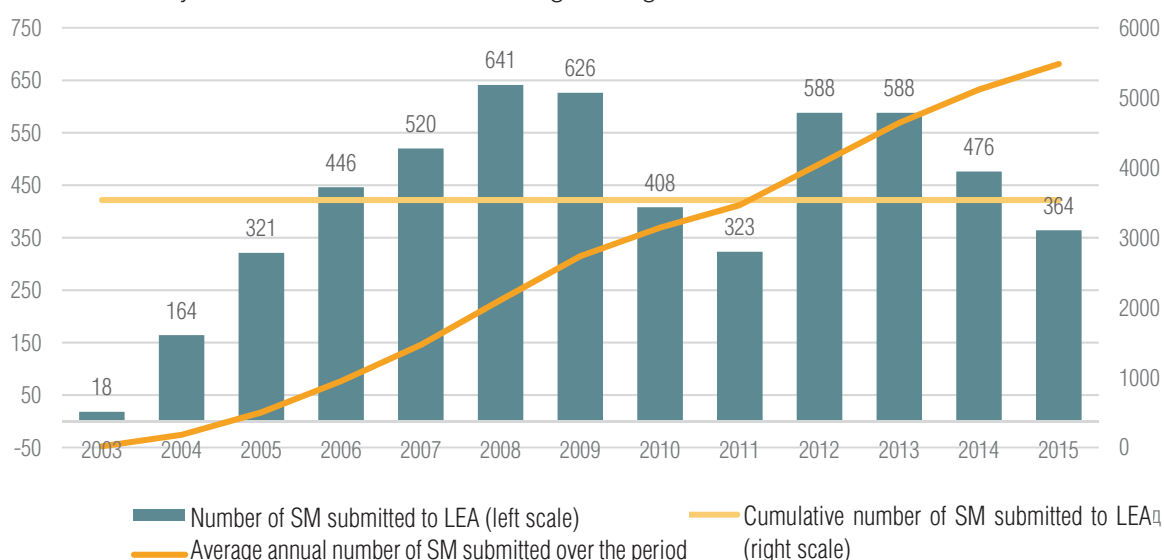


Fig. 2.1.10. Number of SM submitted by the SFMSU to the LEA⁸⁸

Fig. 2.1.10 shows that starting 2003 and through 2015, the SFMSU submitted 5,483 SM to the LEA. On the average, during the period the SFMSU annually submitted 422 SM to the LEA.

⁸⁷ Source: based on the SFMSU data.

⁸⁸ Source: based on the SFMSU data.

Fig. 2.1.11 shows information on the evolution of the ASM submitted to the LEA. During the entire period of its functioning from 2003 through 2015, the SFMSU submitted 3,494 ASM to the LEA. On the average, during the period the SFMSU annually submitted 269 ASM to the LEA.

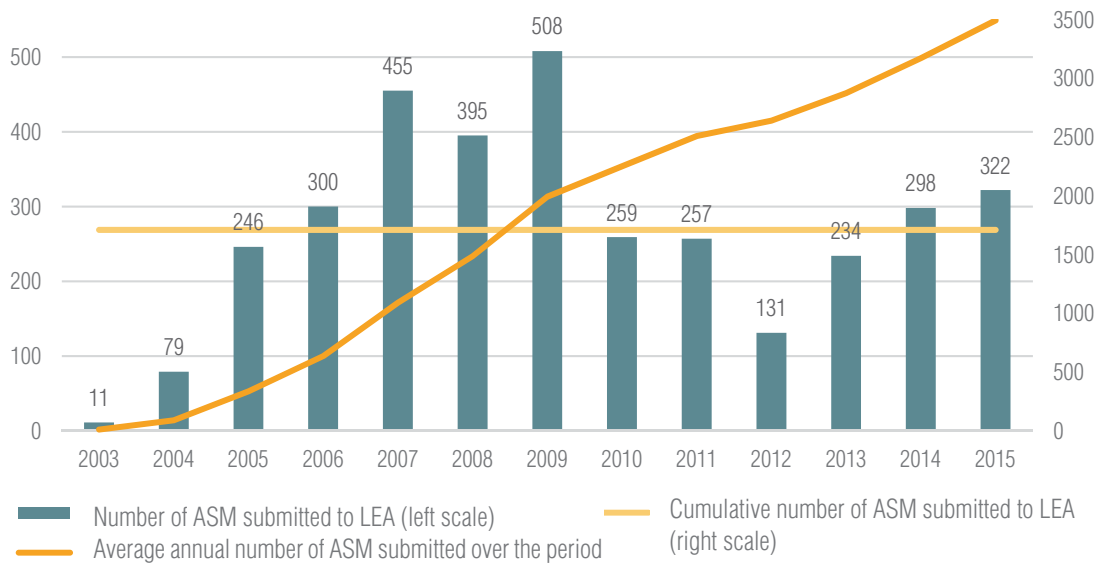


Fig. 2.1.11. Number of ASM submitted by the SFMSU to the LEA⁸⁹

Fig. 2.1.12 and 2.1.13 shows the number and amounts of reports on risky financial transactions that were the basis for starting investigations and that were submitted to the LEA as part of the SM/ASM with distribution by indicators of mandatory and internal monitoring stipulated by the Law (one transaction may have several indicators).

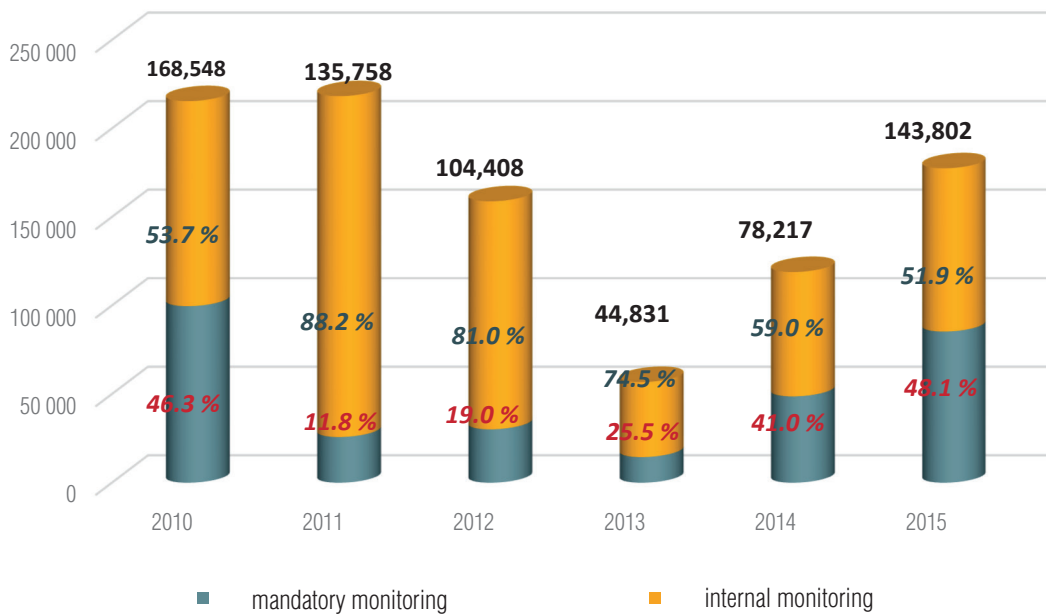


Fig. 2.1.12. Number and fractions of risky financial transactions submitted by the SFMSU to the LEA as part of the SM/ASM with distribution by the mandatory and internal monitoring indicators⁹⁰

⁸⁹ Source: based on the SFMSU data.

⁹⁰ Source: based on the SFMSU data.

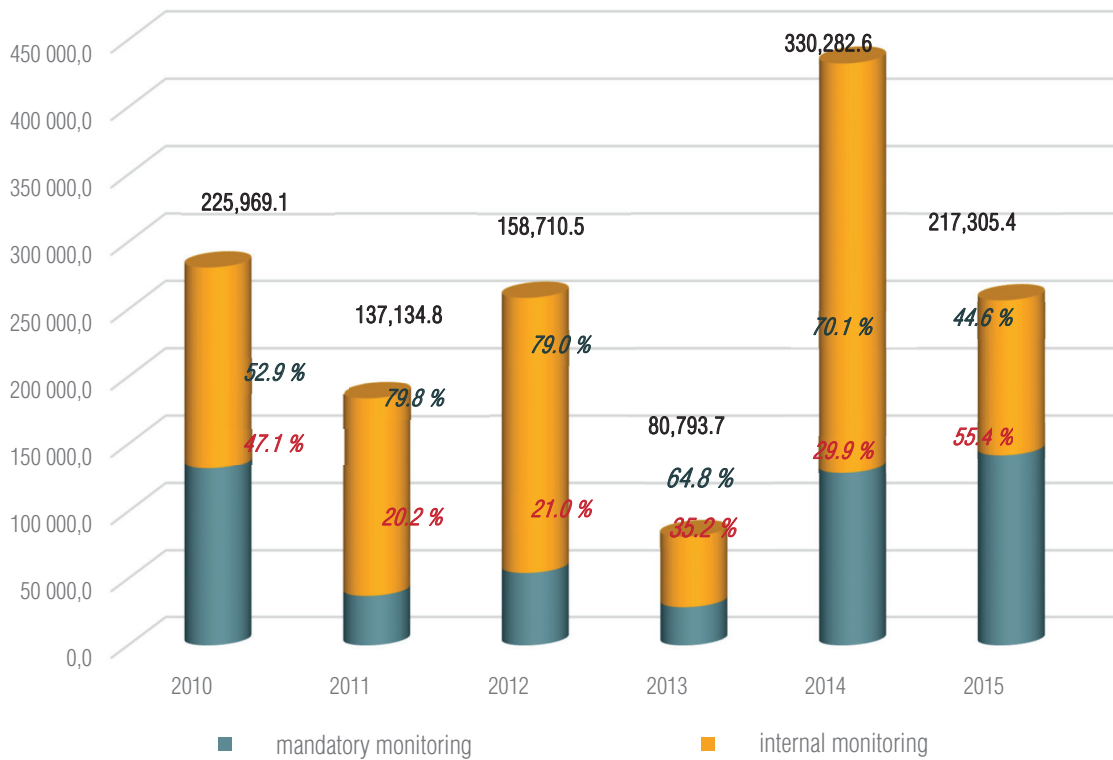


Fig. 2.1.13. Amounts and fractions of risky financial transactions submitted by the SFMSU to the LEA as part of the SM/ASM with distribution by the mandatory and internal monitoring indicators ⁹¹

In view of the technological connection between the SM and ASM described above, it is necessary to analyze the ASM fraction in relation to the total number of the SM submitted to the LEA. The evolution of this share is shown in Fig. 2.1.14.

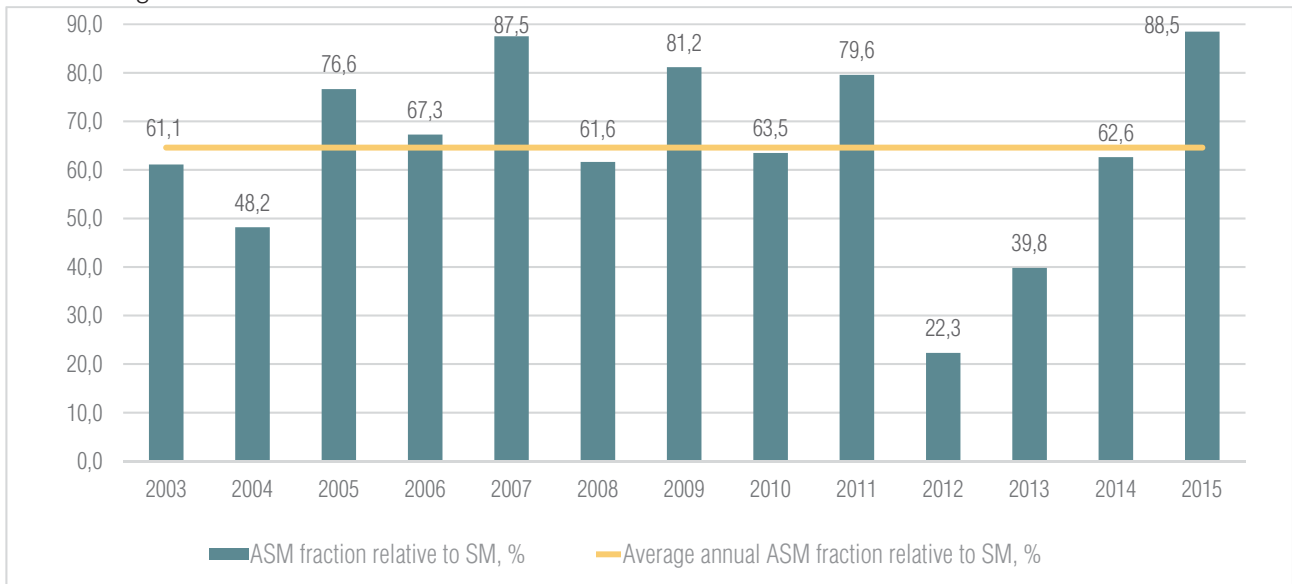


Fig. 2.1.14. Fraction of the ASM in relation to the total number of the SM submitted by the SFMSU to the LEA ⁹²

The results shown in Fig. 2.1.14 can be interpreted in terms of analysis of such a risk event as “non-detection or under-detection of ML and subjects that launder proceeds of crime”. With sufficient initiative, primarily on the part of the LEA and following a proper review of the SFMSU SM, they would have developed additional investigative versions and additional circumstances of the predicate crime and ML-related crime would have been disclosed. Based on the sum total of the newly discovered circumstances, the LEA would have approached the

⁹¹ Source: based on the SFMSU data.

⁹² Source: based on the SFMSU data.

SFMSU for preparation of ASM. Under such circumstances, each set of SM, as a rule, would have been accompanied with at least 1 ASM (the ASM share in relation to SM would have been at least 100 %), and in some cases there could have been more than 1 ASM to each specific SM. The average annual relation of ASM to SM at the level of 65 % in the period from 2003 through 2015 may evidence insufficient initiative of the interaction subjects (LEA, SFMSU) in detecting ML transactions or receiving by them information from other sources than PFMS STRs.

Fig. 2.1.15 demonstrates a moderate direct correlation between the number of the SM submitted to the LEA and the number of the submitted ASM. The approximation confidence level (determination coefficient – R2) is 0.3914, which evidences that only 39,1 % of the ASM submitted to LEA depended on the number of the previously submitted initial SM (such a situation can also be explained by the fact that several ASM may be prepared for one SM at different times on the initiative of the SFMSU, and not LEA, whereas nothing may be prepared for another SM). The regression equation evidences that in 2003-2015 there were only 3 ASM per each 10 SM developed and submitted to the LEA.

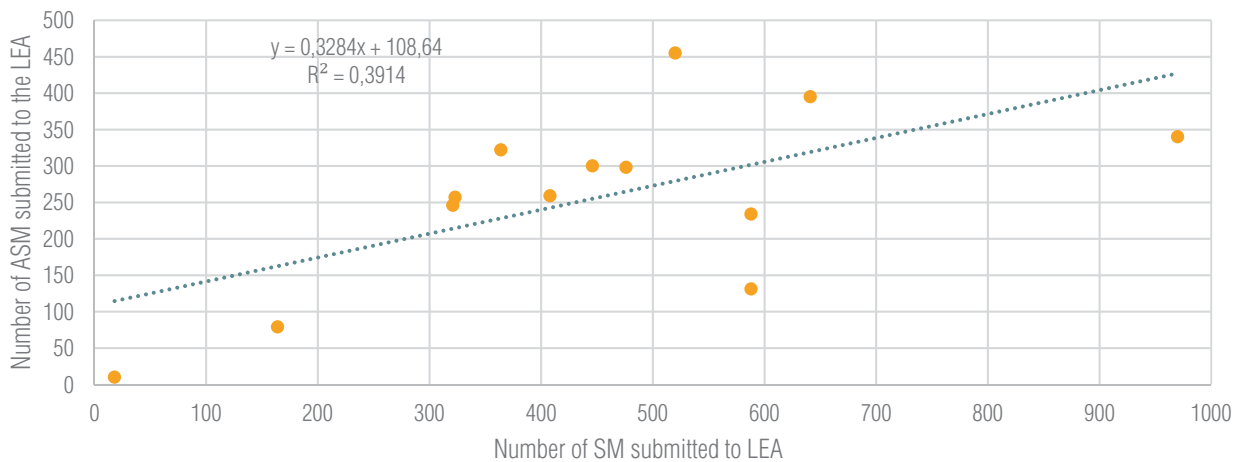


Fig. 2.1.15. Analysis of correlation between the total number of the initial SM submitted to LEA and the number of the submitted ASM⁹³

Fig. 2.1.16 shows the total number of the SM submitted in 2003-2015 by the LEA.

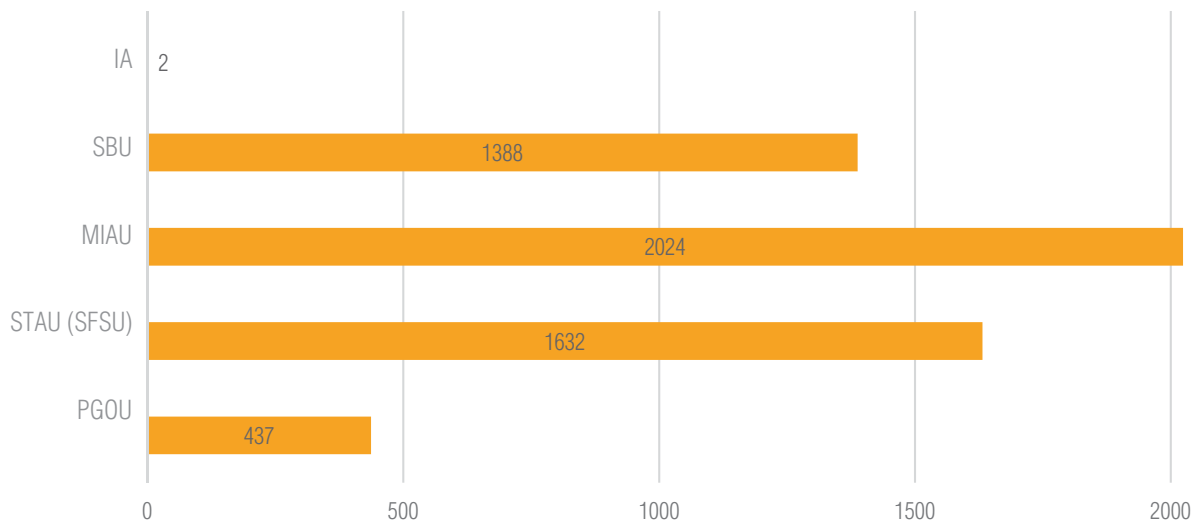


Fig. 2.1.16. Total number of the SM submitted in 2003-2015 with distribution by the LEA and IA⁹⁴

Fig. 2.1.17 shows the annual fraction of the total number of the SM submitted by the SFMSU with distribution by the LEA and IA.

⁹³ Source: based on the SFMSU data.

⁹⁴ Source: based on the SFMSU data.

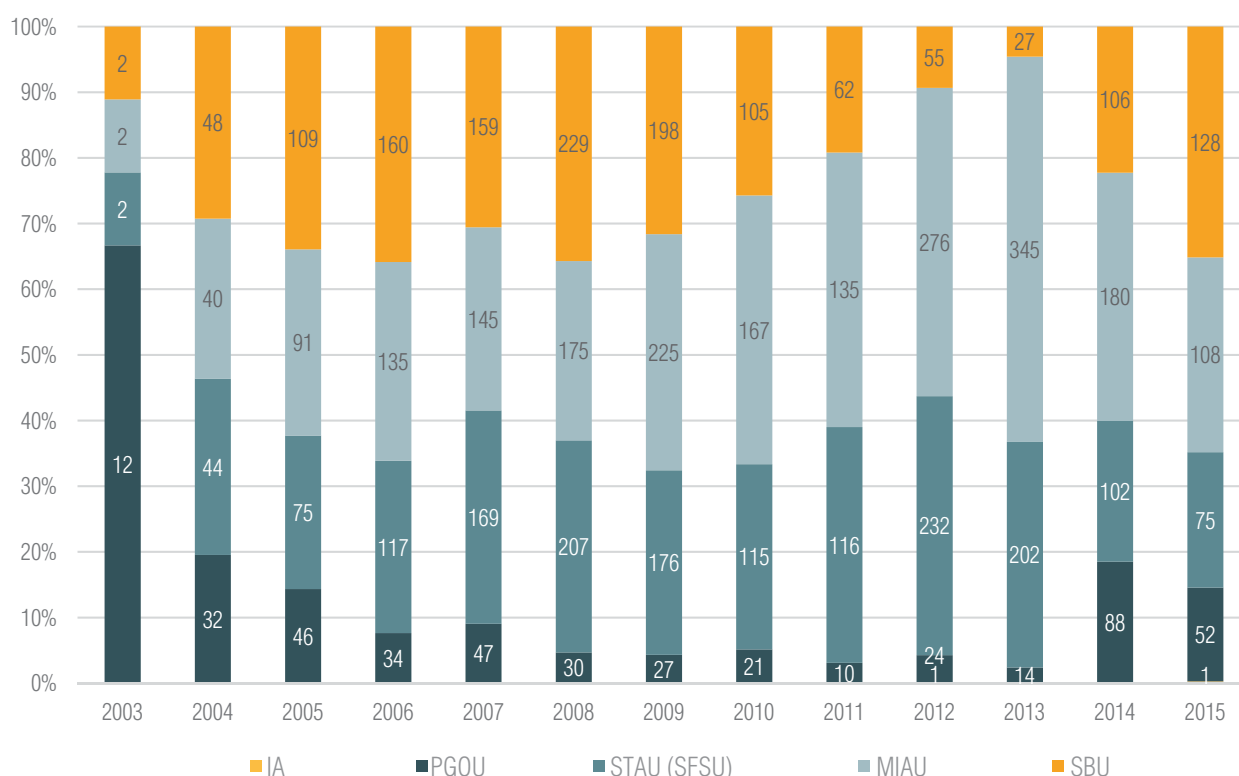


Fig. 2.1.17. Distribution of the SM submitted to the LEA in 2003-2015⁹⁵

Tables 2.1.3 and 2.1.4 show the main risks of financial transactions, by internal monitoring indicators, submitted as part of the SM/ASM (by the number and amounts of transactions submitted).

Indicator	2010		2011		2012		2013		2014		2015	
	pcs	%	pcs	%	pcs	%	pcs	%	pcs	%	pcs	%
Avoiding financial monitoring procedures	40,659	35.1 %	72,570	37.7 %	45,226	35.1 %	10,474	24.8 %	19,687	28.1 %	11,699	12.7 %
Suspicious of ML/FT	39,455	34.1 %	11,130	5.8 %	12,786	9.9 %	5,111	12.1 %	6,220	8.9 %	20,591	22.3 %
Intricate nature of the financial transaction	11,877	10.3 %	6,143	3.2 %	1,800	1.4 %	73	0.2 %	131	0.2 %	56	0.1 %
Regular cash transactions	5,325	4.6 %	18,047	9.4 %	22,864	17.8 %	13,687	32.4 %	15,286	21.8 %	25,343	27.5 %
Financial assistance	1,479	1.3 %	7,277	3.8 %	5,344	4.2 %	4,240	10.0 %	21,136	30.1 %	13,731	14.9 %
Other	16,918	14.6 %	77,223	40.1 %	9,074	7.1 %	269	0.6 %	29,811	42.5 %	26,189	28.4 %
Total	115,713	100.0	192,390	100.0	128,686	100.0	42,289	100.0	70,166	100.0	92,154	100.0

Table 2.1.3. Number of risky financial transactions submitted based on the internal monitoring indicators and provided by the SFMSU to the LEA as part of SM/ASM⁹⁶

⁹⁵ Source: based on the SFMSU data.

⁹⁶ Source: based on the SFMSU data.

Indicator	2010		2011		2012		2013		2014		2015	
	mIn UAH	%	mIn UAH	%	mIn UAH	%	mIn UAH	%	mIn UAH	%	mIn UAH	%
Avoiding financial monitoring procedures	42,404.7	28.5 %	33,602.1	22.9 %	52,057.0	25.5 %	7,796.4	14.7 %	21,705.8	7.1 %	21,035.6	18.4 %
Suspicious of ML/FT	63,161.5	42.5 %	12,875.1	8.8 %	18,276.0	8.9 %	9,600.6	18.1 %	13,820.5	4.5 %	17,610.1	15.4 %
Intricate nature of the financial transaction	13,198.6	8.9 %	5,560.9	3.8 %	1,760.3	0.9 %	41.7	0.1 %	331.4	0.1 %	64.1	0.1 %
Regular cash transactions	8,519.1	5.7 %	30,645.1	20.9 %	64,451.8	31.6 %	20,662.4	39.0 %	120,115.3	39.5 %	27,004.2	23.6 %
Financial assistance	2,943.7	2.0 %	10,726.2	7.3 %	19,889.6	9.7 %	4,350.7	8.2 %	118,677.7	39.0 %	21,895.2	19.1 %
Other	18,473.0	12.4 %	53,567.0	36.4 %	47,790.8	23.4 %	10,475.7	19.8 %	29,380.0	9.7 %	26,975.3	23.5 %
Total	148,700.6	100.0 %	146,976.4	100.0 %	204,225.5	100.0 %	52,927.5	100.0 %	304,030.7	100.0 %	114,584.5	100.0 %

Table 2.1.4. Amounts of risky financial transactions submitted based on the internal monitoring indicators and provided by the SFMSU to the LEA as part of SM/ASM⁹⁷

These data demonstrate that the bulk of risky financial transactions in the submitted SM/ASM is taken by the financial transactions, reports on which were submitted by the PFMS to the SFMSU based on the internal monitoring indicators, as well as transactions related to ML or committing of other crimes detected by the PFMS using their own criteria and risks.

Also, the analysis of the PFMS compliance with the requirements of the Law evidences that failure to meet some requirements for provision of information on financial transactions to the SFMSU is too cumbersome for the PFMS and inefficient, and significantly increases the PFMS expenses on the financial monitoring procedures. Out of the total number of the mandatory and internal financial monitoring indicators, only 10-13% are used by the PFMS when submitting information on financial transactions to the SFMSU.

In 2015, about 89% of the information submitted by the PFMS to the SFMSU was information on the financial transactions subject to mandatory financial monitoring.

At the same time, most financial transactions submitted as part of the SM/ASM were received from the PFMS based on the internal financial monitoring indicators.

Thus, transition to a new reporting structure, which envisages PFMS focusing on the financial transactions in relation to which suspicions arose based on risk assessment and analysis, will help significantly enhance the probability of identifying suspicious financial transactions and unlawful financial flows.

The need to reduce the number of the mandatory financial monitoring indicators was also mentioned in the IMF Report⁹⁸, as well as the need to apply a risk-oriented approach when submitting PFMS information to the SFMSU.

On the mandatory financial monitoring indicators, it should be noted that one of the priorities of selection for the SFMSU investigations in 2015 is analysis of financial transactions effected with participation of senior officials and publicly exposed persons, including members of the previous Government and persons related to them. For example, in 2015 the SM/ASM submitted to the LEA included 20% of reports on the financial transactions effected by publicly exposed persons to the total amount of 27,287 mln UAH.

When analyzing the financial transactions submitted to the LEA, special attention should be paid to the regional distribution of the financial transaction participants.

The regional dependence of the financial transaction participants, information on which the SFMSU submitted to the LEA as part of the SM/ASM in 2010-2015, as well as the number and amounts of transactions effected with their participation are provided below.

⁹⁷ Source: based on the SFMSU data.

⁹⁸ Source: conclusions of the IMF Report on technical assistance related to application of measures to counter legalization of criminal proceeds in support of the counter-corruption efforts (the Financial Intelligence Unit component).

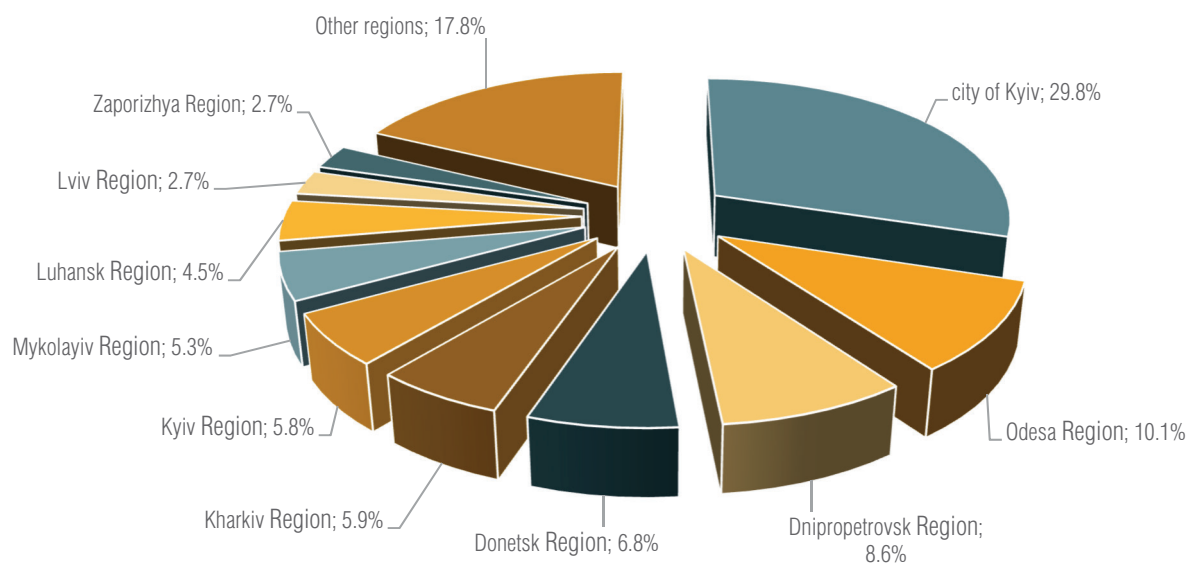


Fig. 2.1.18. Regional distribution of financial transaction participants submitted by the SFMSU to the LEA in SM/ASM⁹⁹

Name of the region	Number of participants						
	2010	2011	2012	2013	2014	2015	Average for 2010-2015
	Q-ty	Q-ty	Q-ty	Q-ty	Q-ty	Q-ty	Q-ty
city of Kyiv	741	437	550	340	883	1,615	614
Odesa Region	352	150	189	83	348	446	203
Dnipropetrovsk Region	262	162	119	181	173	444	195
Donetsk Region	204	85	124	73	258	324	135
Kharkiv Region	104	87	144	92	141	327	126
Kyiv Region	128	69	99	79	169	345	120
Mykolayiv Region	112	57	60	41	124	408	113
Luhansk Region	197	150	127	51	55	129	109
Lviv Region	115	48	59	35	29	125	64
Zaporizhya Region	105	56	45	20	37	142	61
Other regions	584	387	389	163	135	1,092	436
TOTAL	2,904	1,688	1,905	1,158	2,352	5,397	2,175

Table 2.1.5. Number of financial transaction participants submitted to the LEA in SM/ASM with distribution by regions and years

An overview of this data evidences that according to the regional principle, the highest number of clients effecting suspicious transactions is concentrated in large megalopolises, namely the city of Kyiv, followed by the Odesa Region in the second place, and Dnipropetrovsk Region in the third.

The same regions see the highest number of suspicious financial transactions, information on which was submitted by the SFMSU to the LEA.

⁹⁹ Source: based on the SFMSU data.

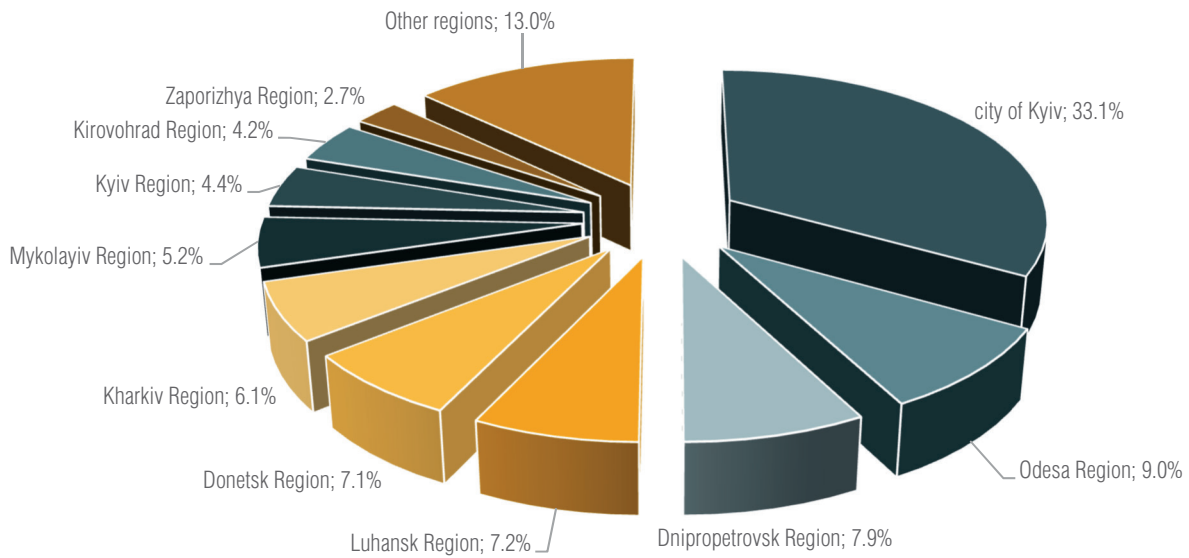


Fig. 2.1.19. Number of STRs submitted by the SFMSU to the LEA in SM/ASM with distribution by regions¹⁰⁰

By the amounts of effected suspicious transactions the leader is the city of Kyiv, second place – Donetsk Region, third place – Dnipropetrovsk Region.

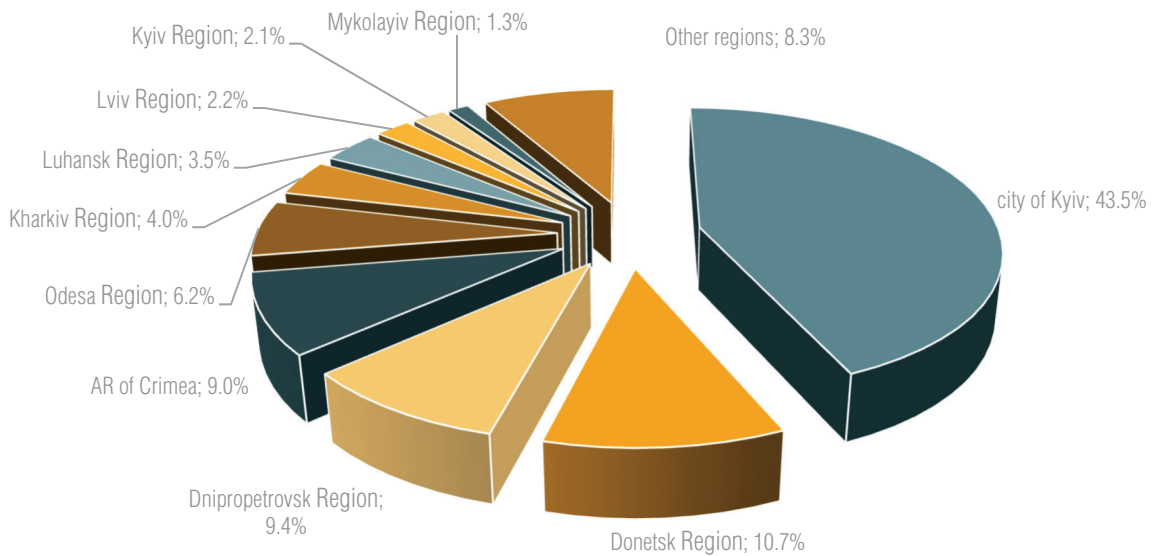


Fig. 2.1.20. Fraction of STRs submitted by the SFMSU to the LEA in SM/ASM with distribution by regions¹⁰¹

Fig. 2.1.21 shows the number of refusals (in bringing criminal charges) and/or dismissal of criminal cases which were brought/started following review by the LEA of the SFMSU SM or in which SM were used.

¹⁰⁰ Source: based on the SFMSU data.

¹⁰¹ Source: based on the SFMSU data.

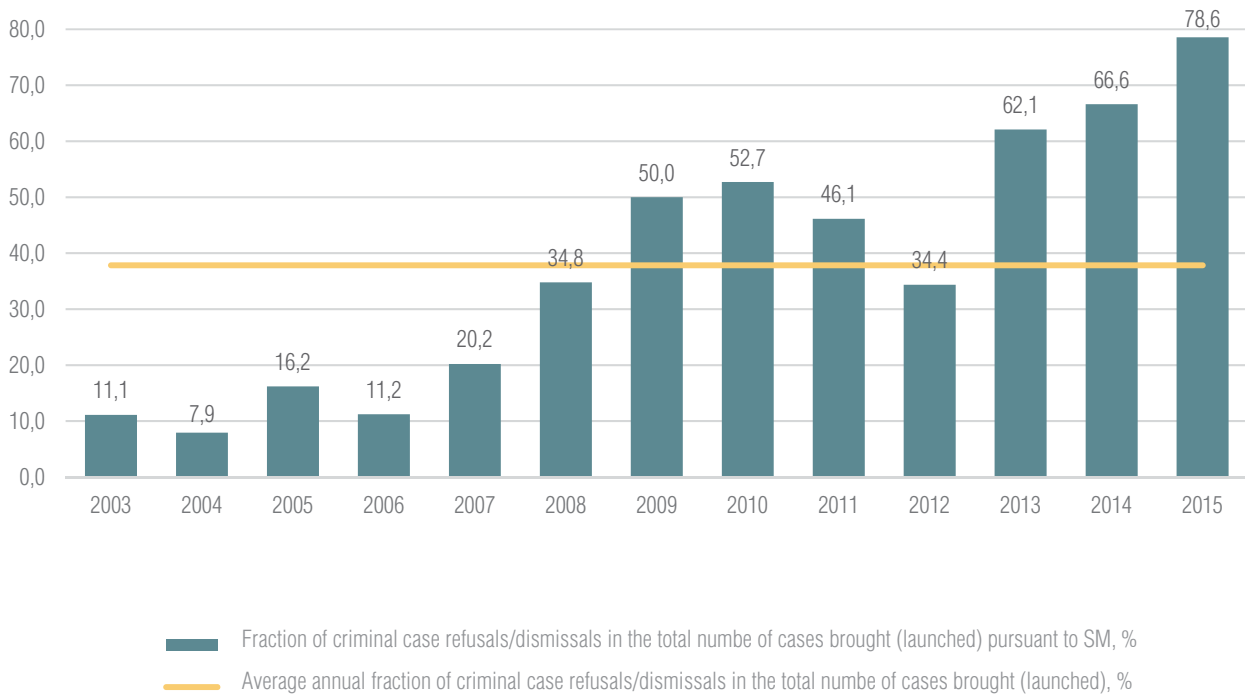


Fig. 2.1.21. Fraction of refusals/dismissals of the criminal cases versus the total number of the criminal cases brought (launched) in 2003-2015¹⁰²

Fig. 2.1.22 shows the annual fraction of refusals/dismissals of criminal cases versus the total number of criminal cases brought (launched) with distribution by the LEA.

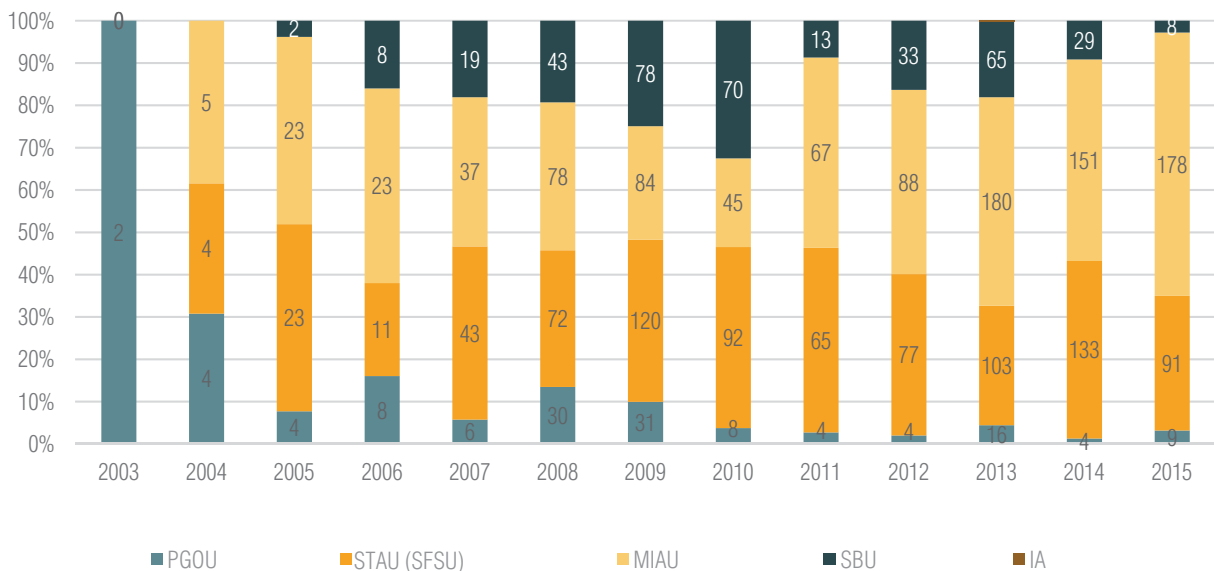


Fig. 2.1.22. Distribution of refusals/dismissals of the SM-based criminal cases brought/launched¹⁰³

¹⁰² Source: based on the SFMSU data. The specific weight calculated as a ratio of the number of refusals to bring SM-based criminal charges/criminal case dismissals submitted in 2003-2015 to the number of SM submitted to the LEA in the current year.

¹⁰³ Source: based on the SFMSU data. The specific weight calculated as a ratio of the number of refusals to bring SM-based criminal charges/criminal case dismissals submitted in 2003-2015 to the number of SM submitted to the LEA in the current year.

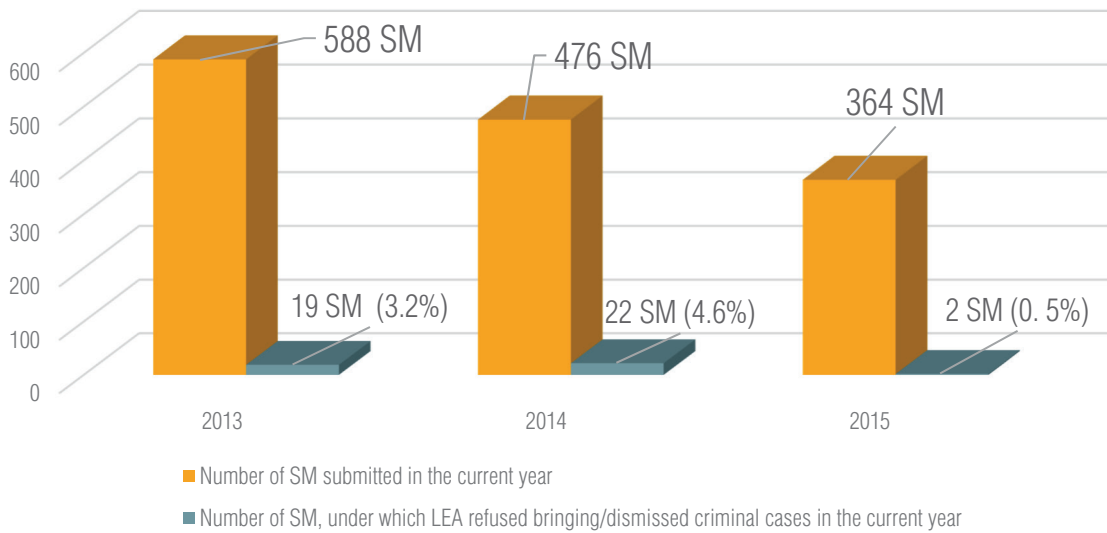


Fig. 2.1.23. Number and specific weight of SM under which a decision to refuse/dismiss a criminal case was made in the current year

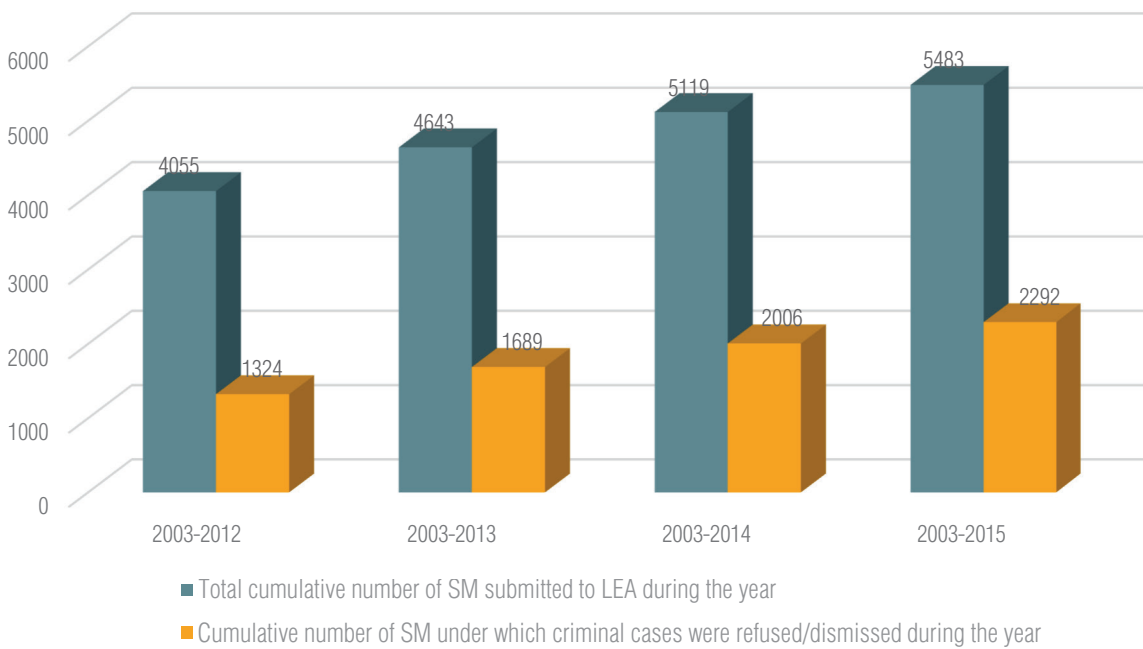


Fig. 2.1.24. Cumulative number of SM under which criminal cases were refused/dismissed in 2003-2015

Fig. 2.1.25 shows a cumulative (accrued) number of criminal cases refused/dismissed in 2003-2015 with distribution by the LEA.

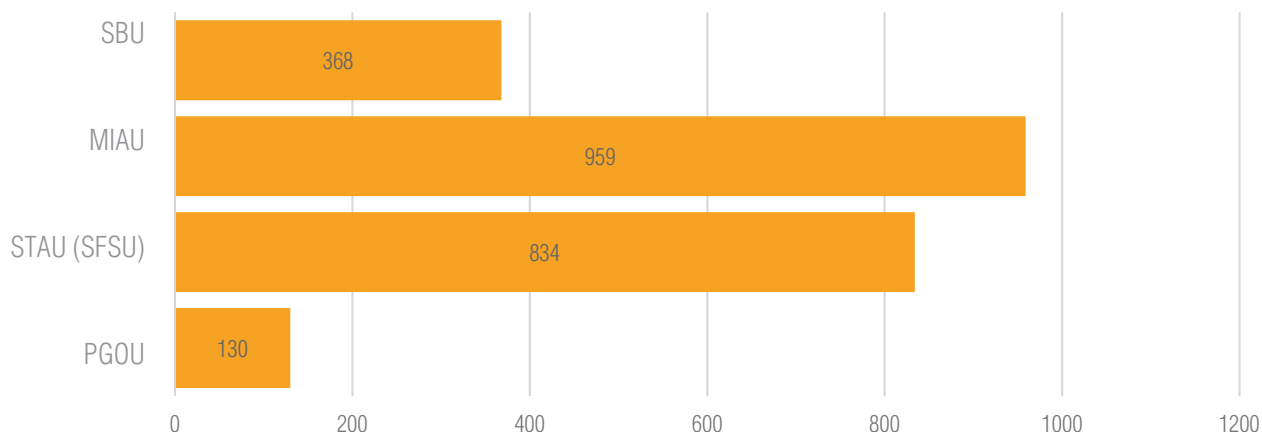


Fig. 2.1.25. Cumulative number of the SM-based criminal cases refused/dismitted in 2003-2015 with distribution by the LEA¹⁰⁴

Fig. 2.1.26 illustrates the specific weight of criminal cases refused/dismitted with distribution y the LEA.

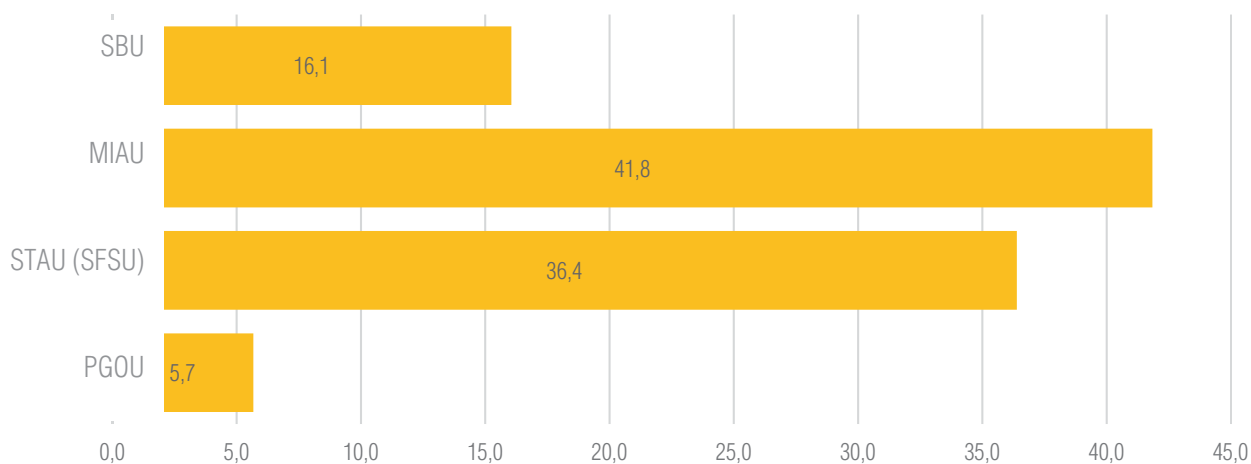


Fig. 2.1.26. Specific weight of the SM-based criminal cases refused/dismitted in 2003-2015 with distribution by the LEA¹⁰⁵

Indicators	2003-2012	2013	2014	2015	Total
Number of SM submitted to LEA/IA	4,055	588	476	364	5,483
Number of SM (including provided in the previous years) which were used by the LEA/IA to launch criminal cases/in the criminal cases	2011	791	584	358	3,744
Number of SM on which the pre-trial investigation was completed and the indictment submitted to court	statistics was not kept	209	83	62	354
Number of completed pre-trial investigations due to submitting an indictment to court	575	177	79	58	889

¹⁰⁴ Source: based on the SFMSU data.

¹⁰⁵ Source: based on the SFMSU data.

Total number of arrested/seized property (funds)	statistics was not kept	598.68 mln UAH	3,070.22 mln UAH	5,492.61 mln UAH	9,161.51 mln UAH
Criminal cases reviewed by courts	388	115	156	70	729
Number of persons in relation to which the court reviewed criminal cases based on submitted SM	statistics was not kept	175	228	112	671
Amount of legalized proceeds (funds or other property) of crime established by court	statistics was not kept	39.97 mln UAH	0.07 mln UAH	19.60 mln UAH	59.64 mln UAH
Amount of money (property) (seized/voluntarily reimbursed during pre-trial investigation) established by court and to be returned to the country under the verdict	statistics was not kept	132.30 mln UAH	26.13 mln UAH	14.62 mln UAH	173.05 mln UAH

Table 2.1.6. Results of review of the SFMSU SM by the LEA/IA in 2003-2015

Fig. 2.1.27 demonstrates the evolution of the PFMS reports on the financial transactions, the information on which was included in the SM (ASM). In 2003-2015, SM (ASM) on the average annually contained 128,370 STRs from the PFMS. The cumulative (accrued over the contemplated period) number of the PFMS STRs included in the SM (ASM) as of Jan. 1, 2016 was 1,668,804 STRs.

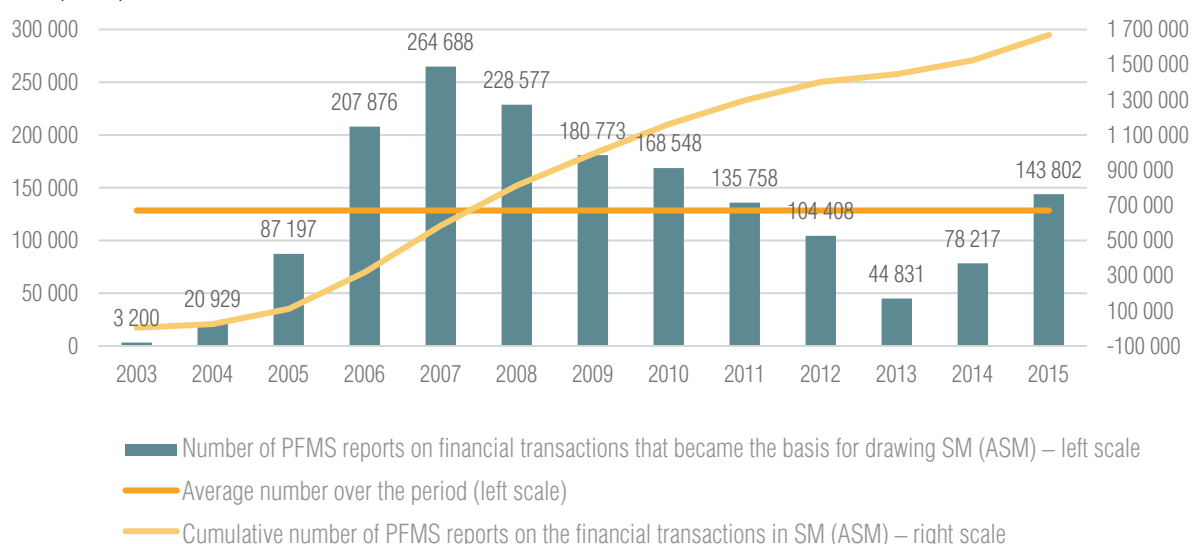
Fig. 2.1.24. Number of STRs from PFMS that became the basis for SM (ASM)¹⁰⁶

Fig. 2.1.28 shows the evolution of the fraction of PFMS STRs that became the basis for SM (ASM) versus the total number of all the STRs received from the PFMS in 2003-2015. It should be noted that the average fraction over the period was 12.6 %.

¹⁰⁶ Source: based on the SFMSU data.

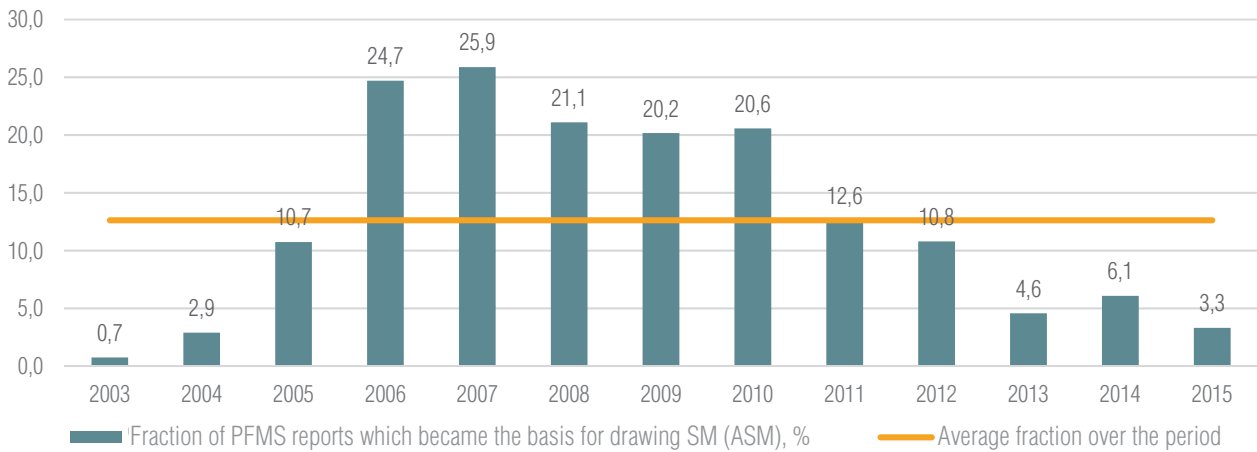


Fig. 2.1.28. Fraction of STRs from PFMS that became the basis for SM (ASM) versus the total number of STRs received by the SFMSU in 2003-2015¹⁰⁷

Fig. 2.1.29 shows that about 9 STRs out of 100 received from the PFMS become the basis for SM (ASM) through analytical work of the SFMSU in cooperation with LEA and foreign FIU. At the same time, the determination coefficient explains only 1.2 % of changes in the relevant resulting indicator depending on the factor one. This fact, established through analysis of the 12-year functioning of the national AML/CFT system, can be considered one of the main occurrence factors of a risk event related to the fact that the PFMS-detected financial transactions related to money laundering subsequently are not properly verified and analyzed by the relevant interaction subjects along the SFMSU – LEA line.

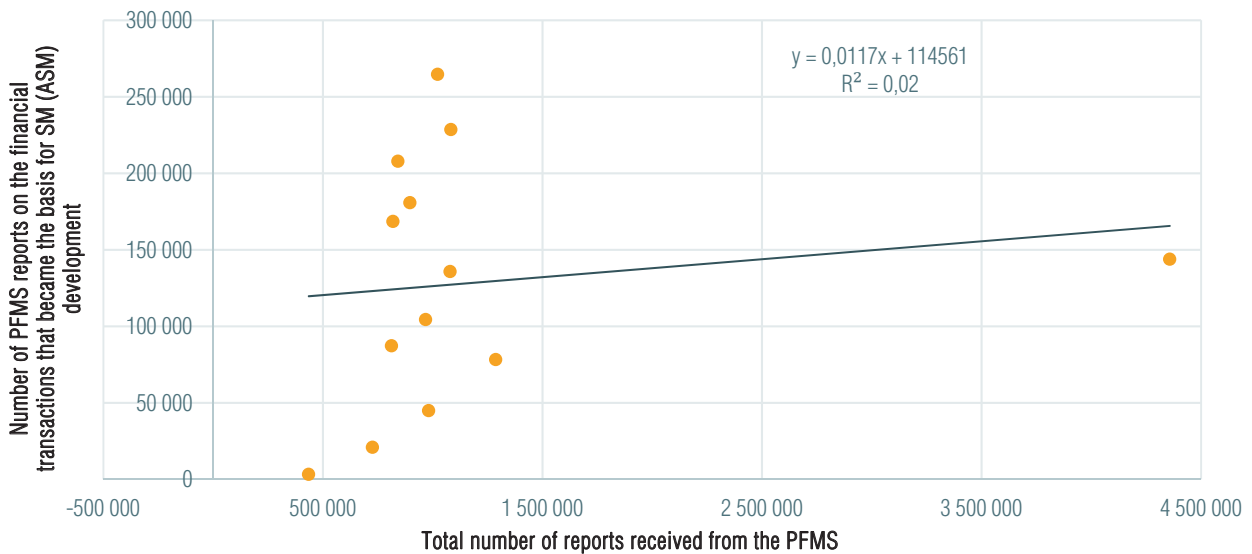


Fig. 2.1.29. Analysis of relation between the total number of STRs received from the PFMS and the number of those used as a basis for SM (ASM)¹⁰⁸

One of the reasons for a missing correlation between the total number of the reports received by the SFMSU from the PFMS and the number of the reports used as a basis for SM (ASM) may be the fact that the SFMSU and the law enforcement system of Ukraine focuses not on the large number of reports on minor suspicious financial transactions, but on a smaller number of the reports that contain information on significant amounts of suspicious financial transactions. In this context, additional risk-oriented analysis of a similar correlation was made with a link to the amounts of financial transactions in the PFMS reports that were included in the SM (ASM).

Fig. 2.1.30 shows the amounts of financial transactions included in the SM (ASM) both in the nominal (current) and in the real (comparison with 2010) prices. As of the end of 2015, the cumulative (accrued starting June 2003) amount of the financial transactions was 1 trillion UAH in the current prices, which translates to 567.3 bln UAH in the comparative prices of 2010 or 126.7 bln USD. On the annual average (calculated in the comparative prices of 2010), the SM (ASM) included PFMS suspicious transaction reports to the amount of 80.9 bln UAH.

¹⁰⁷ Source: based on the SFMSU data.

¹⁰⁸ Source: based on the SFMSU data.

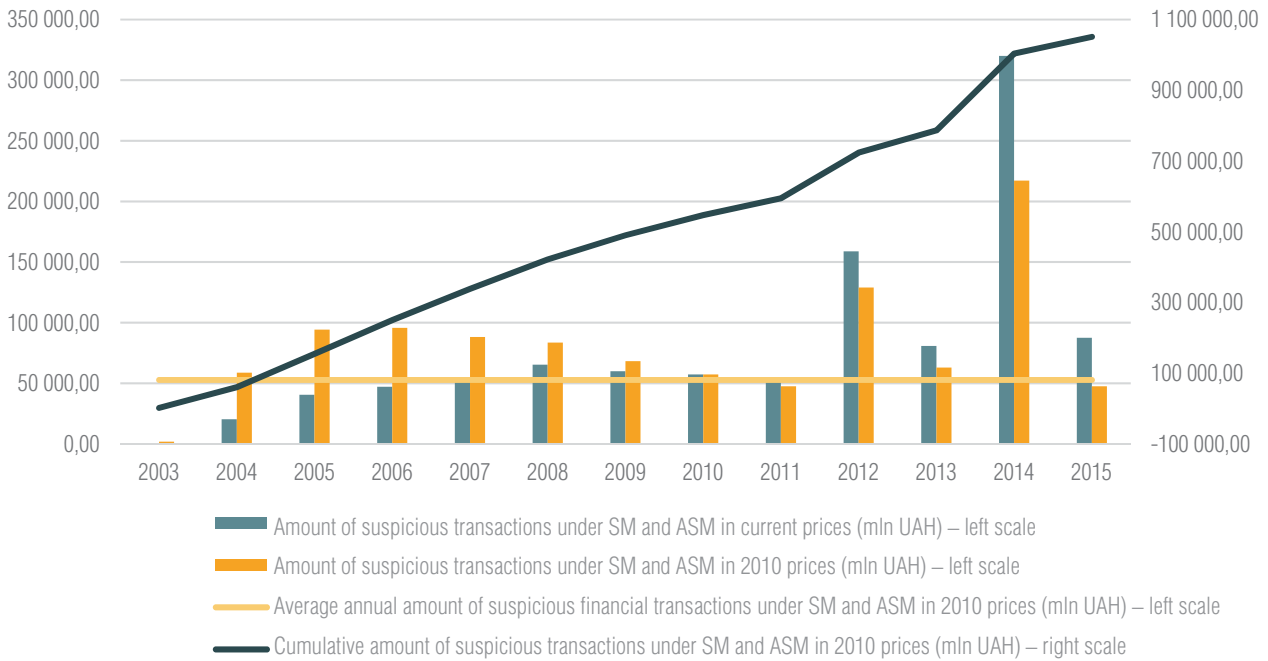


Fig. 2.1.30. Amounts of financial transactions based on the PFMS reports Included in the SM (ASM)¹⁰⁹

Fig. 2.1.31 shows additional evidence of the missing direct correlation between the amount of PFMS-reported suspicious financial transactions received by the SFMSU and the amount of such suspicious financial transactions included in the SFMSU SM (ASM), both in the current and comparative prices of 2010. In both charts, the approximation confidence level (determination coefficient – R2) does not exceed 0,05.

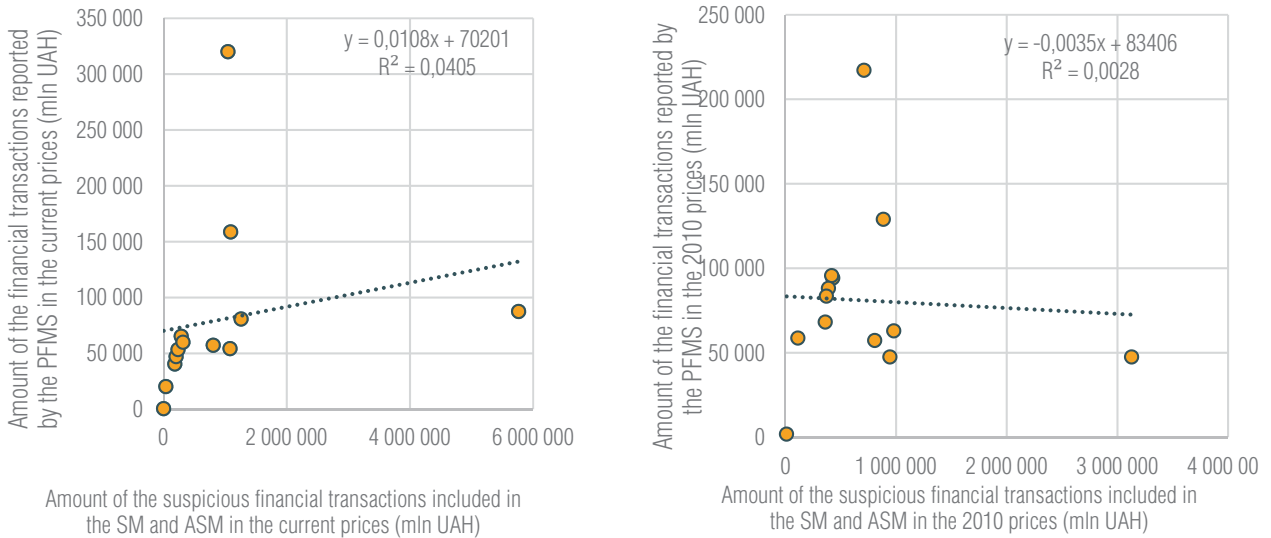


Fig. 2.1.31. Analysis of correlation between the amount of PFMS-reported suspicious financial transactions included in the SM (ASM) in the current prices (left figure) and in the comparative 2010 prices (right figure)¹¹⁰

The analysis of the regression correlation between the above indicators measured in the current prices evidences that only 8.1 % of the amounts of the financial transactions included in the SM (ASM) depend on the amount of the reports received from PFMS. The regression correlation measured in the actual prices of 2010 gives reason to state an even smaller dependence between the two contemplated indicators – at the level of 0.3 %.

Thus, it confirms the previous identified risk of incomplete detection by the interaction subjects along the SFMS-LEA line of the ML/FT-related financial transactions detected by the PFMS.

¹⁰⁹ Source: based on the SFMSU data.

¹¹⁰ Source: based on the SFMSU data.

The following figures illustrate the number of the SM (ASM) prepared by the SFMSU independently (on its own initiative) and the number of those prepared in response to a LEA request.

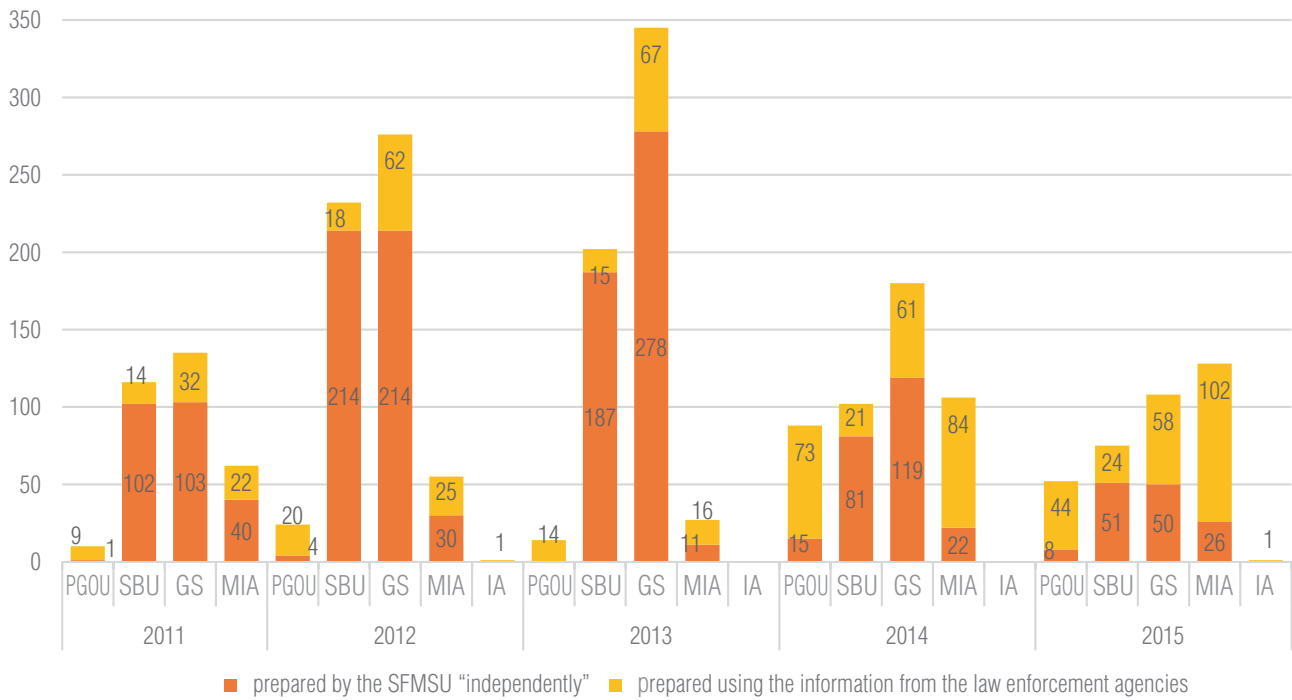


Fig. 2.1.32. SM submitted by the SFMSU to the LEA¹¹¹

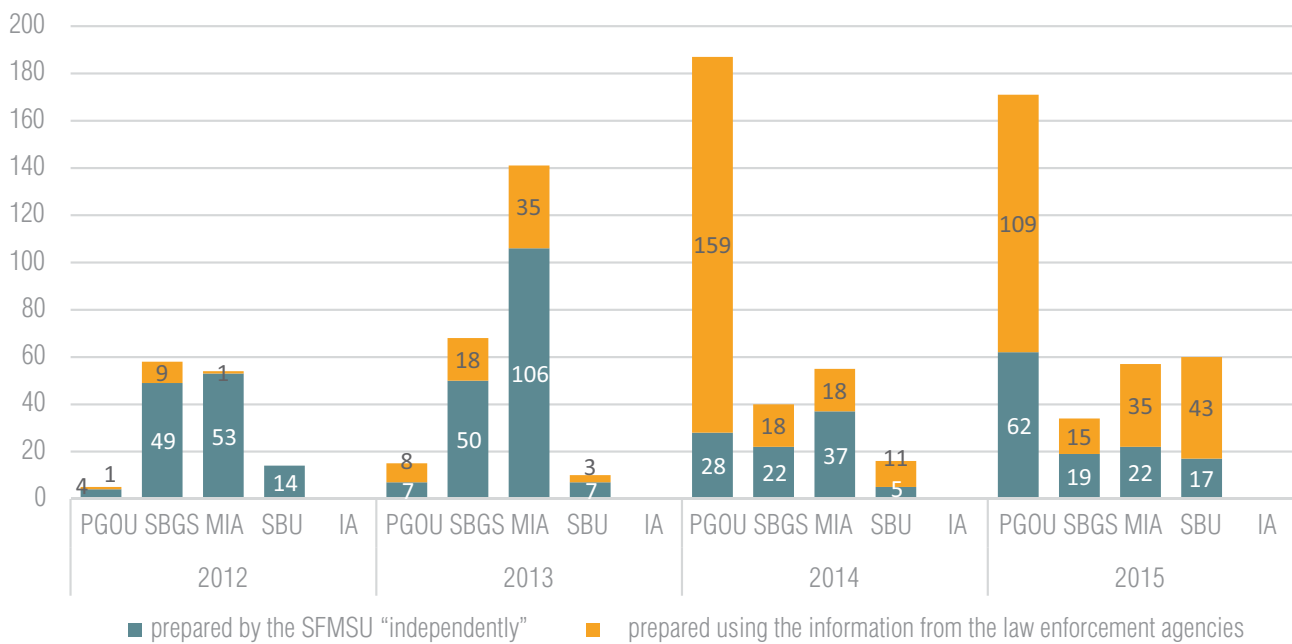


Fig. 2.1.33. ASM submitted by the SFMSU to the LEA¹¹²

In 2013, the SFMSU received 573 requests from the law enforcement authorities, in 2014 – 1,255 requests, in 2015 – 1,341 requests from the LEA for performing financial monitoring.

The following figure illustrates the specific number of the SM (ASM) prepared by the SFMSU independently (on its own initiative) and the number of those prepared in response to a LEA request versus the total number of the SM and ASM prepared by the SFMSU.

¹¹¹ Source: based on the SFMSU data.

¹¹² Source: based on the SFMSU data.

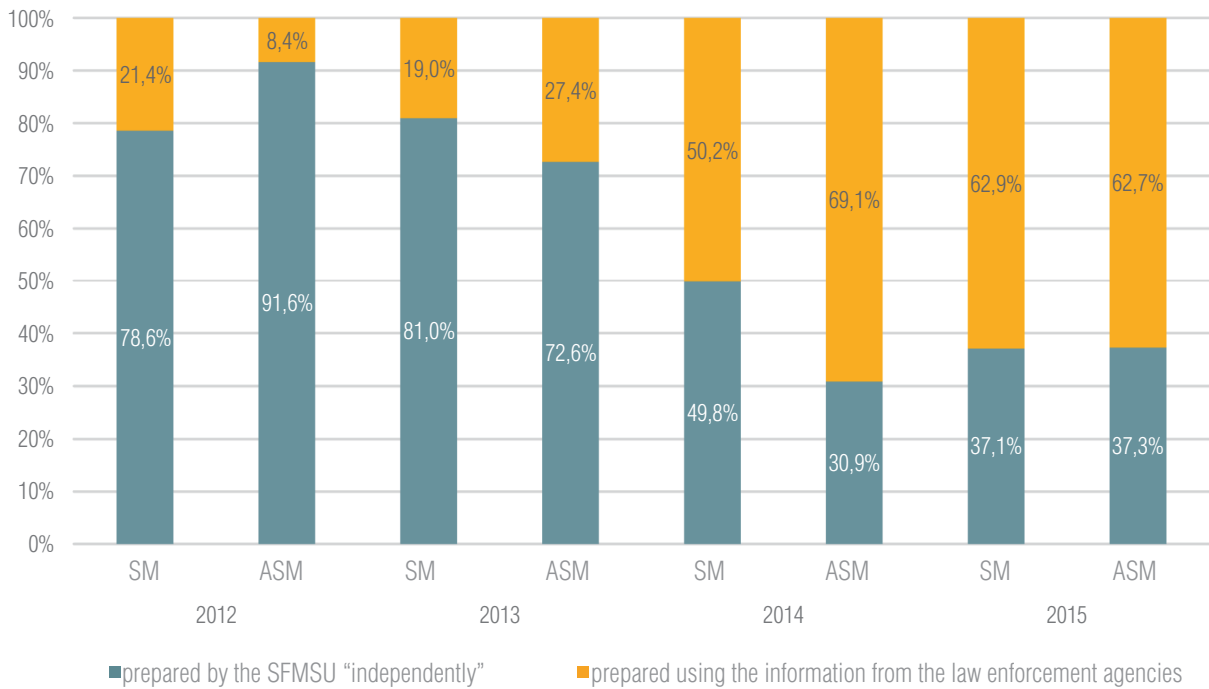


Fig. 2.1.34. Specific weight of the SM (ASM) prepared by the SFMSU¹¹³

It will be observed from the figure that the specific weight of the SM and ASM, according to the LEA in 2012-2015, gradually increased with a simultaneous reduction in the weight of the SM and ASM "independently" prepared by the SFMSU, which evidences an improvement in the LEA activities in the context of informing the SFMSU on the detected ML suspicions (such informing is mandatory for the LEA for each fact of a detected suspicion pursuant to the requirements of the Law).

To analyze the efficiency with which LEA detect ML-related crimes, let us analyze the information on the review status of the criminal cases started pursuant to the SM submitted by the SFMSU.

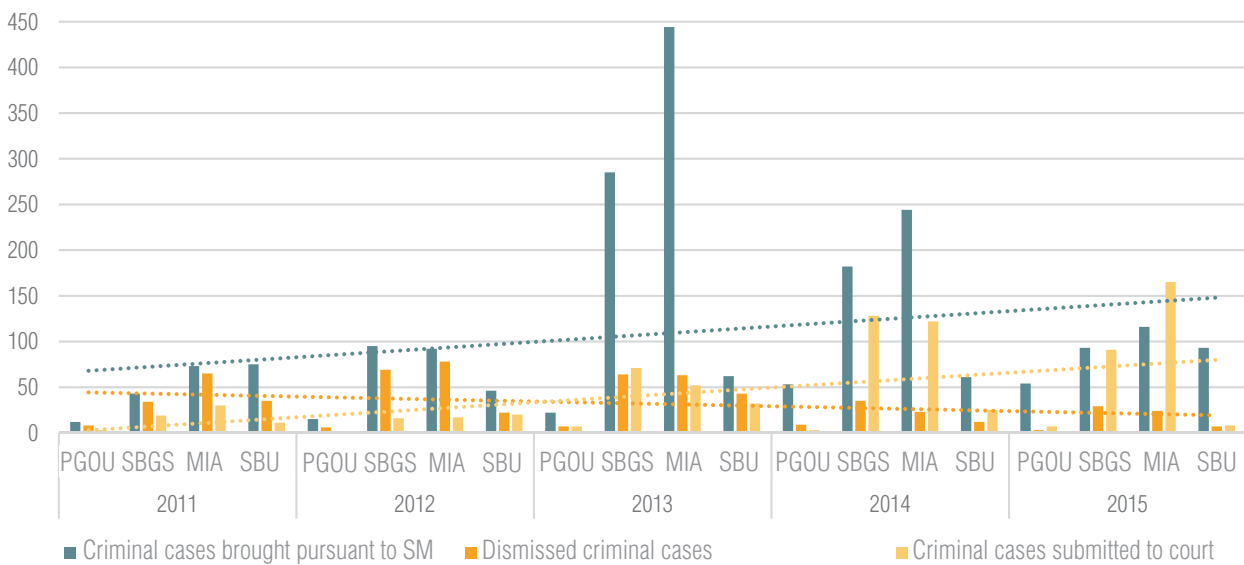


Fig. 2.1.35. Review status of the criminal cases started pursuant to the SFMSU-submitted SM¹¹⁴

It will be observed from the figure below that each period, starting 2011, is characterized by a declining trend in the number of criminal cases which use SM and the number of completed criminal cases due to submittal of an indictment to court.

¹¹³ Source: based on the SFMSU data.

¹¹⁴ Source: based on the SFMSU data.

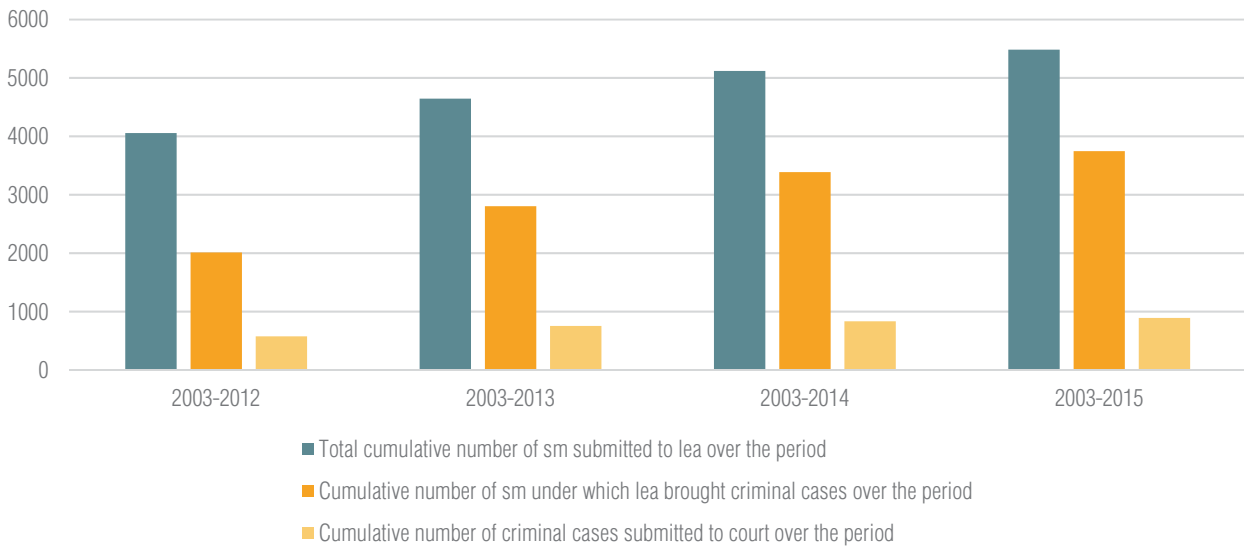


Fig. 2.1.36. Cumulative number of SM under which criminal cases were brought and submitted to court in 2003-2015

At the same time, the period of 2011-2015 saw a trend towards dismissal of criminal cases by the LEA.

A reduction in the number of completed criminal cases due to submittal of an indictment to court with a simultaneous reduction in the started criminal cases based on the SFMSU-submitted SM and a simultaneous increase in the number of dismissed criminal cases may testify to inappropriate detection by the LEA of violations with indicators of ML.

Another risk zone related to detection of ML financial transactions can be identified by an in-depth analysis of the audit processes and decision-making based on the review by the LEA of the SFMSU SM (ASM).

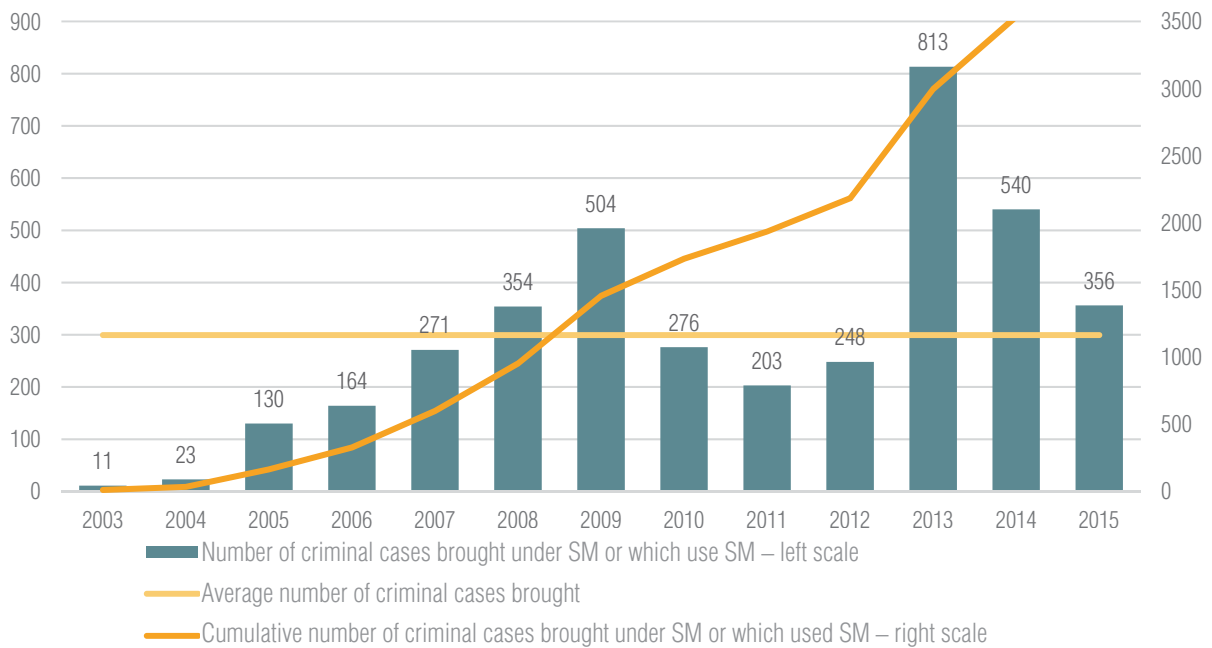


Fig. 2.1.37. Number of criminal cases brought (launched) pursuant to SM/ASM or which used SM/ASM¹¹⁵

Fig. 2.1.37 shows the qualitative characteristics of the LEA review and verification of the SFMSU SM. In 2003-2015 LEA brought (launched) 3,893 criminal cases. Annually, the LEA on the average brought (launched) 299 criminal cases which were based on the SM verification or in which SM/ASM were used.

¹¹⁵ Source: based on the SFMSU data.

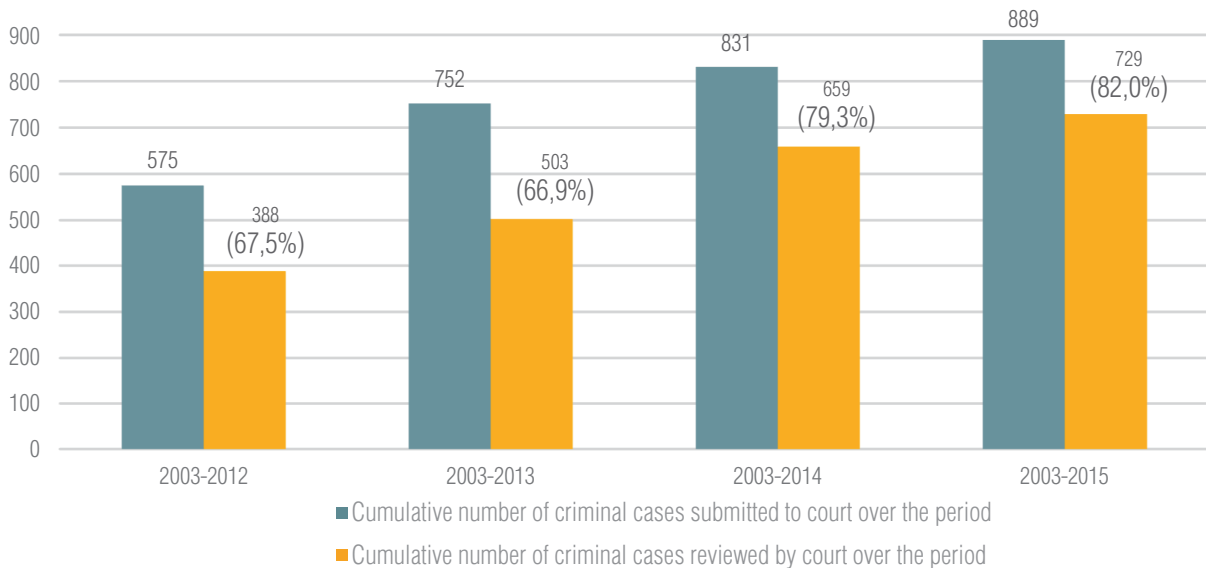


Fig. 2.1.38. Cumulative number and specific weight of the criminal cases reviewed by court in 2003-2015

Fig. 2.1.39 shows a significant direct correlation between the number of the primary SM/ASM submitted to the LEA and the number of the criminal cases which were brought (launched) by the LEA pursuant to SM/ASM or in which SM/ASM were used in 2003-2015. The approximation confidence level (determination coefficient – R²) is 0.5691, which evidences that almost 57 % of the criminal cases with indicators of predicate offenses and/or ML brought (launched) by the LEA depended on the SM/ASM developed and submitted by the SFMSU. The regression equation evidences that in 2003-2015 there were 4 brought (launched) criminal cases per 10 SM/ASM developed and submitted to the LEA.

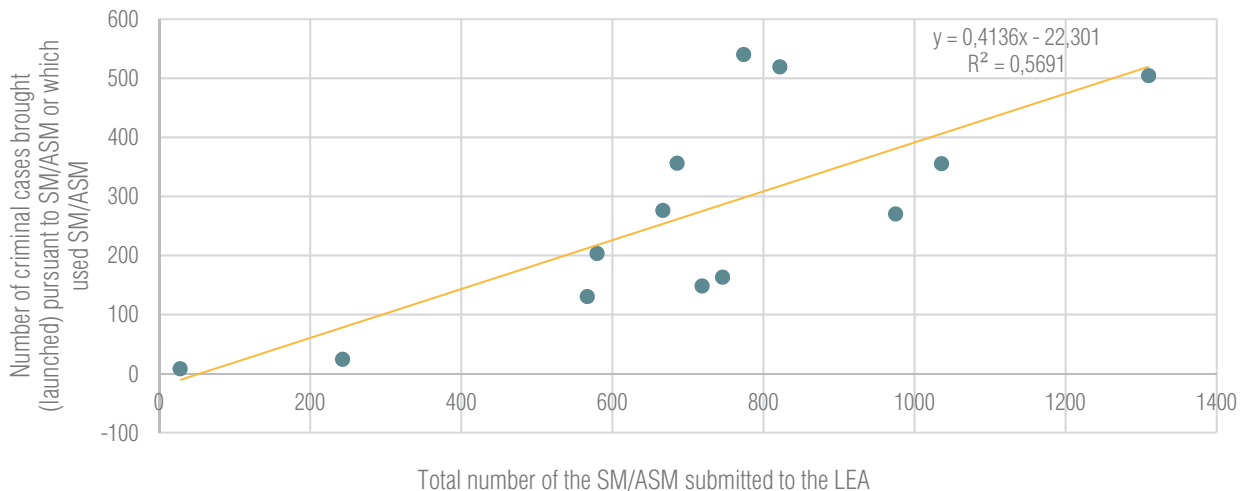


Fig. 2.1.39. Analysis of the correlation/regression dependence between the total number of the SM/ASM submitted to the LEA and the number of criminal cases which were brought (launched) by the LEA pursuant to SM/ASM or in which SM/ASM were used in 2003-2015¹¹⁶

Fig. 2.1.40 shows that the cumulative number of the criminal cases brought (launched) pursuant to SM/ASM or those which used SM/ASM that were submitted to court, at the end of 2015, was 889 (33.4 % of the cumulative number of the criminal cases reviewed by courts in 2003-2015 and 40.7 % of the cumulative number of the criminal cases in this category brought (launched) by the LEA over a similar period). The average annual number of the criminal cases of this category submitted to court was 82.

¹¹⁶ Source: based on the SFMSU data.

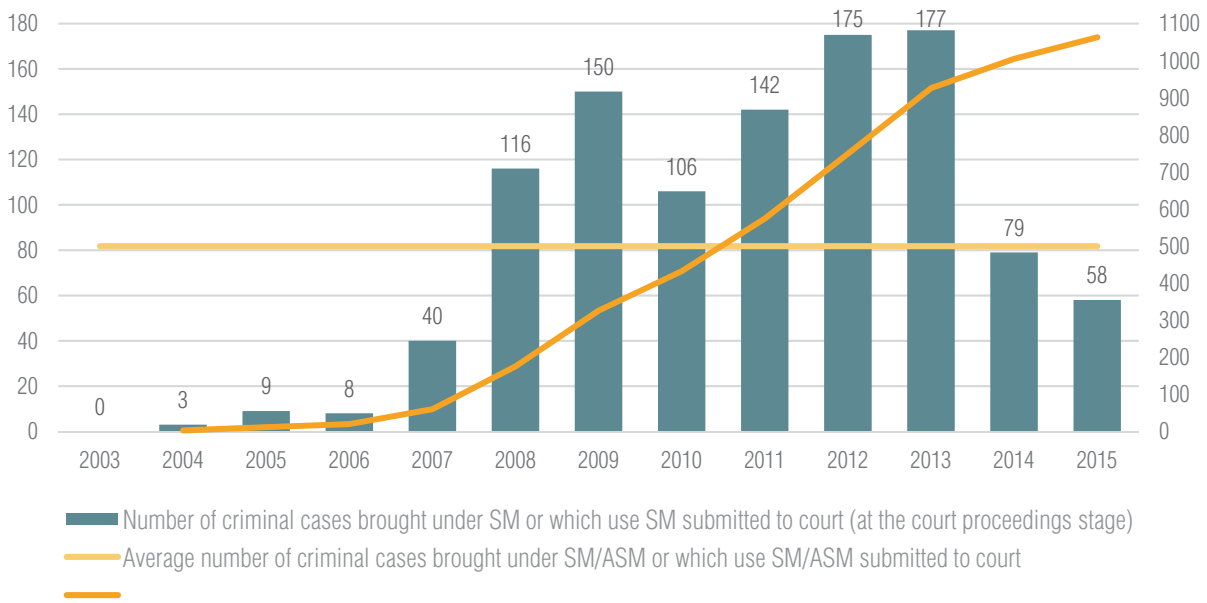


Fig. 2.1.40. Number of criminal cases brought (launched) pursuant to SM/ASM or which used SM/ASM submitted to courts (were at the court proceeding stage) in 2003-2015¹¹⁷

Fig. 2.1.41 shows a moderate direct correlation between the number of the criminal cases brought (launched) pursuant to SM/ASM or which used SM/ASM and the number of the criminal cases in this category submitted to court by the LEA in 2003-2015. The determination coefficient – R² is 0.3375, which evidences that almost 34 % of the criminal cases in this category (predicate offenses, ML) submitted to court depended on the criminal cases previously brought (launched) by the LEA and which used the SFMSU SM/ASM. The regression equation evidences that in 2003-2015 only every 2nd out of 10 brought (launched) criminal cases of this category made it to court.

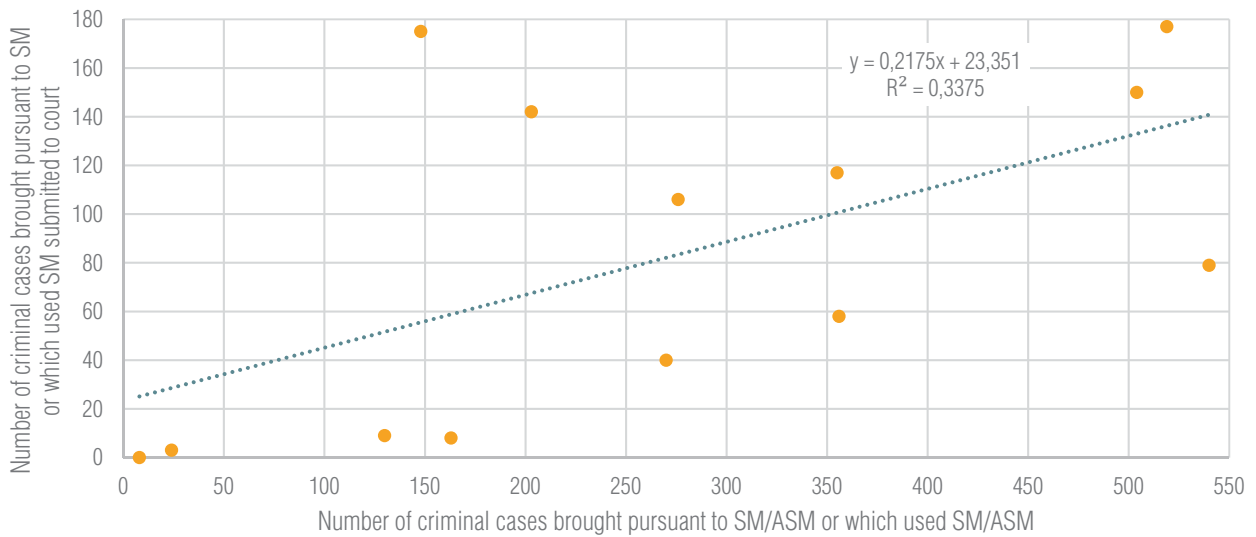


Fig. 2.1.41. Analysis of the correlation/regression dependence between the number of the criminal cases brought (launched) pursuant to SM/ASM or which used SM/ASM and the number of the criminal cases in this category submitted to court by the LEA in 2003-2015¹¹⁸

Of the above criminal cases in the corresponding category submitted to courts, the courts reviewed and passed a guilty/not guilty verdict in 729 criminal cases (82 % of the cumulative number of the criminal cases sent to court).

¹¹⁷ Source: based on the SFMSU data.

¹¹⁸ Source: based on the SFMSU data.

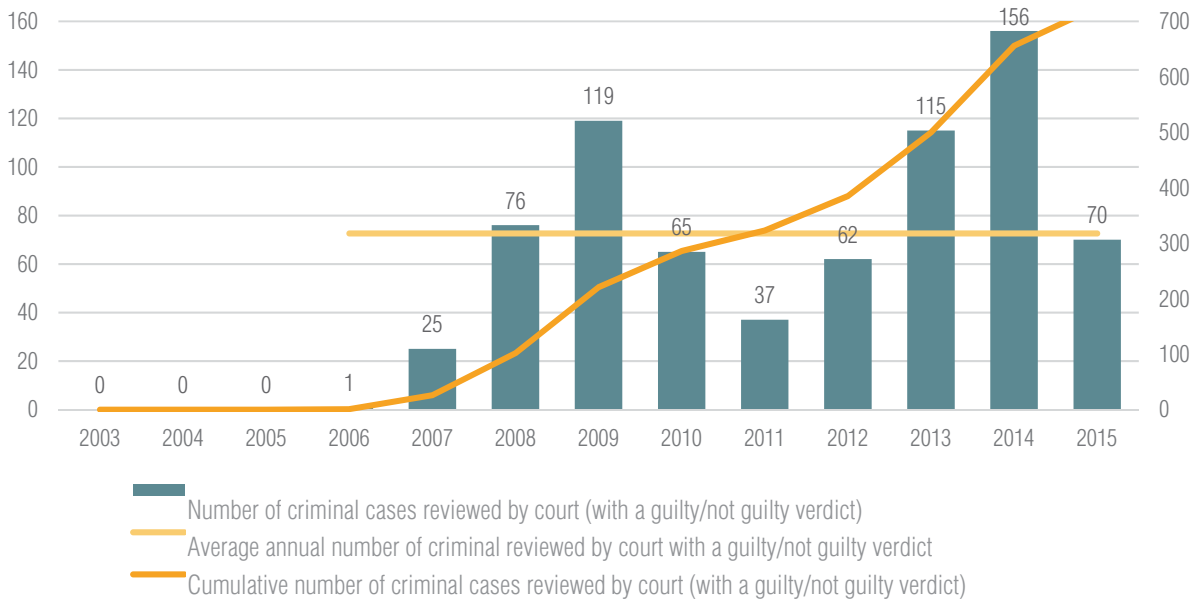


Fig. 2.1.42. Number of criminal cases reviewed by courts with a verdict in 2003-2015

Fig. 2.1.43 demonstrates absence of even a weak correlation between the amount of financial transactions based on the PFMS reports and the amount of money recognized by court as legalized.

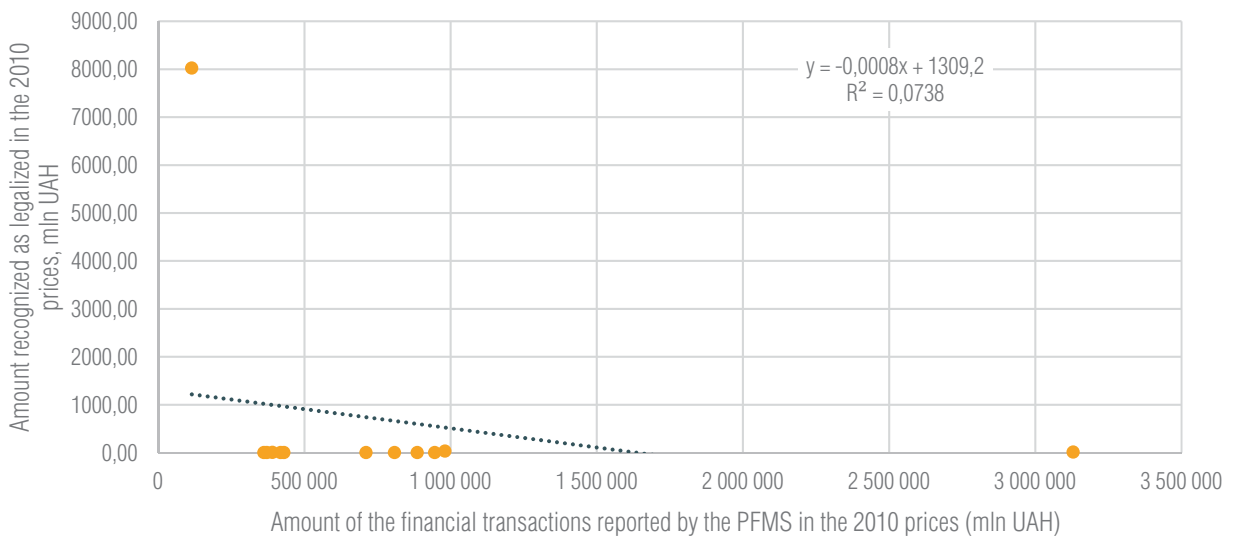


Fig. 2.1.38. Analysis of the correlation/regression dependence between the amount of financial transactions according to the PFMS reports and the amount of money recognized as legalized by court in 2004-2015¹²⁰

Even more indicative is absence of even a weak correlation between the amount of money recognized by court as legalized and the amount returned to the country's revenues.

¹¹⁹ Source: based on the SFMSU data.

¹²⁰ Source: based on the SFMSU data.

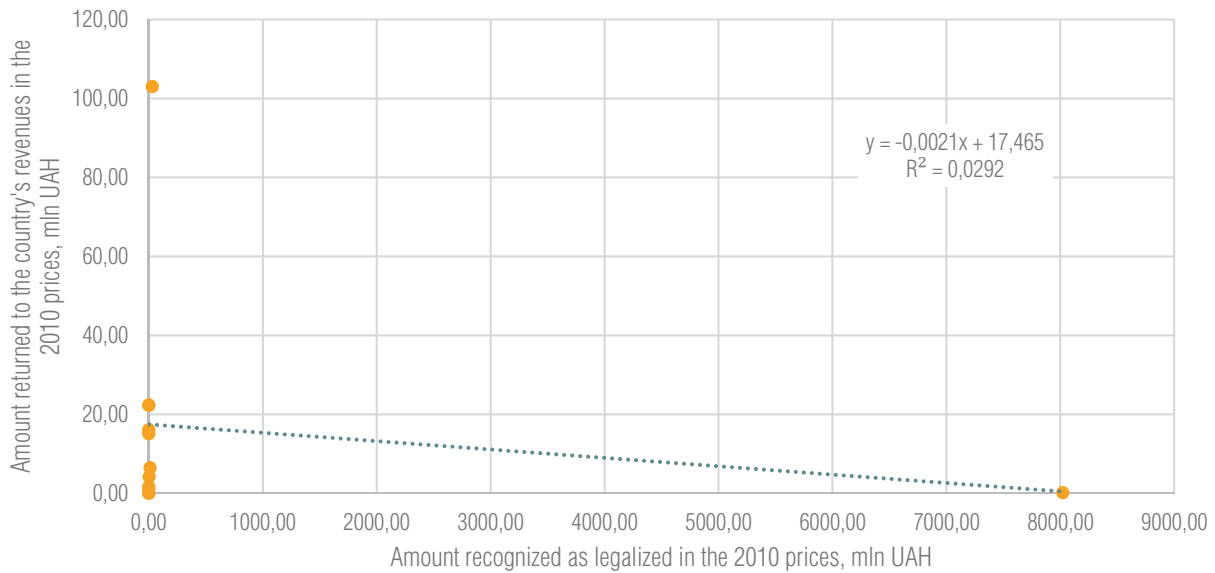


Fig. 2.1.44. Analysis of correlation/regression dependence between the amount recognized by court as legalized and the amount returned to the country's revenues in 2004-2015¹²¹

Another tool of the SFMSU AML/CFT activities is stopping of financial transactions.

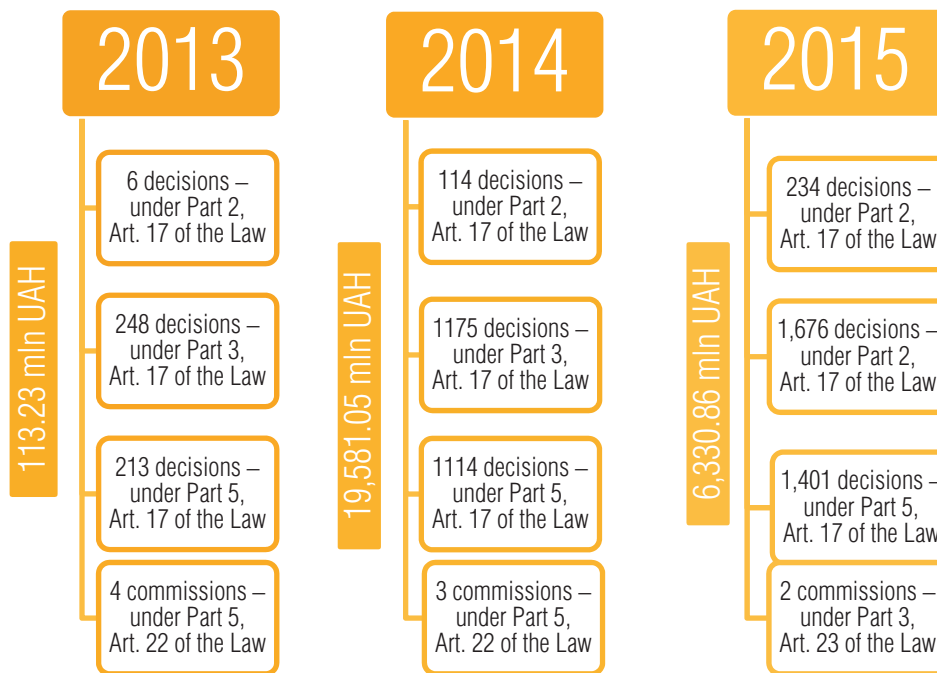


Fig. 2.1.45. SFMSU decisions and commissions on the financial transactions stopped in 2013-2015

An example of effective use of the SFMSU decisions on financial transaction suspension is the fact that during the period of investigations from March 2014 through August 2016, the SFMSU blocked an equivalent of 1.52 bln USD on the accounts of natural persons and legal entities connected to former senior officials.

SFMSU actively cooperates with the competent foreign agencies in the AML/CFT area. Since the start of its activities, as of Sept. 1, 2016, Ukraine's SFMSU signed 70 Memorandums of Understanding with foreign FIUs, under which cooperation is pursued.

In 2015 foreign FIUs submitted 245 information requests, most of which came from Cyprus, US, UK, British Virgin Islands, and Austria. In its turn, in 2015, the SFMSU submitted 421 information requests to foreign FIUs, most of which were sent to Latvia, Cyprus, UK, US, Switzerland, and British Virgin Islands.

The average duration of review for the incoming and outgoing SFMSU requests is 30 days. More details on the number of the incoming/outgoing FIU requests is provided below.

¹²¹ Source: based on the SFMSU data.

Indicators	2010	2011	2012	2013	2014	2015
Number of incoming requests received from foreign FIUs	135	187	172	174	251	245
Number of completed incoming requests received from foreign FIUs	135	189	172	173	253	285
Number of outgoing requests submitted to foreign FIUs	394	467	433	439	458	421
Number of completed outgoing requests submitted to foreign FIUs	421	430	322	449	395	489
Total	1,085	1,273	1,099	1,235	1,357	1,440

Table 2.1.7. Information on the number of SFMSU information requests to foreign FIUs in 2013-2015

SFMSU in its activities ensures daily use of the international cooperation tool (Egmont). The Egmont Group facilitates FIU development and information exchange.

The geographical distribution of the interaction between the SFMSU and foreign FIUs from 2003 through 2015 is shown in Fig. 2.1.46.

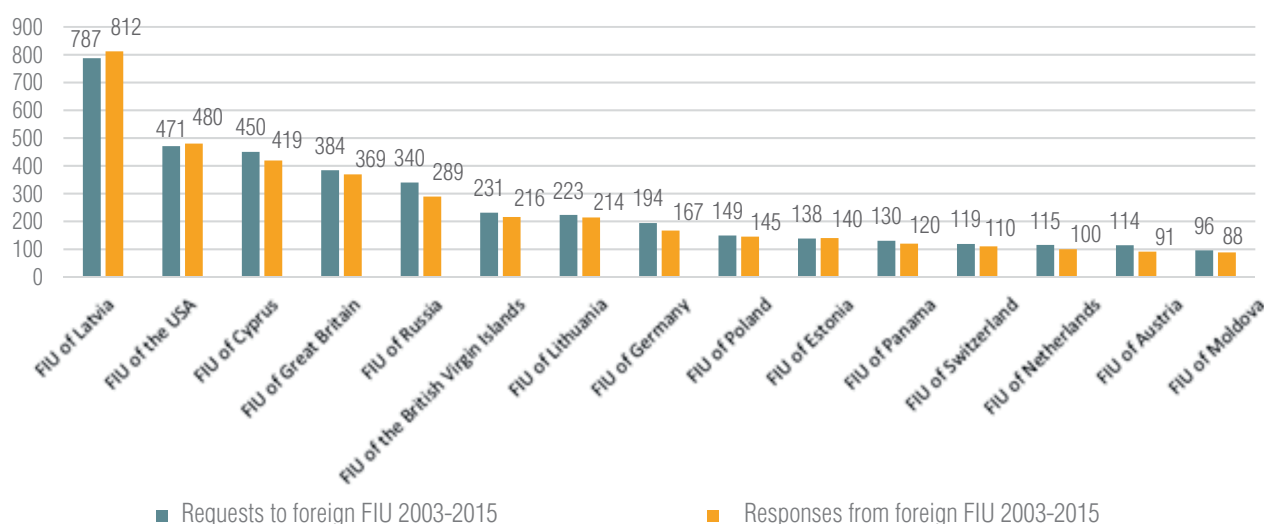


Fig. 2.1.46. Geographical distribution of the interaction between the SFMSU and foreign FIUs from 2003 through 2015

It will be observed from Fig. 2.1.46 that the SFMSU most frequently exchanges information with the FIU of Latvia, US, Cyprus, and United Kingdom.

Summarizing the section, the following factors should be noted.

1. A growing fraction of SM relative to ASM with a significant growth in the number of participants and the use of possibilities to receive additional information on the financial transactions evidences the depth and thorough analysis of financial transactions related to indicators of laundering and other offenses and thus about significant increase in the SM quality and accuracy of analytical assessments.

The procedure of submitting information from the PFMS on financial transactions to the SFMSU is complicated, contains a lot of information, which, considering openness of many state registers, is not always necessary to the SFMSU.

For instance, in 2015, about 89% of the information submitted by the PFMS to the SFMSU was information on the financial transactions subject to mandatory financial monitoring.

At the same time, PFMS should focus on the financial transactions in relation to which suspicions arose based on risk assessment and analysis, which will help significantly enhance the probability of identifying suspicious financial transactions and unlawful financial flows.

Thus, PFMS should dedicate more time to the transactions subject to internal financial monitoring using a risk-oriented approach.

2. In 2003-2008, USIS was established allowing for gathering, processing, and analysis of information by the SFMSU. For over 13 years USIS has been in operation and since 2009 it has not been supported by funding for maintenance, support, and upgrade. As a result:

- a significant part of the equipment is outdated or non-functional (all the USIS server equipment and storage systems have exhausted their lifetime, as well as over 85% of the computer hardware and over 60% of the peripheral equipment);
- regular malfunctions in the USIS operation (which lead to temporary impossibility of receiving information from banks and delay in informing banks of the decisions to suspend financial transactions);
- increased duration of information gathering and processing (malfunction of servers stops the process of financial transaction information processing);
- reduced efficiency and speed of its analysis (suspended automatic access of the SFMSU to USIS information resources);
- a threat of losing the information gathered over the years of the SFMSU operation;
- a threat of breaching the requirements for processing restricted-access information;
- the USIS data storage is insufficient and in the near future may become inaccessible for processing of information due to lack of free space.

3. Retention of qualified staff is one of the SFMSU main tasks, since a lot of employees move to the private sector (mostly banks), which propose significantly higher salaries in the anti-legalization sphere. As a consequence, the past years have seen a high personnel turnover among senior managers and other staff.

As of December 2015, the SFMSU lost a large share of its personnel, specifically of the analytical division and investigative division. Most employees who resigned got employment with the NABU due to a significantly higher, compared to the SFMSU, salary.

Low salary is one of the threats to losing qualified, uniquely professional staff, which adversely affects the level of SFMSU operation.

2.2. Regulatory and Supervisory Authorities

According to the Law, the state regulators include the NBU, Ministry of Finance, Ministry of Justice, Ministry of Infrastructure, MEDTU, NSSMC, SCRFSMU, and SFMSU.

National Bank of Ukraine (NBU)

As of Dec. 31, 2013, the NBU staff was 11,610 persons, of which 364 persons were involved in the AML/CFT issues.

The overall number of the National Bank staff as of Dec. 31, 2015 reduced significantly and was 3,510 persons (FTE¹²²), of which 115 persons were immediately involved in the AML/CFT issues. At the same time, after reduction in the general number of employees due to reorganization of the NBU territorial divisions, the ratio of the staff involved in the AML/CFT remained at the level of 3 % of the total number.

The NBU, pursuant to the IMF recommendations, developed a risk-oriented approach for supervision in the AML/CFT sphere and amended the regulatory and legal documents, specifically the NBU Board of Directors Resolution “On Amending the Provision on the Procedure of Organizing and Conducting Audits on Preventing and Countering Legalization (Laundering) of Proceeds of Crime, Financing of Terrorism, and Financing of Proliferation of Weapons of Mass Destruction”¹²³ amended the Provision on the Procedure of Organizing and Conducting Audits on Preventing and Countering Legalization (Laundering) of Proceeds of Crime, Financing of Terrorism, and Financing of Proliferation of Weapons of Mass Destruction¹²⁴. Such an approach started to be used from 2016.

The number of PFMS-banks supervised by the NBU in 2013-2015 (both private and government banks) was:

- in 2013: 179 – banks in the form of a public joint stock company;
3 government banks;
- in 2014: 162 – banks in the form of a public joint stock company;
3 government banks;
- in 2015: 119 – banks in the form of a public joint stock company;
3 government banks;

Thus, due to economic instability in the country in the past three years, the number of banks in the form of a public joints stock company reduced by 33.5 % or by one third.

Further, the NBU regularly prepares explanation letters for banks and bank associations on combating ML/FT, namely 84 in 2013, 53 in 2014, and 46 in 2015.

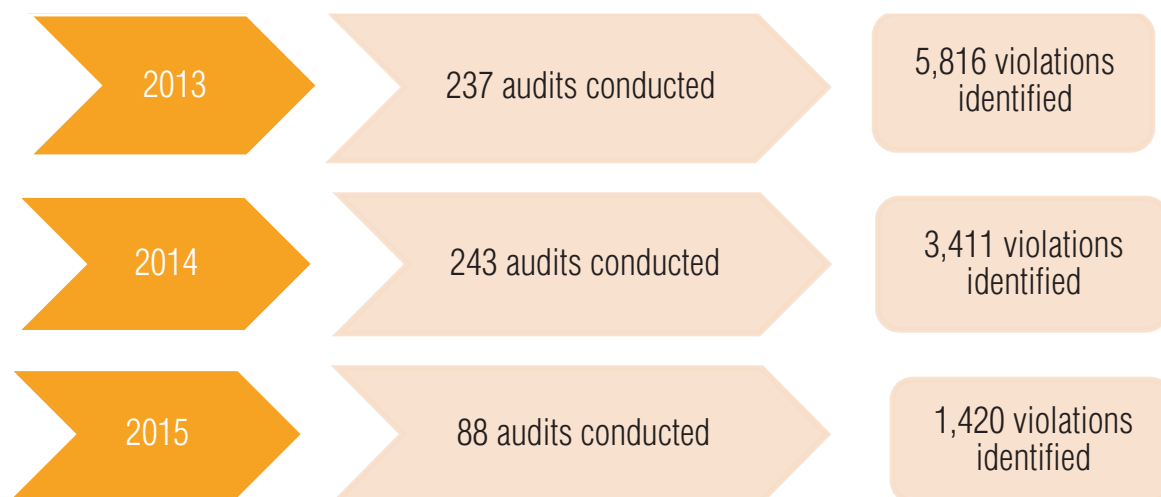


Fig. 2.2.1. General information on the NBU supervisory activities in 2013-2015

¹²² FTE – full-time equivalent

¹²³ On Amending the Provision on the Procedure of Organizing and Conducting Audits on Preventing and Countering Legalization (Laundering) of Proceeds of Crime, Financing of Terrorism, and Financing of Proliferation of Weapons of Mass Destruction: NBU Board of Directors Resolution, Dec. 23, 2015 No. 920: [Electronic resource]. – Access mode: <http://zakon2.rada.gov.ua/laws/show/v0920500-15>

¹²⁴ On Approving the Provision on the Procedure of Organizing and Conducting Audits on Preventing and Countering Legalization (Laundering) of Proceeds of Crime, Financing of Terrorism, and Financing of Proliferation of Weapons of Mass Destruction: NBU Board of Directors Resolution, June 20, 2011 No. 197: [Electronic resource]. – Access mode: <http://zakon2.rada.gov.ua/laws/show/z0852-11/paran16#n16>

Indicators	2013	2014	2015
Number of banks audited, of which:	237	243	88
scheduled (legal entities/separated divisions)	89/99	80/82	39/13
ad hoc (legal entities/separated divisions)	4/1	34/8	19/1
desktop supervision	44	39	16
Violations identified	5,816	3,411	1,420
Measures of influence applied for violation of the AML/CFT legislation:			
Fine imposed	81	94	36
Amount of fines, UAH	794,850	1,263,080	4,670,714
Written warnings	18	19	8
Written requests	83	93	46
Banks categorized as troubled	-	1	1
Banks categorized as insolvent	-	5	1
Temporarily, until the violation is eliminated, the bank officials suspended	-	2	-
Banks restricted, suspended or stopped from effecting some bank transactions	-	7	1
Bank license revoked and banks liquidated	-	-	1

Table 2.2.1. Detailed indicators of the NBU supervisory activities in 2013-2015

In 2013-2014 the total average amount of fines imposed on banks for violation of the AML/CFT legislation was 11,760 UAH/470 EUR, in 470 – 129,742 UAH/4,948 EUR.

Apart from regulation of the bank activities, the NBU also effects state regulation of the resident non-bank financial institutions which are payment organizations and/or members or participants of payment systems in their provision of a money transfer financial service based on the relevant licenses, specifically of the NBU license (except for postal operators in their money transfer activities) pursuant to Art. 14 of the Law starting Feb. 6, 2015.

The total number of the NBU staff involved in regulation of the non-bank financial institutions as of Dec. 31, 2015 was 53 persons, of which: the Department for Payment Systems – 17 persons, the Department for Registration Issues and Licensing – 6, and the Department for Financial Monitoring – 30.

As of Dec. 31, 2015, 36 non-bank financial institutions were under supervision.

In 2015, the NBU audited 3 non-bank financial institutions, resulting in 44 identified AML-related violations (no FT-related violations were identified).

In 2015 the sanctions were not imposed. In January 2016, sanctions were applied to one non-bank financial institution. Based on the other audits conducted in 2015, sanctions will be used in 2016.

The highest risks of using non-bank financial institutions for ML/FT are lack of identification of the client who effect financial transactions in insignificant amounts and absence of direct contact with the clients.

State Commission for Regulation of Financial Services Markets of Ukraine (SCRFSMU)

Pursuant to Art. 14 of the Law, the State Commission for Regulation of Financial Services Markets of Ukraine effects state regulation and supervision in the AML/CFT area of payment organizations of payment systems and participants or members of payment systems (in relation to providing financial services, except for money transfer), insurers (reinsurers), insurance (reinsurance) brokers, pawnbroker's shops, and other financial institutions and legal entities that under the legislation provide financial services (except financial institutions and other legal entities, in relation to which state regulation and supervision on AML/CFT is done by other State Financial Monitoring Subjects)

At the SCRFSMU, the division involved in AML/CFT is the Unit for Control of Supervision Subjects' Compliance with the Financial Monitoring Legislation, which is part of the Department for Development of Financial Services Markets and International Cooperation, consisting of 5 employees – the number that remained unchanged in 2013-2015.

As of Dec.31, 2013, the total number of the PFMS supervised by the State Commission for Regulation of Financial Services Markets of Ukraine was 2,438; as of Dec. 31, 2014, this number was 2,424 subjects; and as of Dec.31, 2015 the total number already reached 2,576 subjects. Statistics on the types of the PFMS supervised by the SCRFSMU is shown in the table:

PFMS Type Supervised by the State Commission for Regulation of Financial Services Markets of Ukraine	Number of PFMS as of:		
	Dec. 31, 2013	Dec. 31, 2014	Dec. 31, 2015
Insurance companies	407	382	361
Credit institutions	739	711	728
Pawn Shops	479	477	482
Financial companies	377	415	571
Trust companies	2	2	2
Non-government pension funds	81	76	72
Administrators of non-government pension funds	28	24	23
Legal entities that are not financial institution but have the right to provide some financial services	254	267	268
Credit history bureaus	8	9	8
Insurance/reinsurance brokers	56	51	51
Non-resident insurance/reinsurance brokers who informed of their intention to pursue activities in Ukraine	7	10	10
Total:	2,438	2,424	2,576

Table 2.2.2. Statistics on the types of the PFMS supervised by the SCRFSMU (2013-2015)

The past three years witnesses a reduction in the number of insurance companies (by 11 %), non-government pension funds (by 11 %) and administrators of non-government pension funds (18 %), as well as insurance/reinsurance brokers (by 9 %). At the same time, there was an increase in the number of financial companies (by 44 %) and legal entities that are not financial institutions but have the right to provide some financial services (by 5 %).

The SCRFSMU audits in the AML/CFT sphere are planned on a quarterly basis. The periodicity of scheduled audits depends on the risk level of the supervised subject (a risk-oriented approach has been implemented)¹²⁵.



Fig. 2.2.2. General information on the SCRFSMU supervisory activities in 2013-2014

¹²⁵ On Approval of the Criteria for Risk Assessment of the Primary Financial Monitoring Subjects, Whose State Regulation and Supervision is Effected by the State Commission for Regulation of Financial Services Markets of Ukraine: SCRFSMU Ordinance, Oct. 13, 2015 No. 2481: [Electronic resource]. – Access mode: <http://zakon3.rada.gov.ua/laws/show/z1335-15>

Indicators	2013	2014
Number of PFMS audits conducted on financial monitoring, including:	322	128
insurers (reinsurers) and insurance brokers	165	64
resolutions made on imposition of a fine	104	52
credit unions and other credit institutions	58	24
resolutions made on imposition of a fine	21	1
pawn shops	32	13
resolutions made on imposition of a fine	15	6
financial companies	52	17
resolutions made on imposition of a fine	32	30
non-government pension funds and administrators of non-government pension funds	15	8
resolutions made on imposition of a fine	-	-
representative offices	-	2
Total number of fines, thous UAH	3,140.5	957.1
Administrative Offense Protocols drawn	36	18

Table 2.2.3. Detailed indicators of the SCRFMSU supervisory activities in 2013-2014

In 2015 no penalties were imposed on the PFMS for violations in the AML/CFT sphere and no administrative offense protocols were drawn.

In 2013 the total average amount of fines was 16.50 thous UAH or 646.81 EUR at the rate as of the end of December 2015 and 1,555.14 EUR at the official average rate of 2013.

In 2014 the total average amount of fines was 10.50 thous UAH or 411.60 EUR at the rate as of the end of December 2015 and 667.94 EUR at the official average rate of 2014.

One of the highest perceived risks of using non-bank financial institutions for money laundering and/or financing of terrorism is usually:

- creating conditions for artificial bankruptcy;
- the use of a large number of cash for economic activities;
- convoluted conditions of legal transactions effected between business entities and natural persons or absence of substantial information;
- use of companies with indicators of fictitiousness in the economic activities.

National Securities and Stock Market Commission (NSSMC)

Pursuant to Art. 14 of the Law, the NSSMC effects state regulation and supervision in the AML/CFT area in relation to the stock market (securities market) professional participants (except banks).

The NSSMC has a Financial Monitoring Unit numbering 7 persons, responsible for the interaction with the SFMSU and other supervisory authorities, coordination and audits of the stock market participants on the AML/CFT issues, monitoring of the process of the stock market participants' implementation of the AML/CFT legislation, and efficiency analysis of the AML/CFT measures on the securities market.

The Financial Monitoring Unit is a structural division of the NSSMC central administration and is included in the Legal Control Department established to control compliance with legislation on the securities market and to regulate the securities market in financial monitoring area.

All the NSSMC territorial divisions have designated persons in charge of the state financial monitoring and coordination of the work with the central administration, local executive authorities, and law enforcement authorities. The staff of the NSSMC territorial divisions are involved in the audits.

The past three years witnessed an almost double reduction in the general number of stock market professional participants supervised by the NSSMC (by 44 %): from 1,144 subjects in 2013 to 644 subjects in 2015. Statistics on the types of the PFMS supervised by the NSSMC is shown in the table.

PFMS Type Supervised by the NSSMC	Number of PFMS as of:		
	2013	2014	2015
Securities traders	419	166	132
Securities traders – depository institutions	162	162	144
Depository institutions	204	37	38
Asset management companies	349	345	320
Stock exchanges	10	10	10
Total:	1,144	720	644

Table 2.2.4. Statistics on the types of the PFMS supervised by the NSSMC (2013-2015)

It will be seen from the table that the number of depository institutions reduced almost 5 times (by 81 %) and the number of securities traders reduced almost 3 times (by 68 %); the fluctuations in the number of other stock market professional participants in 2013-2015 were insignificant.

In 2013, the NSSMC submitted 2 explanatory letters to the self-regulatory organizations of the securities market professional participants on the challenging issues of application of the AML/CFT legislation, 2 more explanatory letters in 2014, and 4 of such explanatory letters in 2015.

Further, to provide methodological, procedural, and other assistance to the PFMS on AML/CFT in 2013-2015, the NSSMC representatives continuously took part in workshops, conferences, and other events for the PFMS. In 2013 methodological support was provided to over 140 PFMS, in 2014 – to over 260, in 2015 – to over 280.

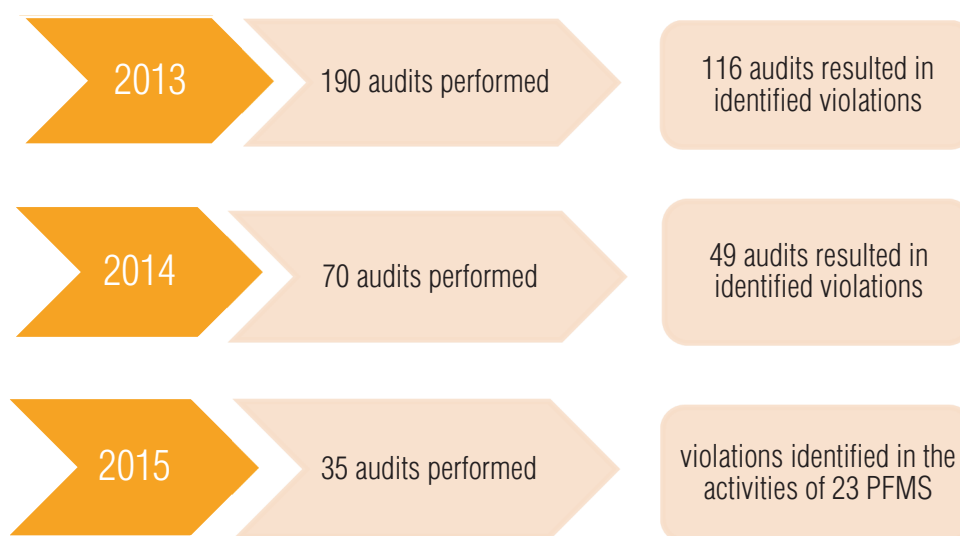


Fig. 2.2.3. General information on the NSSMC supervisory activities in 2013-2015

Indicators	2013	2014	2015
PFMS audited for compliance with the AML/CFT legislation, including:	190	70	35
Securities traders	130	51	28
Securities traders that combine these activities with the securities depositary activities	14	-	-
securities traders of depositary institutions	-	-	6
Asset management companies	45	19	1
Registrars	1	-	-
Number of influence measures used, including:	157	152	70
warnings	34	31	12
ordinances on elimination of securities legislation violations	18	10	1
requirements to eliminate violations on the AML/CFT legislation	34	31	10
Penalties	60	74	29
Amount of penalties, UAH	211,260	109,820	128,700
Administrative Offense Protocols	11	6	9
Number of PFMS whose licenses for professional activities on the securities markets were revoked	13	10	9

Table 2.2.5. Detailed indicators of the NSSMC supervisory activities in 2013-2015

The NSSMC determines the regularity of scheduled field audits depending on the PFMS risk of being used for ML/FT and FPWMD (a risk-oriented approach has been implemented)¹²⁶.

The average amount of fines imposed for violation of the AML/CFT-related legislation was: In 2013 – 3,521 UAH, in 2014 – 1 484 UAH, in 2015 – 4,438 UAH.

It should be noted that the legislation does not provide for suspension of officials of the securities market professional participants and/or dismissal from their positions for violations of the AML/CFT related legislation.

Usually there are significant risks of using stock market professional participants for ML/FT.

Promissory notes are one of the common financial tools on the stock market for ML. Simplicity of their use in ML is primarily due to absence of a unified state register of promissory notes, which is an obstacle for appropriate control of their issuance and circulation.

Shares of the companies with indicators of fictitiousness are most commonly used to overrate/underrate the real value of the company assets. The securities market often demonstrate cases, when, e.g., an investment fund's assets are composed of fictitious companies' securities, which, in its turn, leads to artificial increase in the value of these funds' investment certificates. In a similar way, the assets of insurance companies, pension funds, business entities are built artificially.

It was established that investment certificates can also be a tool to minimize tax obligations. Usually, some investment certificate sales transactions are effected within a group of legally and economically related companies, which also are under direct or indirect control of a legal entity or natural person (group of persons), which may evidence minimization of tax obligations, since these transactions do not envisage any economic benefits.

Corporate investment funds can be used to receive criminal proceeds. For example, dummy (acquire the right of ownership on the eve of making a decision on payment of dividends) natural person fund participants accrue dividends which they receive in cash from a business entity involved in unlawful activities.

¹²⁶ On Approving the Criteria for Risk Assessment of the Primary Financial Monitoring Subject - Stock Market (Securities Market) Professional Participant to Be Used for Legalization (Laundering) of Proceeds of Crime, Financing of Terrorism, and Financing of Proliferation of Weapons of Mass Destruction: NSSMC Decision, May 31, 2016 No. 617: [Electronic resource]. – Access mode: <http://zakon2.rada.gov.ua/laws/show/z0871-16/paran24#n24>

According to the NSSMC, offshore jurisdictions are often used in the ML schemes. For example, the agreements involve persons registered in countries with another jurisdiction (specifically, with a non-transparent reporting system, low requirements for controllers), in whose interests the securities trader acts and who are related by representatives (through power of attorney) and affiliates.

In ML the use of fictitious companies is another common practice. For instance, the use of a fictitious securities trader for securities transactions to evade taxes, minimize tax obligations, artificially increase the company assets or, on the contrary, withdraw money from the company, or to commit other unlawful acts. The NSSMC detects such fictitious securities traders during audits. These subjects in most cases are absent at their location, due to which the NSSMC revokes their licenses for professional activities on the stock market and informs the SFMSU accordingly.

Ministry of Finance of Ukraine

Pursuant to the law, the Ministry of Finance effects state regulation and supervision in the AML/CFT area in relation to business entities that conduct lotteries or any other types of gambling, business entities trading in precious metals and stones and products therefrom, auditors, auditor firms, individual entrepreneurs who provide accounting services (except for persons that provide services under employment relations).

The maximum number of the Ministry of Finance of Ukraine administration staff in 2013-2015 was 738, 694, and 695 employees respectively (at the year end). Of these, the AML/CFT issues were dealt with by a unit numbering 7 staff in 2013-2014 and 6 persons in 2015.

The number of the PFMS under supervision in 2013-2014 was about 120, and in 2015 – 111 PFMS.

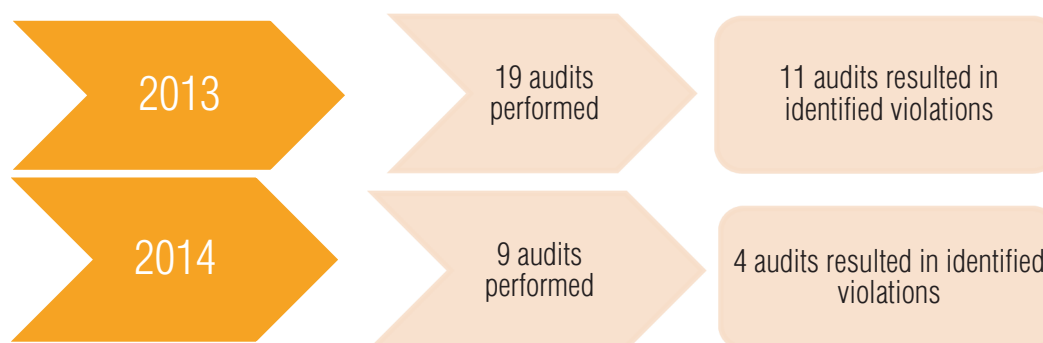


Fig. 2.2.4. General information on the Ministry of Finance supervisory activities in 2013-2014

Indicators	2013	2014 (1st half-year)
Number of PFMS audited for compliance with the AML/CFT legislation:	19	9
Penalties	11	4
Amount of penalties, thous UAH, of which imposed on:	57.8	13.6
economic entities involved in cash trade in precious metals and stones and goods made thereof	5.1	-
economic entities involved in conducting lotteries	13.6	-
auditing firms	39.1	13.6
individual entrepreneurs who provide accounting services	-	-

Table 2.2.6. Detailed indicators of the Ministry of Finance supervisory activities in 2013-2014

The Ministry of Finance developed relevant risk criteria for the PFMS to be used with the purpose of legalization (laundering) of proceeds of crime, financing of terrorism, and financing of proliferation of weapons of mass destruction¹²⁷ (a risk-oriented approach is used), based on which PFMS audit plans are approved.

The average amount of fines imposed for violation of the AML/CFT-related legislation in 2013 – 5,255 UAH (650 EUR); in 2014 – 3,400 UAH (310 EUR).

The Ministry of Finance emphasizes substandard performance by audit firms of their AML/CFT-related obligations. According to the regulator, auditors may be used to provide a positive conclusion on the activities of the companies which, in fact, evade taxes or are potential bankrupts.

Ministry of Justice of Ukraine.

Pursuant to the Law, the Ministry of Justice effects state regulation and supervision in relation to notaries, barristers, barrister bureaus and associations and business entities that provide legal services (except for persons that provide services under employment relations).

The Financial Monitoring Unit of the Department for Notariat of the Ministry of Justice of Ukraine, which numbers 7 employees, has been the Ministry of Justice structural division dealing with AML/CFT since the end of 2015 and until now.

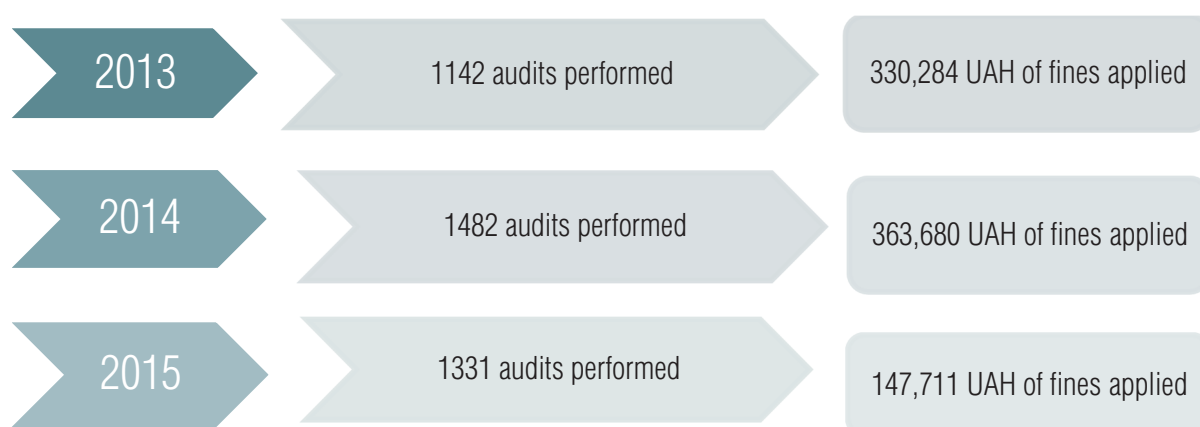


Fig. 2.2.5. General information on the Ministry of Justice supervisory activities in 2013-2015

Indicators	2013	2014	2015
Number of audits performed	1,142	1,482	1,331
Number of fines imposed	878	856	497
Amount of fines, UAH	330,284	363,680	147,711

Table 2.2.7. Detailed indicators of the Ministry of Justice supervisory activities in 2013-2015

The Ministry of Justice determines the regularity of audits depending on the PFMS risk of being used for ML/FT and FPWMD (a risk-oriented approach has been implemented)¹²⁸.

The total average amount of fines for violation of the AML/CFT-related legislation in 2015 was 297 UAH.

¹²⁷ On Approving the Criteria for Risk Assessment by the Ministry of Finance of Ukraine of the Primary Financial Monitoring Subject to Be Used for Legalization (Laundering) of Proceeds of Crime, Financing of Terrorism, and Financing of Proliferation of Weapons of Mass Destruction: Ministry of Finance Order, Jan. 26, 2016, No. 17: [Electronic resource]. – Access mode: <http://zakon2.rada.gov.ua/laws/show/z0481-16>

¹²⁸ On Approving the Criteria for Risk Assessment of the Primary Financial Monitoring Subject to Be Used for Legalization (Laundering) of Proceeds of Crime, Financing of Terrorism, and Financing of Proliferation of Weapons of Mass Destruction: Ministry of Justice Order, Oct. 6, 2015, No. 1899/5: [Electronic resource]. – Access mode: <http://zakon3.rada.gov.ua/laws/show/z1217-15>

Ministry of Economic Development and Trade of Ukraine (MEDTU).

Pursuant to the Law, the MEDTU effects state regulation and supervision in the AML/CFT area in relation to commodity and other exchanges involved in financial transactions with commodities.

The MEDTU established and until 2015 operated the Commodity Market Infrastructure Development Unit at the Financial Policy Department, numbering 5 employees.

Starting 2015, the MEDTU has been operating the Methodological Support Unit of the Department of the State Property Management and Industrial Development, which has the competences of the state financial monitoring subject in relation to commodity and other exchanges involved in financial transactions with commodities, numbering 7 employees.

Starting the 2nd half of 2013 The MEDTU began audits of PFMS-commodity exchanges. Within the said period, 8 scheduled audits of the PFMS-commodity exchanges for compliance with the AML/CFT related legislation were carried out.

The number of PFMS (separated divisions), in the activities of which violations of the financial monitoring legislation were identified – 6.

Throughout 2014 The MEDTU performed 2 scheduled audits of the PFMS-commodity exchanges for compliance with the AML/CFT-related legislation, resulting in identified violations in the sphere. Upon reviewing the cases on failure to comply (on inappropriate compliance) with the requirements of the AML/CFT-related legislation by the PFMS, the MEDTU decided on closing the proceedings in the cases.

Ministry of Infrastructure of Ukraine.

Pursuant to the Law, the Ministry of Infrastructure effects state regulation and supervision in the AML/CFT area in relation to postal operators (on their money transfer activities).

The total number of the Ministry of Infrastructure of Ukraine staff in 2013 was 291 employees, and in 2014-2015 – 262 employees. At the Ministry of Infrastructure of Ukraine, the AML/CFT-related tasks and functions are performed by the Unit for Internal Investigation, Corruption Prevention, and State Financial Monitoring, numbering 8 persons.

The audits are planned based on the peculiarities of the PFMS activities, dates of the previous audits, and risk level of the supervision subject (a risk-oriented approach has been implemented)¹²⁹.

The Ministry of Infrastructure performed 11 AML/CFT audits in 2013-2014 and 1 audit in 2015.

The audits performed in 2013-2015 did not identify any violations punishable by sanctions applied to the PFMS under the Law, Code of Administrative Offenses of Ukraine, and Criminal Code of Ukraine. The audits identified minor gaps in the organization of the AML/CFT system by the PFMS and provided recommendations on their elimination. In 2013-2015, no sanctions were imposed on the PFMS based on the audits performed.

It should be noted that the postal service activities, according to Ukraine's legislation, are not subject to licensing, therefore license revocation is not a sanction that can be applied to the supervised PFMS for violation of the AML/CFT-related legislation.

In 2013-2015 no reports on the violation of the AML/CFT-related legislation identified by the Ministry of Infrastructure were submitted to the SFMSU or LEA.

The level of supervision efficiency and effectiveness in this sector requires improvement. It is related to the fact that currently the effective legislation of Ukraine does not envisage licenses for postal service operators, including those involved in money transfers, which makes it impossible to establish the exact number of the PFMS, supervised by the Ministry of Infrastructure.

State Financial Monitoring Service of Ukraine (SFMSU)

Pursuant to the Law, the SFMSU effects state regulation and supervision in the AML/CFT sphere in relation to entrepreneurs that provide intermediary services during real estate sales transactions (pursuant to the previous revision of the Law, until Feb. 6, 2015, the SFMSU also regulated the activities of individual entrepreneurs and legal entities – involved in financial transactions with goods (performing of work, providing of services) for cash).

The number of the SFMSU staff in 2013-2015 remained unchanged and was 237 employees.

¹²⁹ On Approving the Criteria for Risk Assessment of the Primary Financial Monitoring Subjects, Whose State Regulation and Supervision is Effected by the Ministry of Infrastructure of Ukraine to Be Used for Legalization (Laundering) of Proceeds of Crime, Financing of Terrorism, and Financing of Proliferation of Weapons of Mass Destruction: Ministry of Infrastructure Order, Nov. 2, 2015 No. 437: [Electronic resource]. – Access mode: <http://zakon2.rada.gov.ua/laws/show/z1447-15>

At the SFMSU, the issues of AML/CFT-related regulation and supervision are dealt with by the Department for Interaction with the Primary Financial Monitoring Subjects, staffed with 9 persons.

The SFMSU budget in the past three years dropped 20 % (from 32,075,800 UAH in 2013 to 25,728,300 UAH in 2015; in 2014 the budget was 26,672,300 UAH).

In its AML/CFT-related supervision, SFMSU uses a risk-oriented approach to the supervised PFMS, i.e. the SFMSU in its activities is governed by the Ministry of Finance Order “On Approving the Criteria for Risk Assessment of the Primary Financial Monitoring Subject to Be Used for Legalization (Laundering) of Proceeds of Crime or Financing of Terrorism”¹³⁰.

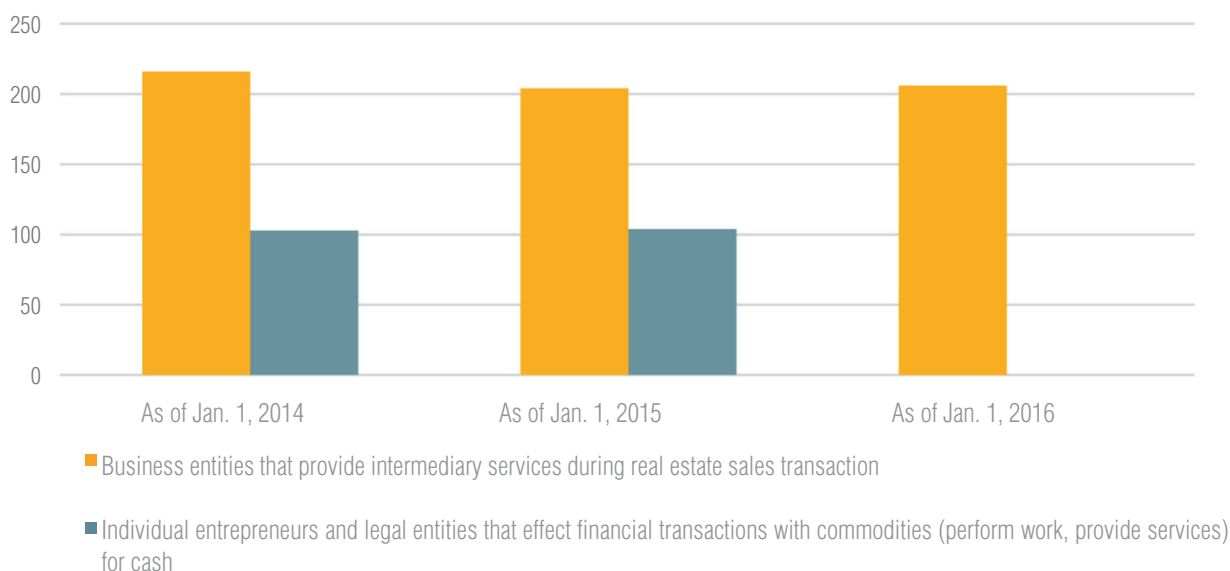


Fig. 2.2.6. Registered PFMS regulated and supervised by the SFMSU¹³¹

In the past three years, the SFMSU developed 18 recommendatory documents on organization of the PFMS financial monitoring and approved 5 regulatory and recommendatory documents on organization of countering FT, which include:

- Recommendations for the primary financial monitoring subjects on the risks related to financing of separatist and terrorist actions in Ukraine, July 21, 2014;
- CMU Resolution “On Implementation of the UN Security Council Resolution regarding Usama bin Laden, Al-Qaida Organization, and the Taliban Movement (Afghanistan)”¹³²;
- Law of Ukraine “On Changes to the Criminal Code and Code of Criminal Procedure of Ukraine regarding Prevention of Terrorism”¹³³;
- SFMSU Order “On Approving the Procedure for Composing by the State Financial Monitoring Service of Ukraine of the List of Persons Related to Terrorist Activities or Subjected to International Sanctions and Providing It to the Financial Monitoring Subjects”¹³⁴;

¹³⁰ On Approving the Criteria for Risk Assessment of the Primary Financial Monitoring Subject to Be Used for Legalization (Laundering) of Proceeds of Crime or Financing of Terrorism: Ministry of Finance Order, March 5, 2012 No. 325: [Electronic resource]. – Access mode: <http://zakon2.rada.gov.ua/laws/show/z0435-12> (Effective until March 31, 2016; starting March 31, 2016, the Ministry of Finance Order of Jan. 26, 2016, No. 18 has been in effect: [Electronic resource]. – Access mode: <http://zakon5.rada.gov.ua/laws/show/z0482-16/paran7#n7>.

¹³¹ Note: individual entrepreneurs and legal entities that carry out financial transactions with goods (perform work, provide services) for cash, pursuant to the new revision of the Law, were excluded from the PFMS list;

¹³² On Implementation of the UN Security Council Resolution regarding Usama bin Laden, Al-Qaida Organization, and the Taliban Movement (Afghanistan): Cabinet of Ministers of Ukraine Resolution, June 1, 2002 No. 749: [Electronic resource]. – Access mode: <http://zakon0.rada.gov.ua/laws/show/en/749-2002-%D0%BF>

¹³³ On Changes to the Criminal Code and Code of Criminal Procedure of Ukraine regarding Prevention of Terrorism: Law of Ukraine, September 21, 2006 No. 170-V: [Electronic resource]. – Access mode: <http://zakon5.rada.gov.ua/laws/show/170-16>

¹³⁴ On Approving the Procedure for Composing by the State Financial Monitoring Service of Ukraine of the List of Persons Related to Terrorist Activities or Subjected to International Sanctions and Providing It to the Financial Monitoring Subjects: SFMSU Order, Sept. 30, 2010 No. 176 [Electronic resource]. – Access mode: www.sdfm.gov.ua/articles.php?cat_id=237&art_id=15693&lang=uk

- Ministry of Finance Order “On Approving the Procedure for Informing the Primary Financial Monitoring Subjects of the List of Persons related to Terrorist Activities or Subjected to International Sanctions, and Instruction on Adding Information to the List”¹³⁵.



Fig. 2.2.7. General information on the SFMSU supervisory activities in 2013-2014

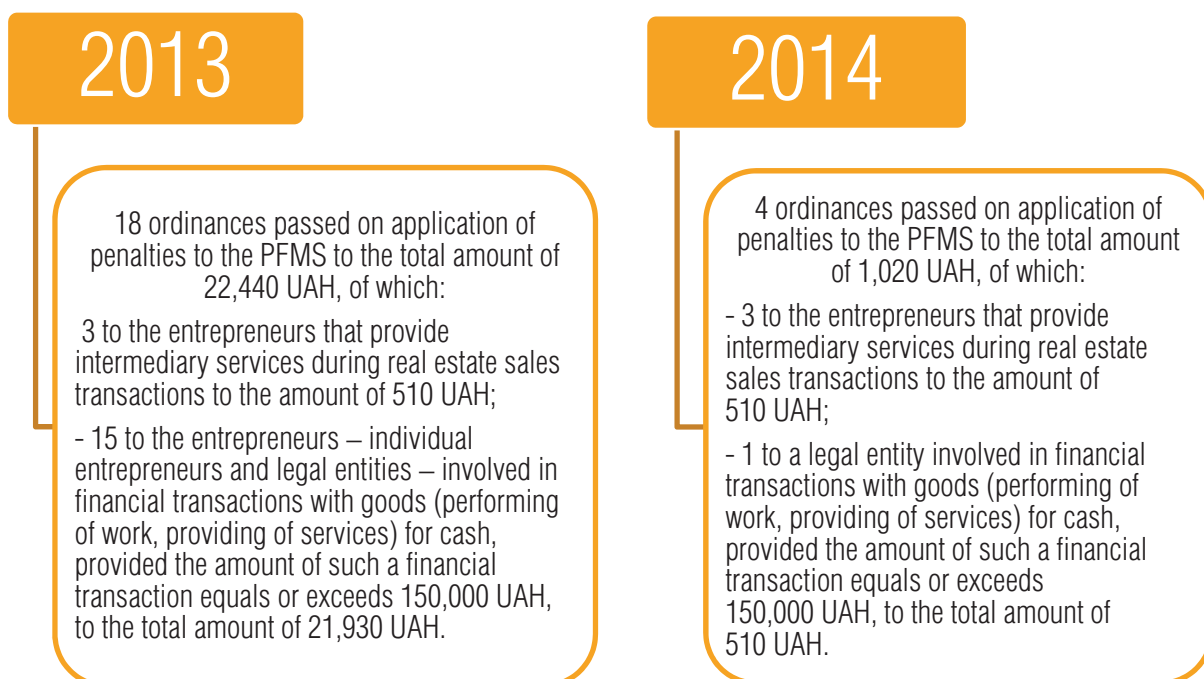


Fig. 2.2.8. Detailed indicators of the SFMSU supervisory activities in 2013-2014

The realtor activities are pursued in Ukraine under the Civil Code of Ukraine. These activities are very indirectly regulated by Chapter 68 of the Civil Code of Ukraine “Agency”. There is no other legal regulation of the real estate agencies' activities in Ukraine.

Further, pursuant to Art. 14 of the Law, in relation to entrepreneurs that provide intermediary services during real estate sales transactions, the SFMSU effects only state regulation and supervision in the AML/CFT sphere.

In 2013, trial courts, following the review of the SFMSU administrative materials, imposed administrative liability on 15 PFMS officials in the form of a fine to the total amount of 25,500 UAH, and in 2014 – to 6 PFMS officials to the total amount of 9,010 UAH.

As of Jan. 20, 2016, trial courts, following the review of the SFMSU 2015 administrative materials, imposed administrative liability in the form of a fine on 13 PFMS officials to the total amount of 20,570 UAH.

¹³⁵ On Approving the Procedure for Informing the Primary Financial Monitoring Subjects of the List of Persons related to Terrorist Activities or Subjected to International Sanctions, and Instruction on Adding Information to the List: Ministry of Finance Order, May 5, 2016 No. 475: [Electronic resource]. – Access mode: <http://zakon0.rada.gov.ua/laws/show/z0772-16/paran8#n8>

2.3. Law enforcement and intelligence system

Prosecutor General’s Office of Ukraine (PGOU)

The PGOU and the regional prosecutor offices structure does not have a designated agency for pre-trial investigation of the ML crimes. Pre-trial investigations of these crimes are carried out by the pre-trial investigation agency that detected the crime. ML/FT cases are investigated pursuant to the norms of the Code of Criminal Procedure of Ukraine per standard procedure.

The department for coordination for investigation of crimes in the sphere of money legalization (laundering) and financing of terrorism includes the department head and 2 prosecutors.

According to the Reports on Countering Legalization of Proceeds of Crime (Form 1-LV)¹³⁶, in 2015 the PGOU had 58 criminal cases in the pre-trial investigation stage (36 in 2014, and 18 in 2013).

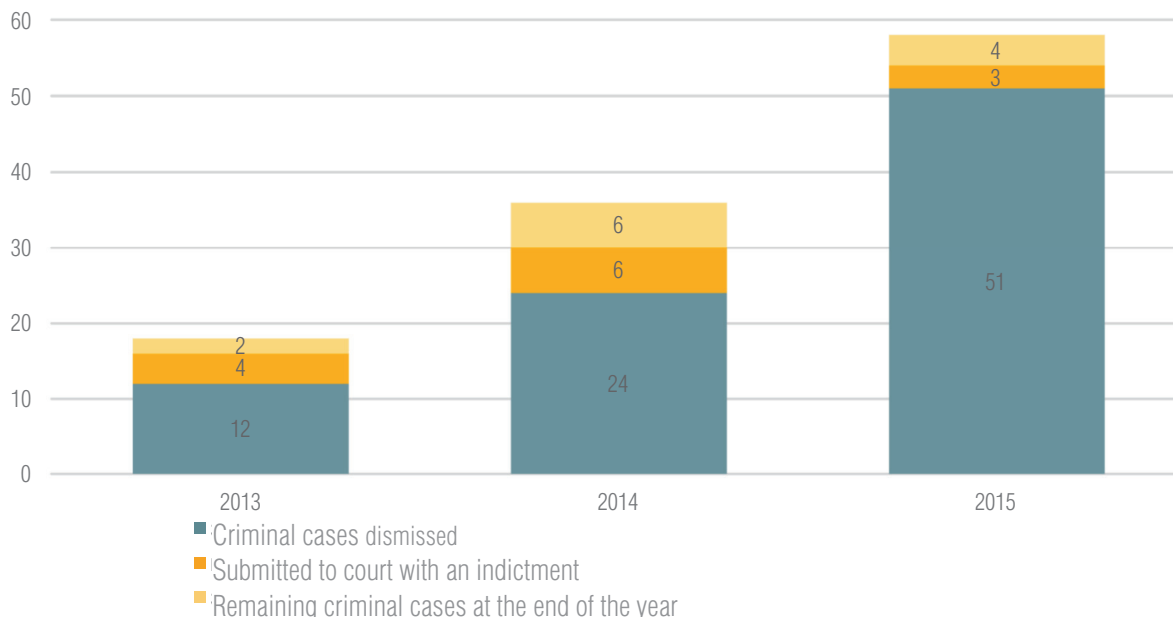


Fig. 2.3.1. PGOU investigation of the criminal offenses under CCU Art. 209 (ML)

The PGOU had no criminal cases in 2013 under CCU Art. 258-5 (“Financing of Terrorism”), 1 criminal case in 2014, and identified 1 person as having committed a criminal offense under CCU Art. 258-5.

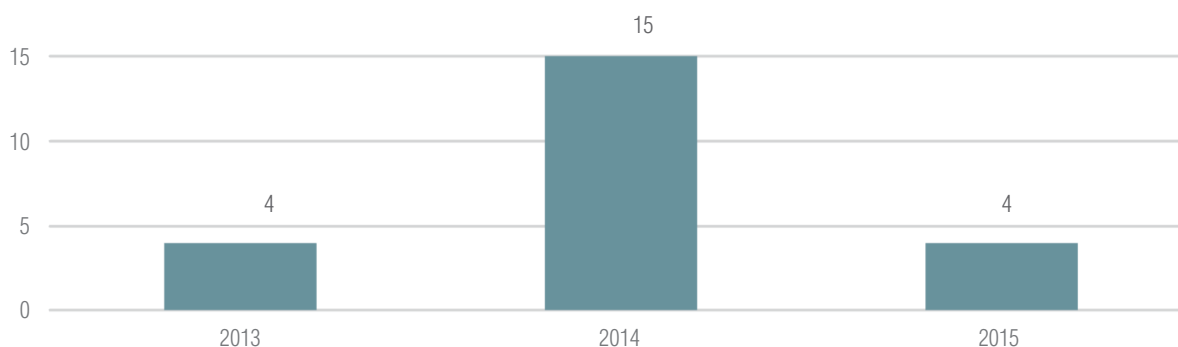


Fig. 2.3.2. Persons identified as having committed criminal offenses under CCU Art. 209 (ML)

Starting 2015, the PGOU has been participating in 1 joint international investigation. Specifically, the international joint investigation team which investigates the downing of the Malaysia Airlines aircraft (MH17) involving representatives of Ukraine, Netherlands, Belgium, and Australia (with participation of Malaysia) has been

¹³⁶ Source: statistical information from the PGOU official web-site: [Electronic resource]. – Access mode: <http://www.gp.gov.ua/ua/stat.html>

looking into the facts on which Ukraine launched a criminal case under CCU Part 3, Art. 258 (terrorist act resulting in death of people).

In 2013, the criminal cases under CCU Art. 209 resulted in seizure of criminal proceeds to the amount of 1,961,478 UAH and arrest to the amount of 13,223,278 UAH (Form 1-LV Report).

In 2014, the criminal cases under CCU Art. 209 resulted in seizure of criminal proceeds to the amount of 5,218,874 UAH and arrest to the amount of 11,280,000 UAH (Form 1-LV Report).

In 2015 the criminal cases under CCU Art. 209 resulted in arrest of securities to the amount of 25 mln UAH and property to the amount of 1.5 mln UAH, and seizure of criminal proceeds to the amount of 277,000 UAH (Form 1-LV Report).

The PGOU operation merits a special attention in the context of legal assistance and extradition.

Incoming Foreign Requests.

In 2013 the PGOU received the total of 21 AML/CFT-related requests from foreign agencies, including:

- 19 requests for AML/CFT-related legal assistance, of which all the requests were granted;
- 2 requests for extradition of persons prosecuted for ML, of which 1 request was granted, and the other one was refused, since the requested person was granted a refugee status in Ukraine.

In 2014 the PGOU received 40 requests from the AML/CFT-related competent foreign agencies on international legal assistance in the ML criminal cases, of which 38 requests were granted in full and 2 – partially. In 2014 the PGOU did not get any extradition requests in the AML/CFT area.

In 2015 the PGOU received a total of 38 requests from AML/CFT-related foreign agencies, including: 35 requests from competent foreign authorities for the international legal assistance in ML criminal cases, 1 request for legal assistance in an FT criminal case, 2 requests for extradition of the persons prosecuted for ML.

In 2015 the PGOU granted 37 requests (36 on provision of legal assistance, 1 on extradition):

- all the 35 foreign requests for international legal assistance in the ML criminal cases were granted by the Ukrainian side, of which 25 were completed and 10 are pending completion;
- 1 foreign request for legal assistance in an FT case was granted and completed;
- 1 foreign request for extradition of a person criminally prosecuted for ML was granted by the PGOU, and the person was extradited to the requesting side.

Currently, the PGOU did not decide on 1 request for extradition of a person criminally prosecuted for ML due to inability to establish the whereabouts of the person.

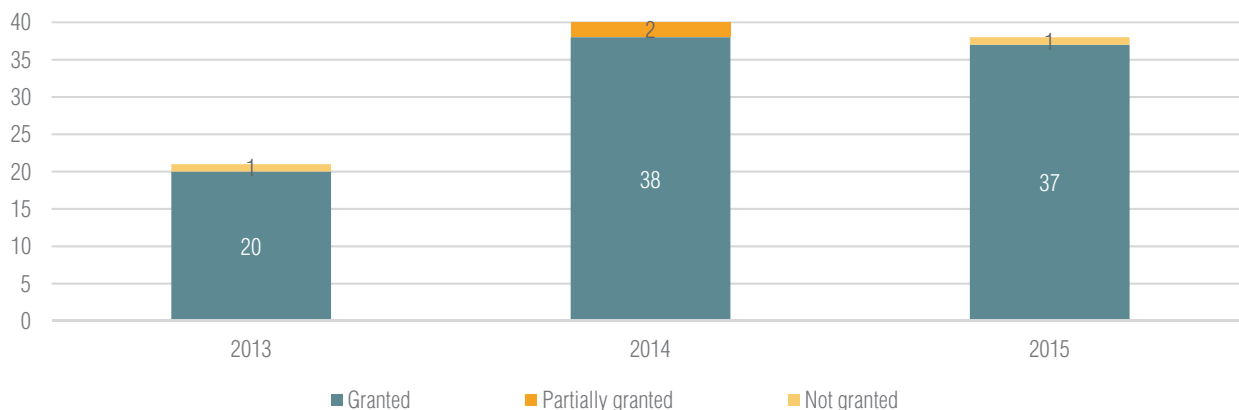


Fig. 2.3.3. Incoming requests from foreign agencies received by the PGOU in 2013-2015

The average term of completing foreign requests for legal assistance in the ML criminal cases in 2013-2015 was three months (about 90 days).

The foreign request on the FT case in 2015 was completed within 2 months (about 60 days).

In 2015, a foreign request for extradition of a person criminally prosecuted for ML was granted by the PGOU within over 1 month (about 45 days).

Thus, it took the Ukrainian competent authorities on the average over 2 months (about 65 days) to complete foreign requests on criminal cases.

In 2013 the largest number of the incoming requests for AML/CFT-related legal assistance came from: the Slovak Republic (3), Republic of Lithuania, Republic of Latvia, Swiss Confederation, and Federal Republic of Germany (2 each). Foreign requests for extradition in the AML/CFT area came from the Republic of Armenia and Russian Federation (1 each).

In 2014 the largest number of the incoming requests for AML/CFT-related legal assistance came from: the Slovak Republic (7), Kingdom of Belgium, Republic of Latvia, Republic of Moldova (5 each), Republic of Austria, United Kingdom of Great Britain and Northern Ireland (3 each).

In 2015, commissions in the ML criminal cases came from the law enforcement authorities of the Republic of Latvia (16), Swiss Confederation (4), Czech Republic (3), USA (2), Slovak Republic, Italian Republic, Republic of Moldova, Republic of Lithuania, Republic of Austria, Russian Federation, Romania, Kingdom of the Netherlands, Republic of Poland, Republic of Belarus (1 each).

A foreign request in the FT case came from the law enforcement authorities of the Republic of Latvia.

Foreign requests for extradition of persons criminally prosecuted for ML were received by the PGOU from Romania and the French Republic (1 each).

Outgoing Foreign Inquiries.

In 2013, the PGOU submitted 30 requests for AML/CFT-related legal assistance and 3 outgoing requests for AML/CFT-related extradition to foreign competent authorities.

In 2014 the PGOU submitted 12 outgoing requests for AML/CFT-related legal assistance, of which: 6 – related to AML, 1 – FT, 3 – facilitating the activities of a terrorist organization, and 2 – financing of illegal armed groups. Within the period, 6 AML/CFT-related extradition requests were submitted to foreign countries.

In 2015 the PGOU submitted a total of 34 AML/CFT-related requests (32 for legal assistance and 2 for extradition).

Both extradition requests were related to committing of crimes related to ML.

The PGOU submitted 25 requests from the Ukrainian pre-trial investigation authorities for international legal assistance in the criminal cases based on the ML facts.

Within the period, 7 requests from the pre-trial investigation authorities of Ukraine for international legal assistance in the criminal cases based on the FT facts were submitted to foreign countries.

It should be noted that in 2015 the requests to foreign countries included 25 requests on the criminal cases under CCU Part 1, Art. 258-3 (creation of a terrorist group or terrorist organization, the leadership of or participation in it, as well as organizational or other support to their creation or activities), CCU Part 3, Art. 260 (creation of unlawful paramilitary or armed formations): the Russian Federation (22), Republic of Estonia (2), USA (1).

In 2013, 16 outgoing requests for AML/CFT-related legal assistance were granted and 10 are pending completion. Three (3) outgoing requests for AML/CFT-related legal assistance were refused due to absence of connection between the criminal offense commitment circumstances and the requested procedural actions, and based on Art. 2 of the 1959 European Convention on Mutual Assistance in Criminal Matters. One (1) request was dropped by the initiator – a Ukrainian pre-trial investigation agency.

Of the outgoing requests for AML/CFT-related extradition in 2013, 1 request was granted, 1 is under review, and 1 was refused because the person was recognized as a requesting party's citizen.

In 2014, 4 outgoing requests for AML/CFT-related legal assistance were granted, 2 are under review, and there is no information available on the status of the other 6.

In 2014 no outgoing request for AML/CFT-related extradition was granted. 2 requests were not reviewed, the review of one was postponed (the person is prosecuted for unlawful actions committed on the territory of the requested party), 3 were refused due to: availability of citizenship of the requested party, lack of criminal evidence in the actions of the person under the requested party's legislation, and failure to identify a person on the territory of the requested party.

In 2015 the PGOU submitted a total of 34 AML/CFT-related requests, of which: 32 for legal assistance and 2 for extradition.

Out of 25 requests from the Ukrainian pre-trial investigation authorities for legal assistance in the ML criminal cases, 4 were completed by foreign competent authorities and 21 are pending completion.

Out of 7 requests from the Ukrainian pre-trial investigation authorities for international legal assistance in the FT criminal cases, 2 were completed and 5 are pending completion.

In 2015 no refusals were received from foreign competent authorities on requests for legal assistance and extraditions in the ML and FT cases.

The average time for completing the outgoing requests in the AML/CFT-related criminal cases in 2013 was 7 months, and in 2014 – 6.5 months. The average time for completing the Ukrainian requests on criminal cases by competent foreign agencies in 2015 was over 7 months (about 228 days).

The Ukrainian requests for extradition of persons have been pending competent foreign agencies' review since April and July 2015.

The average time for completing the Ukrainian requests on the ML criminal cases was 10 months (about 300 days).

The average time for completing the Ukrainian LEA requests on the FT criminal cases was over 4 months (about 135 days).

The requests by the Ukrainian investigation agencies on the criminal cases related to creation of unlawful paramilitary or armed formations, leadership in a terrorist organization, organizational, material, and other

facilitation of its activities have been pending completion in the Russian Federation since February 2015. The competent authorities of the Republic of Estonia completed such requests in 36 days, and the US side has had a request under CCU Part 1, Art. 258-3 in review since August 2015.

In 2013 the largest number of outgoing requests from the PGOU for AML/CFT-related legal assistance was submitted to: the Russian Federation, United Kingdom of Great Britain and Northern Ireland (4 each), Swiss Confederation (3); for AML/CFT-related extradition – the Russian Federation (2) and Hungary (1).

In 2014, the Prosecutor General's Office of Ukraine submitted outgoing requests for AML/CFT-related legal assistance to the Russian Federation (3), Republic of Ecuador, Republic of Estonia, Republic of Latvia, and USA (1 each).

The largest number of the outgoing requests for AML/CFT-related extradition was submitted to the Russian Federation (8), Republic of Ecuador, Republic of Lithuania, and United Kingdom of Great Britain and Northern Ireland (1 each).

In 2015, the Ukrainian authorities that investigate ML criminal cases most commonly submitted their request to the competent authorities of the Republic of Latvia (4), United Kingdom of Great Britain and Northern Ireland (3), and Swiss Confederation (2).

Two extradition requests of the Ukrainian authorities were submitted to the Russian Federation and the Federal Republic of Germany.

The Ukrainian investigative authorities' requests for legal assistance in the FT criminal cases were submitted to the competent authorities of the Republic of Kazakhstan (3), Russian Federation, Republic of Turkey, Republic of Azerbaijan, Georgia (1 each).

As noted above, requests for international legal assistance in the criminal cases under CCU Part 1, Art. 258-3 and Part 3, Art. 260 were submitted to the Russian Federation, Republic of Estonia, and USA.

International cooperation plays an important role in performance of their duties by the prosecution authorities' representatives. Specifically, in 2015 the PGOU representatives conducted 21 working meeting with the Basel Institute on Governance specialists on investigation of criminal cases against former senior officials and identification and return of their assets. The meetings discussed the coordination of criminal investigations against former Ukrainian senior officials, formation of the strategy for international investigations and cooperation with relevant foreign jurisdictions; Ukrainian investigators and prosecutors received valuable recommendations from foreign experts, which were used during pre-trial investigations, including during preparation of the relevant procedural documents.

Security Service of Ukraine (SBU)

The SBU does not have divisions focused exclusively on the ML/FT cases. These functions are shared by several structural divisions.

The SBU Main Directorate for Combating Corruption and Organized Crime has one division (numbering 14 employees), whose tasks, inter alia, includes detection of unlawful actions related to ML.

The most vulnerable economic sectors in the ML/FT cases, in SBU experience, include trade, construction, and real estate.

In 2013, the materials of the SBU operational departments were used to bring 4 criminal cases under CCU Art. 258 "Terrorist Act" and 258-5 "Financing of Terrorism", and 77 in 2014 (a 19-time increase in 2014 over 2013).

In 2015, 916 cases were brought against 129 persons under CCU Art. 258 (of which the court reviewed 3 cases against 4 persons) and 210 cases against 23 persons under CCU Art. 258-5 (of which 6 cases against 7 persons were reviewed) – (a 14.6-time increase in 2015 over 2014).

In 2014, with the aim of blocking bank accounts and performing financial monitoring, SBU submitted 13 reports to the SFMSU on the possible financing of terrorism and separatist activities, and 5 more in 2015.

Ministry of Internal Affairs (National Police of Ukraine)

The National Police of Ukraine organizational structure is hierarchical, composed of the headquarters and territorial divisions in the regions. The divisions' budget is formed within the general budget of the National Police of Ukraine headquarters and regional level budgets.

In 2013-2014, within international police cooperation, the Interpol National Bureau for Ukraine started 61 materials on ML (23 materials in 2013 and 38 materials in 2014).

In 2013-2014, in the sphere of countering terrorism, 124 materials were started (56 materials in 2013 and 68 materials in 2014).

In 2013, the MIA received 4 incoming AML/CFT-related requests from foreign agencies, including: Federal Republic of Germany – 2, Kingdom of Spain – 1, Kingdom of the Netherlands – 1.

In 2014, the MIA received 3 incoming AML/CFT-related requests from foreign agencies – one each from the Russian Federation, Republic of Moldova, and Kingdom of Belgium.

The competent foreign agencies' requests in criminal cases were granted in full and within the time stipulated in the Code of Criminal Procedure of Ukraine. Further, in 2013 within international police cooperation, the Interpol National Bureau for Ukraine received 96 reports and in 2014 – 75 reports from foreign law enforcement agencies on ML. In the sphere of countering terrorism, 76 reports were received in 2013 and 62 reports in 2014.

In 2013-2014, within international police cooperation, the Interpol National Bureau for Ukraine received the largest number of the incoming reports on ML and countering terrorism from the following countries: Russian Federation – 32, Germany – 24, Turkey – 22, Czech Republic – 19, France – 17.

In 2013-2014, within international police cooperation, the Interpol National Bureau for Ukraine submitted 104 reports in 2013 and 126 reports in 2014 reports to foreign law enforcement agencies on laundering of criminal proceeds. In the sphere of countering terrorism, 56 reports were submitted in 2013 and 93 reports in 2014.

In 2013-2014, within international police cooperation, the Interpol National Bureau for Ukraine submitted the largest number of the outgoing reports on ML and countering terrorism to the following countries: Germany – 41, Russian Federation – 33, Czech Republic – 28.

International cooperation plays an important role in performance of their duties by the MIA representatives. Specifically, international law-enforcement cooperation within the framework of ICPO-Interpol focuses on countering transnational crime and commitment of criminal offenses that transgress the state boundaries, international search for criminal prosecution of persons who committed crime and hide from investigation and court, support of safety and security.

State Fiscal Service of Ukraine (SFS)

At the end of 2015, the structure of the SFS included a Department for Combating Laundering of Proceeds of Crime, staffed with 21 employees.

Also, the SFS Main Administrations in the regions and in the city of Kyiv have departments (units) for combating laundering of criminal proceeds, staffed with 223 employees.

The Department for Combating the Laundering of Criminal Proceeds is a structural division of the SFS and is funded by the government as a regulator of the executive authorities.

According to the summarized data of the regional investigative divisions, in 2013 the customs militia investigators had 322 criminal cases under CCU Art. 209 and 209-1, of which 267 were brought within a year. The pre-trial investigation was completed in 132 criminal cases under the above articles, 33 of which were submitted to court with an indictment against 41 suspects, and 101 criminal cases were dismissed.

In 2014, the investigators had 318 of such criminal cases, 231 of which were started within a year. The pre-trial investigation was completed in 118 criminal cases under the above articles, 19 of which were submitted to court with an indictment against 19 suspects, and 98 criminal cases were dismissed.

According to the summarized data of the regional investigative divisions, as of Dec. 1, 2015 the customs militia investigators had 194 criminal cases under CCU Art. 209 and 209-1. In January-November 2015, 121 cases under the said articles were brought. 55 of this number of criminal cases were brought on the SFMSU SM.

No internal regulations on investigation of cases in this area were implemented. In each criminal case, the need for certain investigative (search) and covert investigative actions is decided on by the investigator who conducts the pre-trial investigation and procedural manager in such a case.

In Ukraine criminals and OCGs employ almost all the known ML methods and the identified ML schemes are quite complex.

In the criminal cases submitted to court in 2013, the established amount of criminal proceeds was 64 mln 170 thous UAH, of which 1 mln 195 thous UAH were reimbursed. The arrested criminal proceeds amounted to 880 thous UAH, and the arrested property of the suspected amounted to 1.7 mln UAH.

In the criminal cases submitted to court in 2014, the established amount of criminal proceeds was 65 mln 640 thous UAH, of which 2 mln 35 thous UAH were reimbursed. The arrested criminal proceeds amounted to 6.5 mln UAH, and the arrested property of the suspected amounted to 32.7 mln UAH.

According to the summary data of the regional investigative divisions, as of Dec. 1, 2015, the pre-trial investigation was completed in 64 criminal cases under CCU Art. 209 and 209-1, of which 11 were submitted to court with an indictment against 11 suspects and 44 criminal cases were dismissed. In the criminal cases submitted to court, the established amount of criminal proceeds was 61 mln 208 thous UAH. The reimbursement of the damages inflicted by the offenses was secured to the amount of 6 mln 277 thous UAH.

National Anti-Corruption Bureau of Ukraine (NABU)

The NABU is a government law enforcement agency in charge of prevention, detection, stopping, investigation, and solving corruption-related offenses within its investigative jurisdiction, as well as preventing the commitment of new offenses.

Pursuant to CCPU Art. 216, the NABU detectives carry out, inter alia, pre-trial investigation of the crimes under CCU Art. 209.

Since registration of the criminal cases began from the moment of appointing the Specialized Anti-Corruption Prosecutor's Office on Nov. 30, 2015, the summarized information on the results of pre-trial investigations is absent.

The total number of the central and territorial NABU divisions is 700 persons.

In the detectives' unit, which takes immediate part in ML investigations, the staff roll provides for 257 employees; currently, the staffing is underway.

According to the distribution of the State Budget of Ukraine expenses for 2015, the NABU budget was 247.9 mln UAH.

Investigations follow the procedure stipulated in the Code of Criminal Procedure of Ukraine.

The NABU is entitled, based on a written decision of the NABU Director or his/her Deputy concurred by the Prosecutor, to establish joint investigation teams which include operative and investigative staff.

In Dec. 2015 – Jan. 2016, the number of criminal cases investigated by the NABU was growing in parallel with adding the staff of the SAPO. As of Feb. 1, 2016, the NABU detectives added 56 cases to the Register of Pretrial Investigations. The largest number of cases – 19, were submitted to the NABU from the PGOU. 15 criminal cases were added to the Unified Register of Pretrial Investigations by the NABU detectives and analysts each, as well as based on the information provided by natural persons and legal entities. In terms of economic activities, the majority of the criminal cases are related to state governance, defense, mandatory social insurance – 22, transportation, warehousing, postal and courier activities – 6, supply of electricity, gas, steam, and conditioned air – 5, and financial and insurance activities. In terms of persons audited for engagement in corruption crimes, most cases relate to the activities of state enterprise managers – 19 criminal cases, judges – 13 criminal cases, civil servants and Category 1 and 2 local government officials – 6 criminal cases, and prosecutors – 5 criminal cases. During pre-trial investigation of the criminal cases, the first arrests of the UAH and foreign currency cash assets were made to the amount of 400.7 thous UAH, 109 thous USD, 2.4 thous EUR, and 2 thous RUB. Also, claims were filed to the amount of 346.2 mln UAH.¹³⁷

Customs

In 2015, the State Fiscal Service reviewed 7,004 cases on violation of customs regulations and applied administrative punishment in the form of a fine to the amount in excess of 615.63 mln UAH. Of this amount, over 20.38 mln UAH were claimed and transferred to the State Budget of Ukraine.

The SFS customs submitted 9,767 cases on violated customs rules to court to the amount exceeding 1.8 bln UAH. The court review of the cases resulted in a decision to confiscate the immediate objects of violation to the amount exceeding 901.07 mln UAH. Fines were imposed to the amount in excess of 832.66 mln UAH.

In 2015 the SFS customs identified: 970 facts of trafficking drugs, psychotropic substances, their counterparts and precursors through the customs border of Ukraine with violations of the customs regulations; 574 cases of illegal trafficking of weapons and ammunition over the customs border of Ukraine.

The SFS customs submitted 1,613 reports on detected indicators of criminal offenses to the LEA, of which:

- 211 reports on detected indicators of the crime stipulated by CCU Art. 201;
- 270 reports on detected indicators of the crime stipulated by CCU Art. 305;
- 1,132 reports on detected indicators of other crimes.

One of the methods to prevent and detect customs violations is cooperation and exchange of information with foreign competent authorities within the framework of mutual administrative assistance. The interaction is carried out by 65 customs administration of the World Customs Organization member states. The cooperation in 2015 resulted in bringing 804 cases on violated customs regulations to the amount 879.1 mln UAH. This translates to 4,5 of the total number of cases launched by the customs since the beginning of 2015 and almost 50% of the total cost of violation objects.

¹³⁷ Source: according to the information from the NABU official site: [Electronic resource]. – Access mode: <https://nabu.gov.ua/report/zvit-serpen-2015-lyuty-2016>

46 criminal cases were brought using the materials received through interaction with the foreign customs authorities and submitted by the customs to the State Fiscal Service territorial divisions. The materials of the audits performed together with the foreign customs authorities and submitted since the beginning of 2015 to the tax and customs audit divisions helped establish non-payment of mandatory customs dues in the amount of 67.1 mln UAH.

Administration of the State Border Guard Service of Ukraine

The structure of the SBGSU does not envisage a division charged with AML/CFT. At the same time, individual divisions of the Service, within their competence, participate in countering these unlawful activities by providing (if available) the relevant data to the designated users of intelligence.

The structure of the divisions involved in countering FT: SBGSU Administration, regional divisions, state border protection agencies, state border protection divisions.

In 2015, the SBGSU operative divisions, pursuant to the investigator's instructions, held 2 covert investigative (search actions) and 548 investigative (search) actions in relation to the criminal offenses under CCU Art. 258-5. The materials received were duly submitted to the investigative agencies of the relevant law enforcement divisions.

Foreign Intelligence Service of Ukraine

In 2015, based on the AML/CFT-related materials completed by the FISU, the LEA brought 3 criminal cases and additionally used the materials in 2 already existing criminal cases.

According to the FISU, 5 incoming AML/CFT-related requests from foreign agencies were received in 2015. In its turn, the FISU submitted 10 outgoing AML/CFT-related requests to foreign agencies.

2.4. Judicial System

According to the State Judicial Administration of Ukraine statistics¹³⁸, the number of ML cases reviewed by courts in the past three years showed an almost double reduction (by 46 %).

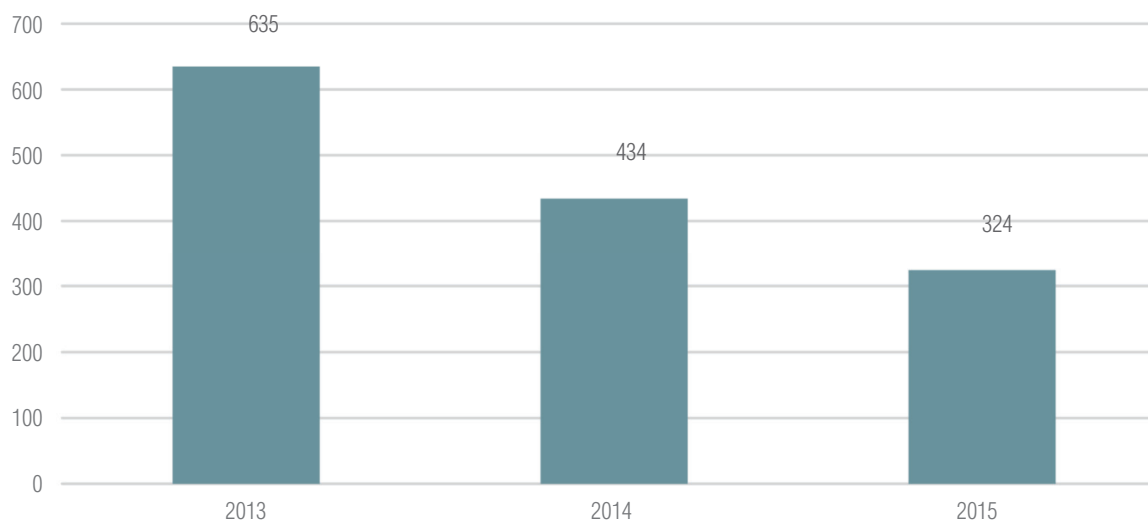


Fig. 2.4.1. Number of ML cases (CCU Art. 209 and 2091) in court review in 2013-2015

Statistical information on the number of guilty/not guilty verdicts in 2013-2015 is shown below.

Indicator	2013	2014	2015
ML criminal cases reviewed with a verdict	150	91	45
Persons convicted for ML crimes	131	73	40
Persons acquitted of ML crimes (persons)	99	48	35
including convicted under another CCU article	93	35	26

Table 2.4.1. Number of guilty and not guilty verdicts in 2013-2015

¹³⁸ Source: information from the Judiciary of Ukraine official web-portal. [Electronic resource]. – Access mode: http://court.gov.ua/sudova_statystyka/

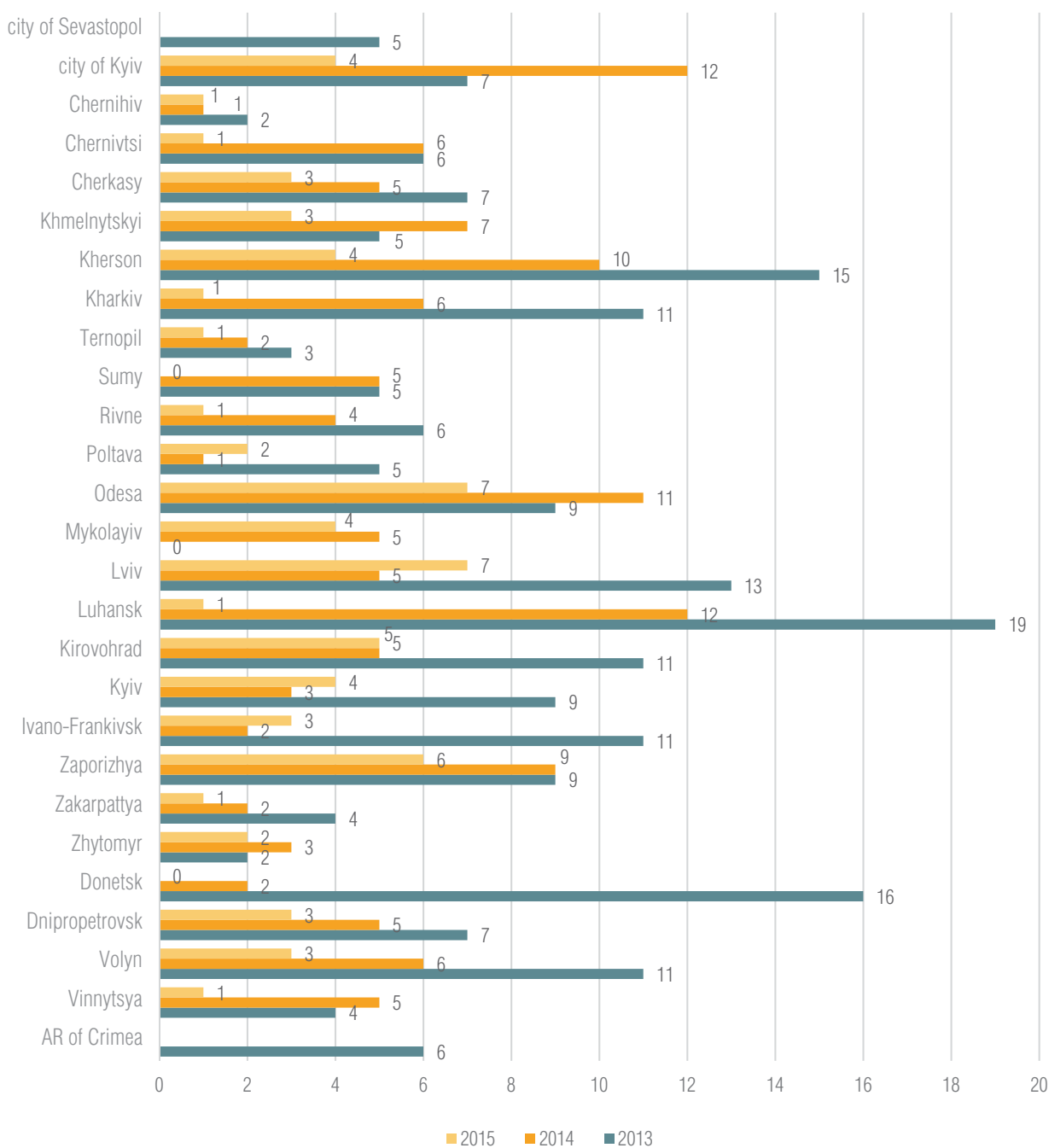


Fig. 2.4.2. Number of court decisions (verdicts) in the ML cases¹³⁹

The fraction of those convicted under the verdicts that took effect for tax crimes in 2013-2015 was below 1 % of the total number of those convicted for all the types of crime. In 2013 the total number of convicted persons was 122,973, of which 119 were convicted for tax crimes. In 2014 out of 102,170 persons 86 were convicted for tax crimes, and in 2015 out of 94,797 persons 58 were convicted for tax crimes.

The following punishment was imposed on those convicted for ML (under the verdicts that became effective) in 2013-2014.

¹³⁹ The data on the number of court decisions (verdicts) in the ML cases in 2013-2015 is provided without the data for the courts of the Autonomous Republic of Crimea, city of Sevastopol, some courts of the Donetsk and Luhansk Regions

Indicator	2013	2014	2015
Imprisonment	37	21	6
Fine	0	1	0
Released from punishment, of which:	23	33	7
with a probation	23	18	3
due to amnesty	0	15	4

Table 2.4.2. Punishment imposed on those convicted for ML (under the verdicts that took effect) in 2013-2014

The number of convicted persons, in relation to which the court decided on confiscation of money or other criminal proceeds and property confiscation, in 2013-2015 was 113, 52, and 19.

The amounts of legalized criminal proceeds (money, property) established by trial courts in 2013-2015 were 200,639,732 UAH, 35,662,575 UAH, and 3,162,882 UAH respectively.

Indicator	2013	2014	2015
Indictments (number of criminal cases under CCU Art. 209, 209-1 reviewed by courts)	283	180	103
Number of criminal cases with a verdict	150	91	45

Table 2.4.3. ML cases, number of indictments and convictions (cases)

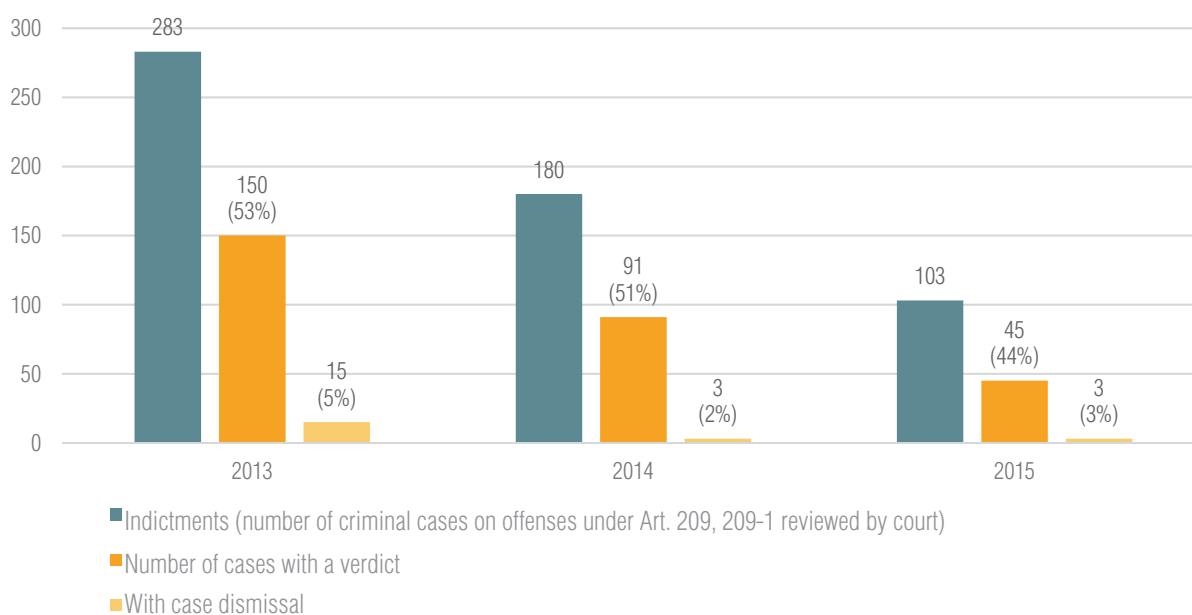


Fig. 2.4.3. Number of ML cases reviewed by courts

Following a review by courts of the criminal cases on the crimes under CCU Art.209, 209-1, only about 50 % of the criminal cases in 2013-2015 were reviewed with a verdict.

In 2013, the number of the ML criminal cases dismissed was 15, in 2014 the number of dismissed ML cases was 3, and 3 more in 2015.

The level of ML crime in 2013-2015 by the regions of Ukraine based on the court verdicts can be seen in the following figure.

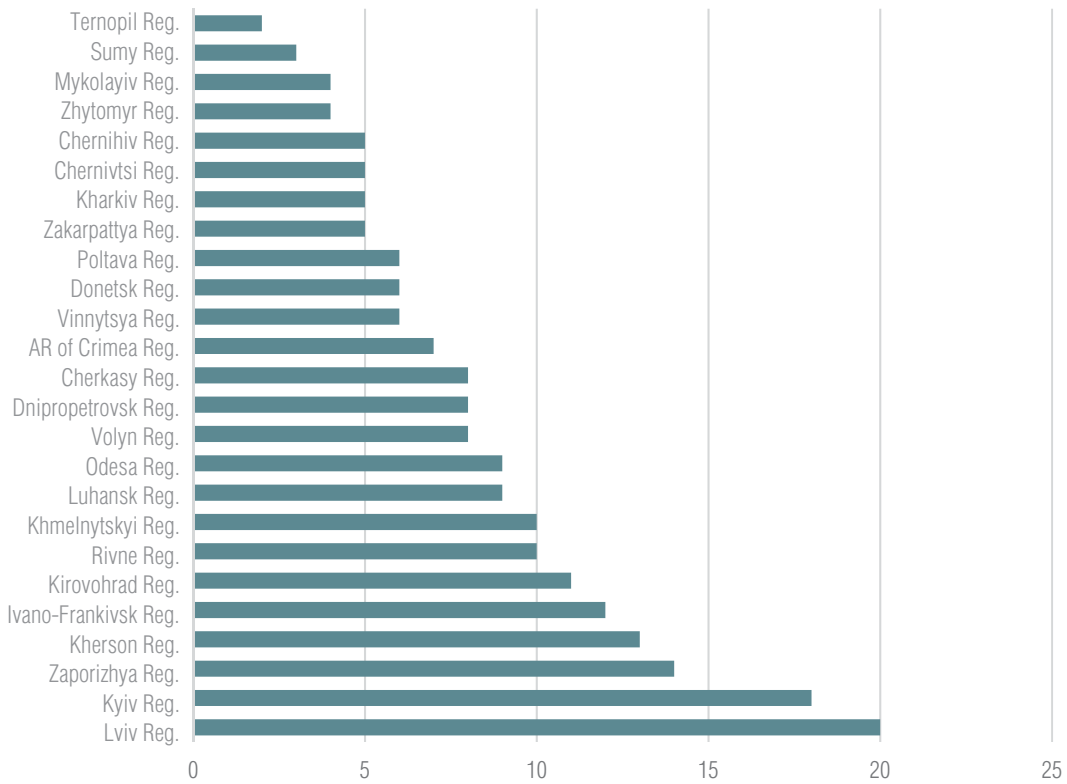


Fig. 2.4.4. Level of ML crime in 2013-2015

The average time between committing an ML crime and the court verdict is about 5 years.



Fig. 2.4.5. Average time between committing an ML crime and the court verdict

2.5. Threats and Risks

Threat 1. Insufficient efficiency of the FIU activities

Risk 1	Insufficient material and technical support of the FIU		
Level of consequences	4	Comment	<p>Insufficient technical support of the FIU with the required modern equipment and software, as well as agency funding in general, makes full-fledged performance by FIU of its AML/CFT duties impossible.</p> <p>A significant increase in the number of STRs received by the SFMSU since February 2015 and the SFMSU IT system, which is obsolete and worn out, since last time it was upgraded in 2008-2009, generate a high technological risk of further inability of the SFMSU to efficiently perform its basic functions on collection, processing, storage, and analysis of information on the suspicious financial transactions.</p> <p>The number of reports received by the SFMSU in 2014-2015 increased from 4,000 to 30,000 per day, which imposed a substantial additional load on the SFMSU IT structure, specifically in the context of its inability to store data and the need to destroy the data from the previous periods to release additional space in the central data storage.</p>
Probability level	3	Comment	<p>The USIS has been in operation for 12 years. In 2003-2015 the list of the PFMS obliged to submit information and the requirements for information-related interaction with them increased significantly.</p> <p>Thus, the scope of information received and processed in the USIS in March of the current year is 3.9 times higher than during the same period of the previous year. The said scopes of information significantly exceed the scopes of information specified in the Terms of Reference for the system.</p> <p>Today the UIS is facing challenges in terms of its functioning and subsequent development. The UIS equipment was bought in 2003-2008, and today it has basically exhausted its resource and does not have maintenance support. Most of the equipment is obsolete and does not support current versions of the system and analytical software.</p>
Overall risk level	12		
Effectiveness of the available measures	4	Comment	<p>To save the budget money, Clause 13 of the Provision on the USIS implements two technologies for information exchange between the SFMSU and other UIS subjects: upon request from the SFMSU to the information resource located in the functional system of the USIS subject, or by regular provision of databases by an information resources subject for their updating in the data storage.</p>
Description of measures	<p>To improve the USIS and to implement the actions in the main areas of this system development pursuant to legislation, in 2012 the SFMSU developed a program "Upgrading of the Information System in the Sphere of Preventing and Countering Legalization (Laundering) of Proceeds of Crime, Financing of Terrorism, and Financing of Proliferation of Weapons of Mass Destruction".</p> <p>The upgrade started by the SFMSU should ensure compliance of the national AML/CFT system with the FATF Recommendations, integration of the state authorities' additional information resources in the UIS, replacement of the obsolete hardware and software, improvement of the comprehensive information protection system in line with the new threats to its security. However, according to the funding approved for the SFMSU in the State Budget of Ukraine for 2013-2016, no allocations were made for these purposes.</p>		

Net risk level	16
Description of measures proposed to be taken for risk management	<p>With the aim of efficient risk management, the following is proposed:</p> <ol style="list-style-type: none"> 1. The State Budget of Ukraine for 2017 should include the required funding to implement the program “Upgrading of the Information System in the Sphere of Preventing and Countering Legalization (Laundering) of Proceeds of Crime, Financing of Terrorism, and Financing of Proliferation of Weapons of Mass Destruction” and the SFMSU-started upgrade, which should ensure compliance of the national AML/CFT system with the FATF Recommendations, integration of the state authorities' additional information resources in the UIS, replacement of the obsolete hardware and software, improvement of the comprehensive information protection system in line with the new threats. 2. Resolve the issue on the need to procure a fully integrated IT solution for the SFMSU. Develop a comprehensive budget estimate for the upgrade of the SFMSU IT system.

Risk 2	Low salary of the FIU staff		
Level of consequences	4	Comment	In 2008 the consolidated SFMSU budget (taking into account the territorial divisions existing at that time – regional SFMSU units) exceeded 49 mln USD. The annual SFMSU budgets of 2014-2015 did not exceed 1 mln EUR (for reference: at the end of 2010, all the regional SFMSU units were liquidated). The SFMSU continues losing its staff on the critical level, especially in its key areas – analysis and investigations. One of the reasons is that the SFMSU personnel, which performs almost the same functions as the National Anti-Corruption Bureau of Ukraine, receives an approximately six time smaller salary compared to the SFMSU staff. This causes concern and is unacceptable.
Probability level	3	Comment	Taking into account significant scopes of information analyzed by the FIU, human resources support should be provided in full. However, given the difficult economic situation in the country, there is a risk of low remuneration for the FIU employees. Considering their non-competitive salary, qualified FIU employees, whenever possible, move to other higher-paid jobs, specifically to private sector organizations. According to the IMF Report, as of December 2015 the FIU lost a significant number of its staff, specifically the analytical unit and the financial investigation unit. The share of vacancies reaches 20 %. Most employees who resigned got employment with the National Anti-Corruption Bureau of Ukraine due to a significantly higher salary ¹⁴⁰ . The gap between remuneration and the established standards were also brought up in the EU expert report on visa regime liberalization ¹⁴¹ .
Overall risk level	12		
Effectiveness of the available measures	4	Comment	Notwithstanding the reform initiatives to upgrade the public service in Ukraine, specifically adoption of the Law of Ukraine “On Public Service” ¹⁴² and CMU Resolution “Some Issues of Remuneration of Civil Servants in 2016” ¹⁴³ , which established new official salaries for public servants, the FIU staff salaries have not changed. And given the

¹⁴⁰ Conclusions of the IMF Report on technical assistance related to application of measures to counter legalization of criminal proceeds in support of the counter-corruption efforts (the Financial Intelligence Unit component).

¹⁴¹ Conclusions of the European Commission Expert Report on the Visa Liberalization Action Plan with reference to money laundering, financing of terrorism, and return of assets (Sept. 27 – Oct. 2, 2015), (Block 3, Public Order and Security).

¹⁴² On Public Service: Law of Ukraine, December 10, 2015 No. 889-VIII: [Electronic resource]. – Access mode: <http://zakon2.rada.gov.ua/laws/show/889-19>

¹⁴³ Some Issues of Remuneration of Civil Servants in 2016: Cabinet of Ministers of Ukraine Resolution, April 06, 2016 No. 292: [Electronic resource]. – Access mode: <http://zakon3.rada.gov.ua/laws/show/292-2016-%D0%BF>

			inflation processes in the country and a drop in the national currency exchange range, it will significantly affect the FIU staff motivation.
Description of measures	Actions taken to reduce the risk are predominantly limited to the need of increasing the FIU staff salaries mentioned in the reports by international institutions (EU, IMF). Further, the FIU on several occasions brought the issue to the Ministry of Finance attention.		
Net risk level	16		
Description of measures proposed to be taken for risk management	With the aim of efficient risk management, eliminate disproportion in the FIU staff salaries and other state authorities involved in the AML/CFT and anti-corruption activities, first and foremost the NABU.		

Threat 2. Low efficiency of the anti-legalization process

Risk 1	Inefficient system of initial detection of suspicious financial transactions		
Level of consequences	2	Comment	<p>The system of initial detection and information provision on suspicious financial transactions is based on a formal identification of mandatory criteria (list of pre-determined and legislatively established indicators) and does not always meet and is not always based on real PFMS suspicions on the client's asset sources of origin and methods of effecting transactions or transfers of the corresponding incomes.</p> <p>The mechanism of the legislative (mandatory) establishing of the criterial indicators for the risky financial transactions is inflexible and slow. As an example, the first indicators of the real identification of the national publicly exposed persons' suspicious (in terms of the possible corrupt origin of the incomes) financial transactions were implemented in the national anti-legalization legislation only at the end of 2014, but in fact began appearing only starting February 2015. The new indicators of the mandatory financial monitoring of the publicly exposed persons' financial transactions, as well as the new indicators related to mandatory informing of the financial transactions exceeding 150,000 UAH (about 6,000 USD) were the reason for a quadruple increase in the number of STRs detected and submitted by the PFMS to the SFMSU.</p> <p>In 2003-2015, the PFMS annually submitted on the average 1,177,830 STRs to the SFMSU. The cumulative (accrued) number of the STRs received from the primary financial monitoring subjects with indications of the mandatory and internal monitoring as of 01.01.2016 was 15,311,784.</p> <p>But only about 9 STRs out of 100 received from the PFMS become the basis for SM (ASM) through analytical work of the SFMSU in cooperation with LEA and foreign FIU. At the same time, the determination coefficient explains only 1.2 % of changes in the relevant resulting indicator depending on the factor one.</p>
Probability level	2	Comment	<p>Considering very high probability levels of corrupt acts and further growth in the size of the shadow national economy, if no additional institutional actions are taken to reorient the mechanism of initial detection in the context of increased attention to the financial transactions related to corrupt actions of senior officials (both in the bank and non-bank and non-financial sectors), Ukraine, with a high probability level, will continue to have a low-efficient system of initial detection of suspicious financial transactions.</p> <p>96-99% of all the STRs in the sphere of anti-legalization financial monitoring are detected and submitted to the SFMSU by bank financial institutions. The total of bank institutions accounts for only 1 % of the overall number of PFMS registered in Ukraine. There are reasons to believe that suspicious financial transactions in the non-bank and designated segment are underdetected by the PFMS, and the system of supervision over the corresponding categories of the non-bank PFMS is flawed.</p> <p>To meet the new requirements related to detection of formal indicators of the mandatory financial monitoring in each financial transaction, PFMS (banks) use significant resources; at the same time, the quality of</p>

			<p>the primary monitoring of the previously conducted financial transactions remains very low.</p> <p>In 2013-2015 alone, the PFMS submitted to the SFMSU information on 356,645 or 66.6 % (2013), 780,234 or 60.6 % (2014), 3,873,967 or 88.9 % (2015) of reports on the financial transactions with indicators of mandatory financial monitoring. Further, the number of the SM prepared by the SFMSU and submitted to the LEA in 2013-2015 shows a declining trends from 588 SM in 2013 to 364 SM in 2015. This may evidence low weight of the reports on financial transactions with indicators of mandatory financial monitoring received from the PFMS in SM development.</p> <p>The specific weight of the SM and ASM, according to the LEA in 2012-2015, gradually increased with a simultaneous reduction in the weight of the SM and ASM independently prepared by the SFMSU. In other words, though the number of STRs from the PFMS in 2013-2015 increased significantly, the number of SM and ASM prepared by the SFMSU independently tends to reduce. A significant role in SM and ASM development is played by PFMS reports on financial transactions with indicators of internal financial monitoring compared to reports on financial transactions with indicators of mandatory financial monitoring, which on the average account for about 80% of the STRs submitted by the PFMS.</p>
Overall risk level			4
Effectiveness of the available measures	2	Comment	<p>The system of initial detection and submittal of suspicious financial transaction reports stipulated in the Law is cumbersome for the PFMS, insufficiently efficient for receiving high-quality information and does not always facilitate detection of proceeds of crime, including corruption.</p> <p>To increase the efficiency of STR submittal to the SFMSU, on Aug. 23, 2016 the Cabinet of Ministers of Ukraine approved a Strategy for Reforming Reports in the AML/CFT Sphere¹⁴⁴.</p> <p>A draft Law of Ukraine of July 12, 2016, No. 4960 "On Changes to Some Legislative Acts of Ukraine on Specifying Their Individual Provisions on Preventing and Countering Legalization (Laundering) of Proceeds"¹⁴⁵ was developed and submitted for review of the Verkhovna Rada of Ukraine.</p>
Description of measures	<p>The current legislative framework on report submittal is based on the concept of "mandatory monitoring" which envisages automatic submittal of reports on the financial transactions that exceed the established limit (150,000 UAH), provided they meet some preliminarily specified criteria (set forth in the Law).</p> <p>Also, PFMS shall provide information to their national FIU on their suspicions regarding the activities of persons or their assets if there are grounds to believe that they are related to a crime stipulated by the CCU or if there are grounds to submit the report due to suspicions of corrupt sources of the money origin. However, in real life PFMS predominantly focus on submittal of financial transaction reports based on automatic</p>		

¹⁴⁴ On Approving the Strategy of Reforming the Reporting System on Preventing and Countering Legalization (Laundering) of Proceeds of Crime, Financing of Terrorism, and Financing of Proliferation of Weapons of Mass Destruction: Cabinet of Ministers of Ukraine Ordinance, March 1, 2016 No. 608-r: [Electronic resource]. – Access mode: <http://www.kmu.gov.ua/control/ru/cardnpd?docid=249263966>

¹⁴⁵ On Changes to Some Legislative Acts of Ukraine on Specifying Their Individual Provisions on Preventing and Countering Legalization (Laundering) of Proceeds: draft Law of Ukraine, July 12, 2016 No. 4960: [Electronic resource]. – Access mode: http://w1.c1.rada.gov.ua/pls/zweb2/webproc4_1?pf3511=59658

(legislatively established) indicators, regardless of whether they indeed testify to suspiciousness of a financial transaction.

Such system has failed to demonstrate efficient detection of ML and predicate crimes. Most importantly, in the environment where supervision is more than formalistic and focused only on meeting the requirements, such state of affairs may facilitate corruption (a large number of reports that were not submitted according to these requirements can be explained by human errors prompted by such procedures).

The Provision on the Use of Measures of Influence by the National Bank of Ukraine provides that the indications of banks' risky activities in the financial monitoring sphere may specifically include:

- non-use by banks of their the right to refuse bank clients regular financial transactions, the nature of which gives grounds to believe that their purpose is to use bank services for ML, FT, and FPWMD, or committing of another crime;
- financial transactions effected by a bank or bank clients using lost, stolen, fake documents.

Further, pursuant to Art. 66 of the Law of Ukraine "On Banks and Banking Activities", the NBU in a number of its letters set requirements for bank activities, specifically the need to ensure a comprehensive analysis and check of the documents (information) on financial transactions and their participants. The bank shall ensure a corresponding comprehensive analysis and check of the documents (information) on such a financial transaction and its participants to identify any indicators of a suspicious financial transaction specified in the NBU letters.

The Strategy of Reforming the Reporting System on AML/CFT aims at complying with the agreements within the framework of cooperation with the International Monetary Fund and at transition to using a risk-oriented model during PFMS reporting to the SFMSU on suspicious financial transactions.

The purpose of the Law of Ukraine of July 12, 2016, No. 4960 is improvement and specifying of individual legislative norms on AML/CFT. These changes are designed to transition from the quantitative to the qualitative analysis which focuses on submitting financial transactions based on internal financial monitoring indicators by reducing the number of financial transactions submitted based on the mandatory financial monitoring indicators and improving the quality of information submitted based on the internal financial monitoring criteria.

Net risk level	4
Description of measures proposed to be taken for risk management	<p>With the aim of efficient risk management, the following is proposed:</p> <ol style="list-style-type: none"> 1. Facilitate adoption and implementation of changes in the system of information provision by the PFMS pursuant to the Law from the one that requires providing information based on the indicators of mandatory financial monitoring to the one based on informing on the financial transactions that cause suspicion, i.e. with indicators of internal financial monitoring¹⁴⁶. <p>Apart from the principle of submitting suspicious transaction reports, it is also advisable to transfer the system of initial detection and information provision from mandatory submittal of reports based on typologies to provision of reports on the financial transactions, the amount of which exceeds the established limit with relation to cash transactions and international money transfers.</p> <ol style="list-style-type: none"> 2. Optimize the number of mandatory financial monitoring indicators to automate the process of submittal by the PFMS of information on the financial transactions with mandatory financial monitoring indicators to the SFMSU.

¹⁴⁶ According to the conclusions of the IMF Report on technical assistance related to application of measures to counter legalization of criminal proceeds in support of the counter-corruption efforts (the Financial Intelligence Unit component).

3. Consider the issue of FIU expeditiously providing the results of analysis of information on financial transactions to the NABU.
4. Develop a clear list of positions, holding which automatically refers a person to the category of the national publicly exposed person (enhancing the role of the National Agency of Ukraine on Civil Service in this issue).

Risk 2		Outdated (inefficient) suspicious financial transaction information analysis system	
Level of consequences	4	Comment	<p>The SFMSU reviews reports on financial transactions with indicators of mandatory or internal financial monitoring received from the PFMS and provides the results of the review to the LEA in the form of SM and/or ASM. In terms of the criminal procedure, the SM is a report on a committed criminal offense and the basis for taking investigative and counter-intelligence activities by the law-enforcement and intelligence agencies of Ukraine.</p> <p>Starting 2003 and through 2015, the SFMSU submitted 5,483 SM to the LEA. On the average, during the period the SFMSU annually submitted 422 SM to the LEA.</p> <p>During the entire period of its functioning from 2003 through 2015, the SFMSU submitted 3,494 ASM to the LEA. On the average, during the period the SFMSU annually submitted 269 ASM to the LEA.</p> <p>The main SM recipients among the LEA in 2003-2015 were SFS and MIA.</p> <p>In 2003-2015, the SM (AMS) on the annual average included 128,370 PFMS suspicious transaction reports (10.9 % of the total of reports received from the PFMS). Cumulatively, as of Jan. 1, 2016, the SM (ASM) included 1,668,804 PFMS reports.</p> <p>The fraction of the financial transactions included in the SM (ASM) in 2013-2015 were 3-4 times smaller than the average annual indicator (12.6 %) calculated in 2003-2015.</p> <p>This statistics shows that the consequences of the identified risk are comparable with the results of inadequate investigation of the information contained in the SFMSU SM (ASM) under the CCPU.</p>
Probability level	4	Comment	<p>The analysis of the regressive relation evidences that about 9 reports out of 100 submitted by the PFMS, based on the results of the SFMSU analysis in interaction with the LEA and FIU of foreign countries, become the basis for developing of the SM (ASM). This fact can be considered as one of the main occurrence factors of a risk event related to the fact that the PFMS-detected financial transactions related to ML subsequently are not properly verified and analyzed by the relevant interaction subjects along the SFMSU – LEA line.</p> <p>Only 4 % of the financial transaction amounts included in the SM (ASM) depend on the amount received from the PFMS reports. The regression correlation measured in the actual prices of 2010 gives reason to state an even smaller dependence between the two contemplated indicators – at the level of 0.3 %.</p>
Overall risk level	16		
Effectiveness of the	3	Comment	Regardless of the automation level at the early stages of receiving (bank) reports, the tools for verification, initial analysis and determining the

<p>available measures</p>	<p>priorities relied on by the SFMSU analysts for further analysis and development of SM are mostly non-automated. These processes are based on: uploading the financial transaction data to Excel spreadsheets, development of i2 visual diagrams on their basis to visualize the relations, and development of reports using Microsoft Word.</p> <p>The process of transferring data from one system to another, their analysis with subsequent export of partly analyzed data and loading them into another system, and so on until the materials are finally developed, requires significant time, resources, and with a high probability may cause human-related errors. It also means that a large number of different systems needs to be supported, periodically upgraded, and their licenses paid.</p>
<p>Description of measures</p>	<p>All the PFMS-submitted STRs go through three stages of verification and priority setting. Two stages of such verification are automated. First, the data contained in the report are checked for compliance with the file attributes and structure, and then, according to the verification rules integrated in the electronic information exchange system. The STRs that failed the verification are returned to the PFMS for error elimination and repeated submittal. If the report passes the verification, it is physically uploaded to the USIS. After this, the report goes through priority identification, which begins with the search for data coincidences in the online mode using the USIS. The process takes place at night and the reports are assigned priority according to the rules integrated in the system. For example, the reports which are assigned the highest priority include the reports with the FT codes or reports on the financial transactions suspended by the PFMS. All the reports are submitted to the relevant analytical division, where they undergo a third (non-automated) verification, during which stage a decision is made on whether any action (if needed) will be taken. At the third stage the data processing is based on the risk-oriented approach, and depending on the results the reports are divided according to three risk levels – high/medium/low. If a report relates to a suspicion of FT, it is processed immediately and the SM are prepared on the same day. All the STRs which did not detect anything at the preliminary stage remain in the database for future use.</p> <p>The SFMSU has broad powers on collection of the information additionally to receiving the financial transaction reports from the PFMS envisaged by legislation. The SFMSU has the right to receive additional information from the PFMS, government authorities, other economic entities, foreign FIU, and from open sources. Through the USIS established in 2007 and commissioned in 2008, the SFMSU has real-time access to 15 internal databases of government authorities. The information received from the Unified State Information System is used at the initial stages of the analytical process and facilitates automation of determining the analysis priorities used by the SFMSU.</p>
<p>Net risk level</p>	<p>12</p>
<p>Description of measures proposed to be taken for risk management</p>	<p>With the aim of efficient risk management, the following is proposed:</p> <ol style="list-style-type: none"> 1. Take action on the technical upgrade of the USIS. Considering the size of the SFMSU, the scope of data it receives, and the number of staff analysts, the focus should be given to buying an integrated IT solution. A modern completely integrated IT solution would allow eliminating the human factor during preparation of the SM (ASM). 2. Ensure that the PFMS focus on providing reports on the financial transactions subject to internal financial monitoring (are suspicious), with a simultaneous actions to implement advanced information products at the SFMSU.

Risk 3	Inefficient system of investigation of materials by the FIU		
Level of consequences	4	Comment	<p>The fraction of refusals (in bringing criminal cases) and/or dismissals of criminal cases which were brought/launched following the review by the LEA of the SFMSU SM or those which used SM on the average amounted to 37.8 % in 2003-2015. An increase in the said fraction in 2014-2015 to 66.6% and 78.6 % respectively evidences an extremely negative trend in investigation of the ML/FT related cases. It should be noted that the corresponding indicator of 2015 is an absolute negative maximum from the beginning of the SFMSU activities on the SM preparation and their submittal to the LEA for verification and decision making based on the results of such a verification in accordance with the CCPU.</p> <p>Cumulatively (accrued) in 2003-2015, the SFS and the MIA accounted for 36.4 % and 41.8 % of refusals (dismissals) of the criminal cases which used SM, respectively. Cumulative fraction of refusals/dismissals of criminal cases brought (launched) pursuant to SM or which used SM.</p> <p>The specific weight of the SM and ASM, according to the LEA in 2012-2015, gradually increased with a simultaneous reduction in the weight of the SM and ASM independently prepared by the SFMSU, which evidences an improvement in the LEA efficiency in the context of informing the SFMSU on the detected ML suspicions (such informing is mandatory for the LEA for each fact of a detected suspicion pursuant to the requirements of the Law).</p> <p>The regression equation evidences that in 2003-2015 there were 4 brought (launched) criminal cases per 10 SM/ASM developed and submitted to the LEA.</p> <p>The cumulative number of criminal cases brought (launched) pursuant to SM/ASM or in which LEA used SM/ASM submitted to courts as of the end of 2015 was 889. The average annual number of the criminal cases of this category submitted to courts was 82.</p> <p>The regression equation evidences that in 2003-2015 only every 2nd out of 10 brought (launched) criminal cases of this category made it to court. Of the above criminal cases in the corresponding category submitted to courts, the courts reviewed and passed a guilty/not guilty verdict in 692 criminal cases (7.5 % of the cumulative number of the SM/ASM submitted to the LEA in 2003-2015 and 65 % of the cumulative number of the criminal cases sent to court).</p>
Probability level	3	Comment	<p>A significant increase in the fraction of refusals/dismissals of the criminal cases versus the total number of the criminal cases brought (launched) may have two reasons:</p> <ol style="list-style-type: none"> 1) reduction in the SM/ASM quality; 2) inadequate quality of verification by the LEA of the SFMSU SM/ASM and decision making based on such verification. <p>A substantial increase in the number of SM submitted by the SFMSU to the SBU in 2014-2015 compared to 2013 (given the changes in the CCPU in terms of jurisdictions of the SBU investigative agencies) is explained by a growing importance of the anti-terrorist problems in Ukraine related to the Anti-Terrorist Operation in some districts of the Luhansk and Donetsk Regions of Ukraine.</p> <p>The analysis of the consolidated data for 2003-2015 gives grounds to state absence of even a weak correlation between the amount of financial transactions based on the PFMS reports and the amount of money recognized as legalized by court.</p> <p>Even more indicative is absence of even a weak correlation between the amount of money recognized by court as legalized and the amount returned to the country's revenues.</p>

			<p>Another issue related to the probability of the identified risk is the procedure of financial transaction suspension by the SFMSU.</p> <p>The SFMSU has the right to suspend financial transactions for the analysts to make further analysis of the reports obtained. This right is stipulated in Art. 17 and 23 of the Law. The maximum allowed duration for suspension is 30 work days, although requests based on the foreign FIU requests may have no time limits. To arrest the SFMSU-stopped assets in accordance with a relevant decision provided in pursuance of Art. 17 of the Law for the duration which exceeds 30 work days, the LEA which submitted the SM shall receive a court decision.</p> <p>There are only “informal” processes and no “formal” feedback mechanisms on the cases related to suspended financial transactions submitted to the LEA for further decisions. The lack of feedback and statistical data on the number of the suspension decisions extended after a 30-day period and used to confiscate funds from the accounts, and the number of indictments and verdicts for ML versus the accounts to which suspension was applied does not allow for an objective evaluation of the usefulness of applying the SFMSU legitimate right to suspend financial transactions.</p>
Overall risk level	12		
Effectiveness of the available measures	3	Comment	<p>A reduction in the amount of completed criminal cases due to submittal of an indictment to court with a simultaneous reduction in the started criminal cases based on the SM submitted by the SFMSU, the bulk of specific weight of which is based on the LEA reports, and a simultaneous increase in the number of dismissed criminal cases may testify to inappropriate detection by the law enforcement authorities of violations with indicators of ML or to the peculiarities of the SFMSU – LEA cooperation at the stage of pre-trial investigation of detected crimes (taking into account reformation of the current and establishing of the new anti-corruption LEA).</p> <p>During the period of investigations from March 2014 through August 2016, the SFMSU blocked an equivalent of 1.52 bln USD on the accounts of natural persons and legal entities connected to former senior officials.</p>
Description of measures	Given the statistical indicators on reduction in the number of criminal cases brought pursuant to the SFMSU-submitted SM and increase in the number of dismissed criminal cases based on the SFMSU materials, actions to limit the identified risk are not taken or taken only formally (meetings, trainings, discussions).		
Net risk level	12		
Description of measures proposed to be taken for risk management	<p>With the aim of efficient risk management, the following is proposed:</p> <ol style="list-style-type: none"> 1. The LEA to analyze the status of the SFMSU SM (ASM) review to identify the reasons for a significant fraction of their non-implementation. 2. Ensure that the provisions on “suspension of financial transactions” are applied by the SFMSU in exceptional cases and in close cooperation with the LEA to avoid the risks of thwarting investigations, especially in the ML cases, when suspects can easily move proceeds of crime and their assets¹⁴⁷. 		

¹⁴⁷ Requirement from the IMF Report on technical assistance related to application of measures to counter legalization of criminal proceeds in support of the counter-corruption efforts (the Financial Intelligence Unit component).

Threat 3. Insufficient regulation and supervision of the primary financial monitoring subjects' activities in the AML/CFT area

Risk 1	Inefficient sanctions for violation of the AML/CFT-related legislation		
Level of consequences	4	Comment	Inefficient sanctions applied by the State Financial Monitoring Subjects to the PFMS for AML/CFT-related legislation increases these violations. Further, the PFMS understanding of the insufficiency of sanctions on the part of the regulator will cause PFMS to inadequately perform their obligations on the monitoring of financial transactions for indications of ML/FT. This fact increases the risk of using PFMS for ML/FT.
Probability level	2	Comment	In 2013-2014, the NBU did not supervise the activities of the non-bank institutions. The legislation does not provide for suspension of officials of the securities market professional participants and/or dismissal from their positions for violations of the AML/CFT related legislation. Starting 2015, there has been a moratorium on auditing companies, institutions, organizations, and individual entrepreneurs by the supervisory agencies established by the Law of Ukraine "On Amending and Declaring Null and Void Some Legislative Acts of Ukraine" ¹⁴⁸ and the Law of Ukraine "On Amending the Tax Code of Ukraine and Some Legislative Acts of Ukraine with Regards to the Tax Reform" ¹⁴⁹ ; therefore, the SCRFMSU, the Ministry of Finance of Ukraine, the MEDTU, and the SFMSU do not audit the PFMS.
Overall risk level	8		
Effectiveness of the available measures	3	Comment	The SFMSU supervisory activities in the AML/CFT sphere specifically include: performing scheduled and ad-hoc audits, including on-site; regulation and supervision, in line with the policy, of the procedures and control systems, and assessing the risks to determine appropriateness of the measures taken by the PFMS, and reducing the risks during PFMS activities in the financial monitoring sphere; the right to require that the PFMS meet the requirements of the legislation, and, in case of detected violations of the legislative requirements, take actions stipulated by the law. The State Financial Monitoring Subjects adopted regulatory documents on imposition of sanctions on the PFMS for their violation of the AML/CFT-related legislation. Further, the State Financial Monitoring Subjects use a risk-oriented approach in their AML/CFT-related supervision. The NBU, pursuant to the IMF recommendations, developed a risk-oriented approach for supervision in the AML/CFT sphere and amended the regulatory and legal documents, specifically amended the Provision on the Procedure of Organizing and Conducting Audits on Preventing and Countering Legalization (Laundering) of Proceeds of Crime,

¹⁴⁸ On Amending and Declaring Null and Void Some Legislative Acts of Ukraine: Law of Ukraine, December 28, 2014 No. 76-VIII: [Electronic resource]. – Access mode: <http://zakon4.rada.gov.ua/laws/show/76-19/page>

¹⁴⁹ On Amending the Tax Code of Ukraine and Some Legislative Acts of Ukraine with Regards to the Tax Reform: Law of Ukraine, December 28, 2014 No. 71-VIII: [Electronic resource]. – Access mode: <http://zakon0.rada.gov.ua/laws/show/71-19>

		Financing of Terrorism, and Financing of Proliferation of Weapons of Mass Destruction ¹⁵⁰ . Today, the internal documents used by the NBU in its application of the risk-oriented approach for planning bank audits in the AML/CFT sphere are being improved pursuant to the IMF recommendations.
Description of measures	<p>The NBU applies measures of influence to banks pursuant to Art. 73 and 77 of the Law of Ukraine “On Banks and Banking Activities” and Provision on Application of Measures of Influence by the National Bank of Ukraine, namely:</p> <ul style="list-style-type: none"> - a written warning; - imposing fines on a bank (up to 1 % of the bank statutory capital); - restriction, suspension, or stopping of banks from effecting some transactions; - temporary, until the violation is eliminated, suspension of a bank official; - bank categorization as troubled; - bank categorization as insolvent; - revoking the bank license and banks liquidation. <p>In 2013-2014 the total average amount of fines for banks for violation of the financial monitoring legislation was 11,760 UAH/470 EUR, in 470 – 129,742 UAH/4,948 EUR.</p> <p>In 2013-2014, the NBU did not supervise the activities of the non-bank institutions. As of Dec. 31, 2015, 36 non-bank financial institutions were under supervision.</p> <p>In 2015, the SCRFMSU imposed no penalties on the primary financial monitoring subjects for violations in the financial monitoring sphere and drew no administrative offense protocols.</p> <p>In 2013 the total average amount of fines was 16.50 thous UAH or 646.81 EUR at the rate as of the end of December 2015 and 1,555.14 EUR at the official average rate of 2013.</p> <p>In 2014 the total average amount of fines was 10.50 thous UAH or 411.60 EUR at the rate as of the end of December 2015 and 667.94 EUR at the official average rate of 2014.</p> <p>In 2013-2015, the NSSMC imposed the following sanctions on the securities market professional participants for violation of the AML/CFT-related legislation: a written warning; fines; ordinances on elimination of securities legislation violations; drawing of administrative protocols; imposing requirements on elimination of the AML/CFT legislation; license revocation.</p> <p>The average amount of fines imposed by the NSSMC for violation of the AML/CFT-related legislation was: In 2013 – 3,520 UAH, in 2014 – 1,480 UAH, in 2015 – 4,438 UAH.</p> <p>The total average amount of the Ministry of Justice fines for violation of the AML/CFT-related legislation in 2015 was 297 UAH.</p>	
Net risk level	9	
Description of measures proposed to be taken for risk management	<p>With the aim of efficient risk management, the following is proposed:</p> <ol style="list-style-type: none"> 1. Review the level of sanctions for violation by the PFMS of the AML/CFT-related legislation. 2. Cancel the PFMS audit moratorium. 	

¹⁵⁰ On Amending the Provision on the Procedure of Organizing and Conducting Audits on Preventing and Countering Legalization (Laundering) of Proceeds of Crime, Financing of Terrorism, and Financing of Proliferation of Weapons of Mass Destruction: NBU Board of Directors Resolution, December 23, 2015 No. 920: [Electronic resource]. – Access mode: <http://zakon2.rada.gov.ua/laws/show/v0920500-15>

Risk 2		Insufficient staff and resources for efficient supervision	
Level of consequences	4	Comment	Insufficient staff of the State Financial Monitoring Subjects involved in auditing the PFMS for their compliance with the AML/CFT-related legislative requirements may lead to inadequate regulation and supervisions. This situation, in its turn, will increase the risk of the PFMS not meeting the AML/CFT-related legislation and using the PFMS for ML/FT purposes.
Probability level	2	Comment	Comparing the number of the PFMS and the number of the State Financial Monitoring Subjects staff involved in regulation and supervision of their AML/CFT-related activities, one can observe a significant number of the PFMS per one employee involved in regulation and supervision. In other words, there is clearly a significant load on the state regulators' employees.
Overall risk level	8		
Effectiveness of the available measures	2	Comment	The number of the NBU staff as of Dec. 31, 2015 immediately involved in the AML/CFT issues, was 115 employees. The SCRFMSU has a division involved in AML/CFT, staffed with 5 persons, which in 2013-2015 remained unchanged. The NSSMC has a financial monitoring unit staffed with 7 persons. At the Ministry of Finance of Ukraine in 2013-2015 the AML/CFT issues were dealt with by a division staffed with 6 persons. The Financial Monitoring Unit of the Department for Notariat of the Ministry of Justice of Ukraine, which numbers 7 employees, has been the Ministry of Justice of Ukraine structural division dealing with AML/CFT at the end of 2015 (unit head, unit deputy head, 3 chief specialists, and 2 lead specialists). The MEDTU operated the Commodity Market Infrastructure Development Unit at the Financial Policy Department, numbering 5 employees. At the Ministry of Infrastructure of Ukraine, the AML/CFT issues are dealt with by the Department for Preventing and Detecting Corruption, staffed with 8 persons. The SFMSU operates a division dealing with the PFMS supervision, staffed with 9 persons.
Description of measures	<p>Despite a small number of the State Financial Monitoring Subjects staff, AML/CFT-related supervision over the PFMS was done pursuant to the legislation.</p> <p>For example, NBU: in 2013 performed 237 audits of the PFMS-banks, in 2014 performed 243 audits, and in 2015 performed 88 audits.</p> <p>The State Commission for Regulation of Financial Services Markets: in 2013, the number of financial monitoring audits was 322, and in 2014 – 128.</p> <p>The NSSMC performed 190 PFMS audits in 2013, 70 in 2014, and 34 in 2015.</p> <p>The Ministry of Finance performed 19 PFMS audits in 2013 and 9 in 2014.</p> <p>The Ministry of Justice performed 1,142 PFMS audits in 2013, 1,482 in 2014, and 1,331 in 2015.</p> <p>In 2014, the MEDTU performed 2 PFMS audits.</p> <p>The Ministry of Infrastructure performed 11 AML/CFT audits in 2013-2014 and 1 audit in 2015.</p> <p>The SFMSU performed 40 PFMS audits in 2013 and 18 in 2014.</p>		
Net risk level	6		
Description of measures proposed to be taken for risk management	<p>With the aim of efficient risk management, the following is proposed:</p> <ol style="list-style-type: none"> 1. Increase the number of the State Financial Monitoring Subjects staff involved in AML/CFT supervision of the PFMS to reduce the work load on each employee. 2. Increase the number of trainings for the State Financial Monitoring Subjects staff to enhance their efficiency during audits. 3. Increase the funding of the State Financial Monitoring Subjects to provide for remuneration for the staff involved in audits and covering of their travel expenses (field supervision). 		

Risk 3	Lack of the PFMS sectoral risk assessment in the AML/CFT sphere		
Level of consequences	2	Comment	Lack of the PFMS sectoral risk assessment for the probability of being used for ML/FT leads to development of inefficient plans of auditing the PFMS for compliance with the AML/CFT-related legislation, which, in its turn, increases the risk of using PFMS for ML/FT.
Probability level	2	Comment	Emergence of financial innovations and improvement of financial transaction technologies not only ensures convenient and quick serving of clients at the financial and credit institutions, but also ever more facilitates the growth of the shadow economy and ML. Currently, the sectoral risk assessment of using the PFMS for ML is not done by the state regulators involved in regulation and supervision of their activities in the AML/CFT sphere. Of all the State Financial Monitoring Subjects, only the MEDTU has not adopted a regulatory legal act on the use of a risk-oriented approach for supervision in the AML/CFT sphere.
Overall risk level	4		
Effectiveness of the available measures	2	Comment	In its AML/CFT supervision of the PFMS, the SFMS applies a risk-oriented approach.
Description of measures	<p>The NBU, pursuant to the IMF recommendations, implemented a risk-oriented approach for supervision in the AML/CFT sphere and amended the regulatory and legal acts, specifically amended the Provision on the Procedure of Organizing and Conducting AML/CFT Audits, which has been in use since 2016.</p> <p>In its AML/CFT-related supervision, SFMSU uses a risk-oriented approach to the supervised PFMS, i.e. the SFMSU in its activities is governed by the Ministry of Finance Order “On Approving the Criteria for Risk Assessment of the Primary Financial Monitoring Subject to Be Used for Legalization (Laundering) of Proceeds of Crime or Financing of Terrorism”.</p> <p>The SCRFMSU audits in the AML/CFT sphere are planned on a quarterly basis. The periodicity of scheduled audits depends on the risk level of the supervised subject (risk-oriented approach).</p> <p>The NSSMC, in its supervision of the PFMS that are professional participants of the securities market, applies the analysis based on risk assessment “On Approving the Criteria for Risk Assessment of the Primary Financial Monitoring Subject – Securities Market Professional Participant to Be Used for Laundering of Proceeds of Crime or Financing of Terrorism”.</p>		
Net risk level	4		
Description of measures proposed to be taken for risk management	<p>With the aim of efficient risk management, the following is proposed:</p> <ol style="list-style-type: none"> 1. The State Financial Monitoring Subjects should implement a periodic sectoral risk assessment for the probability of using the PFMS for the purposes of ML/FT. 2. Use the sectoral risk assessment results to plan the PFMS audits for compliance with the AML/CFT-related legislation. 3. Draft and adopt the required regulatory legal act to implement the application of a risk-oriented approach for the MEDTU supervision in the AML/CFT sphere. 		

Threat 4. Inefficient investigation of ML and predicate crimes

Risk 1	Insufficient interaction between the law enforcement authorities and the FIU		
Level of consequences	4	Comment	FIU interaction with the LEA determines the efficiency of detection and investigation of ML/FT crimes. Insufficient regard for the results of the FIU analysis (of SM and ASM) on the part of the LEA results in liability evading by the persons committing ML or FT.
Probability level	3	Comment	Fig. 2.1.15 demonstrates a moderate direct correlation between the number of the initial SM and the number of the ASM submitted to the LEA. The approximation confidence level (determination coefficient – R ²) is 0.3914, which evidences that only 39,1% of the ASM submitted to LEA depended on the number of the previously submitted initial SM (such a situation can also be explained by the fact that several ASM may be prepared for one SM at different times on the initiative of the SFMSU, and not LEA, whereas nothing may be prepared for another SM). The regression equation evidences that in 2003-2015 there were only 3 ASM per each 10 SM developed and submitted to the LEA. The increase in the fraction of refusals/dismissals of the criminal cases versus the total number of the criminal cases brought may have two reasons: 1) inadequate quality of the SFMSU SM/ASM; 2) inadequate quality of verification by the LEA of the SFMSU SM/ASM and decision making based on such verification; The excessive increase in the number of refusals/dismissals of criminal cases in 2015 can be explained by a comprehensive reform of the organizational structure of the LEA, the active phase of which occurred in 2015; Substantial increase in the number of SM submitted by the SFMSU to the SBU in 2014-2015 compared to 2013 (given the changes in the CCPU in terms of jurisdictions of the SBU investigative agencies) is explained by a growing importance of the anti-terrorist problems in Ukraine related to the Anti-Terrorist Operation in some districts of the Luhansk and Donetsk Regions of Ukraine.
Overall risk level	12		
Effectiveness of the available measures	2	Comment	The FIU and LEA developed joint regulatory-legal acts, entered into contracts, cooperation and information exchange agreements, however, the efficiency of joint work requires improvement specifically in the practical aspects.
Description of measures	<p>In 2013, the SFMSU received 573 LEA requests, in 2014 – 1,255 requests, in 2015 – 1,341 LEA requests regarding performance of financial monitoring. Thus, the recent years have seen a tendency towards increasing the number of requests submitted to the FIU from the law enforcement authorities LEA.</p> <p>During the entire period of its functioning from 2003 through 2015, the FIU submitted 5,483 SM to the LEA. On the average, during the period the FIU annually submitted 422 SM to the LEA.</p> <p>During the entire period of its functioning from 2003 through 2015, the FIU submitted 3,495 ASM to the LEA (Fig. 2.1.11). On the average, during the period the FIU annually submitted 269 ASM to the LEA.</p> <p>However, the data provided in the description suggest that the efficiency of the FIU-LEA AML/CFT work has room for improvement.</p>		
Net risk level	8		

Description of measures proposed to be taken for risk management	With the aim of efficient risk management, the following is proposed: 1. Enter into cooperation and information exchange agreements, develop joint regulatory legal acts between the FIU and the newly established LEA. 2. Improve the quality of drafting the FIU SM and ASM (and their verification by the LEA), including through increasing the FIU budget, thus ensuring personnel stability. 3. Establish an efficient system for providing LEA feedback to the SFMSU on the results of the SM and ASM review.
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Risk 2		Inefficient investigation of ML crimes	
Level of consequences	4	Comment	Inefficient investigation of ML crimes results in a situation, when the perpetrators are not prosecuted. This, in turn, encourages such persons to commit new ML crimes, develop and implement new laundering schemes and methods.
Probability level	3	Comment	A decisive factor for increasing the number of ML crimes is the situation in the East of the country, which caused the need for the ATO. Fig. 2.1.10 shows the total number of the SM submitted in 2003-2015 by the LEA of Ukraine. Fig. 2.1.21 shows the number of refusals (in bringing criminal charges) and/or dismissal of criminal cases which were brought/started following review by the LEA of the SFMSU SM or in which SM were used. The period of 2011-2015 saw a trend towards dismissal of criminal cases by the LEA on the ML facts. A reduction in the number of completed criminal cases due to submittal of an indictment to court with a simultaneous reduction in the started criminal cases based on the SFMSU-submitted SM, the bulk of specific weight of which is based on the LEA reports, and a simultaneous increase in the number of dismissed criminal cases may testify to inappropriate detection by the LEA of violations with indicators of ML. Further, comparison of the LEA ¹⁵¹ and the court statistics ¹⁵² reveals inconsistencies in the data shown in these reports.
Overall risk level	12		
Effectiveness of the available measures	2	Comment	The LEA interagency cooperation in the ML cases is envisaged by a number of Laws, namely: the Law "On Operative Investigative Activities" ¹⁵³ , "On Counterintelligence Activities" ¹⁵⁴ , "On Organizational and Legal Principles of Combating Organized Crime" ¹⁵⁵ , "On Combating Terrorism" ¹⁵⁶ , the Tax Code and the Code of Criminal Procedure of Ukraine ¹⁵⁷ , as well as by joint interagency orders. The specific weight of the SM and ASM, according to the LEA in 2012-2015, gradually increased with a simultaneous reduction in the weight

¹⁵¹ Unified Report on Criminal Offenses: [Electronic resource]. – Access mode:

http://www.gp.gov.ua/ua/stst2011.html?dir_id=112657&libid=100820&c=edit&_c=fo#

¹⁵² Court of First Instance Report on Review of Criminal Case Materials: [Electronic resource]. – Access mode:

http://court.gov.ua/sudova_statystyka/

¹⁵³ On Operative Investigative Activities: Law of Ukraine, February 18, 1992 No. 2135-XII: [Electronic resource]. – Access mode:

<http://zakon3.rada.gov.ua/laws/show/2135-12/page>

¹⁵⁴ On Counterintelligence Activities: Law of Ukraine, December 26, 2002 No. 374-IV: [Electronic resource]. – Access mode:

<http://zakon0.rada.gov.ua/laws/show/374-15>

¹⁵⁵ On Organizational and Legal Principles of Combating Organized Crime: Law of Ukraine, June 30, 1993 No. 3341-XII: [Electronic resource].

– Access mode: <http://zakon3.rada.gov.ua/laws/show/3341-12/page>

¹⁵⁶ On Combating Terrorism: Law of Ukraine, March 20, 2003 No. 638-IV: [Electronic resource]. – Access mode:

<http://zakon3.rada.gov.ua/laws/show/638-15>

¹⁵⁷ Code of Criminal Procedure of Ukraine: Code, Apr. 13, 2012 No. 4651-VI: [Electronic resource]. – Access mode:

<http://zakon2.rada.gov.ua/laws/show/4651-17>

		<p>of the SM and ASM “independently” prepared by the SFMSU, which evidences an improvement in the LEA efficiency in the context of informing the SFMSU on the detected ML suspicions.</p> <p>Further, the LEA have access to international (foreign) databases. The Interpol National Bureau for Ukraine ensures that the LEA and other competent authorities in Ukraine have access to the Interpol databanks through the Interpol I-24/7 telecommunication network.</p> <p>Ukraine has a total of 96 workstations with such access installed.</p>
Description of measures	<p>In 2013, the criminal cases under CCU Art. 209 resulted in seizure of criminal proceeds to the amount of 1,961,478 UAH and arrest to the amount of 13,223,278 UAH (Form 1-LV Report).</p> <p>In 2014, the criminal cases under CCU Art. 209 resulted in seizure of criminal proceeds to the amount of 5,218,874 UAH and arrest to the amount of 11,280,000 UAH (Form 1-LV Report).</p> <p>In 2015 the criminal cases under CCU Art. 209 resulted in arrest of securities to the amount of 25 mln UAH and property to the amount of 1.5 mln UAH, and seizure of criminal proceeds to the amount of 277,000 UAH (Form 1-LV Report).</p> <p>In 2014, with the aim of blocking bank accounts and performing financial monitoring, SBU submitted 13 reports to the SFMSU on the possible financing of terrorism and separatist activities, and 5 more in 2015.</p> <p>In 2013-2014, within international police cooperation, the Interpol National Bureau for Ukraine started 61 materials on ML (23 materials in 2013 and 38 materials in 2014).</p> <p>According to the summary data of the regional investigative divisions, as of Dec. 1, 2015, the pre-trial investigation was completed in 64 criminal cases under CCU Art. 209 and 209-1, of which 11 were submitted to court with an indictment against 11 suspects and 44 criminal cases were dismissed. In the criminal cases submitted to court, the established amount of criminal proceeds was 61 mln 208 thous UAH. The reimbursement of the damages inflicted by the offenses was secured to the amount of 6 mln 277 thous UAH.</p> <p>Further, the Main Investigative Directorate for Financial Investigations takes systematic actions to improve the system of criminal investigations in the ML/FT sphere.</p> <p>According to the PGOU, in 2015 there were 50 criminal cases under CCU Art. 209, of which: regional prosecutor's office investigators – 11, central administration investigators – 39, military prosecutor's office – 13.</p> <p>16 and 17 pretrial investigations were brought under CCU Art. 209 in 2013-2014 respectively.</p> <p>In the criminal cases investigated by the prosecution agencies, the following amounts of legalized proceeds were identified: 2013 – 6,508,742 UAH; in 2014 – 43,116,628 UAH; in 2015 – 277,000 UAH (Military Prosecutor's Office – 250 mln UAH).</p> <p>At the same time, the following criminal cases were brought under CCU Art. 209 pursuant to the materials of the SBU special divisions: In 2013 – 4; in 2014 – 17; in 2015 – 80 criminal cases in relation to 3 persons.</p>	
Net risk level	8	
Description of measures proposed to be taken for risk management	<p>With the aim of efficient risk management, the following is proposed:</p> <ol style="list-style-type: none"> 1. Enhance coordination and establish detailed procedures for the information exchange between the LEA. 2. Ensure agreement between the LEA statistical report forms on the criminal case accounting with the statistical report forms of the court authorities on the results of court review of criminal cases. 3. Focus on the practical training of the LEA staff involved in investigation of the ML crimes. 4. Enhance the efficiency of the actions by the law enforcement system to return the assets blocked abroad back to Ukraine. 	

Risk 3		Inefficient investigation of organized crime	
Level of consequences	4	Comment	Organized crime is a substantial factor, which increases social tension and destabilizes social relations, causes deformation in the economic management, and slows down the country's economic development.
Probability level	4	Comment	Ukraine is becoming the object of a growing interest for international OCGs, specifically in the spheres of ML, human trafficking, illegal trafficking in weapons, hazardous materials, and narcotic substances. The number of illegal migrants has been increasing and the organized ethnic crime is becoming ever more common. OCGs are characterized by a rather high level of organization, sustainable corruption and international criminal ties. To accomplish their goals, organized crime groups participants ever more often resort to acquisitive and violent crimes.
Overall risk level	16		
Effectiveness of the available measures	2	Comment	Pursuant to Art. 2 of the President of Ukraine Decree "On the State Policy Concept in the Sphere of Combating Organized Crime", the SBU takes measures to detect and stop OCGs, whose illegal activities are related to embezzlement of budget funds, ML, organization of the drug business, illegal migration, etc. The President of Ukraine Decree gave effect to the National Security and Defense Council Decision of May 6, 2015 "On Measures To Strengthen the Combating of Crime in Ukraine" ¹⁵⁸ . To counter organized crime, the criminal situation in the country and factors that cause it are continuously analyzed. The results of the operative and search activities related to combating socially dangerous OCGs, armed gangs, OCGs with interregional, transnational connections created on the ethnic basis are studied. Predictions are made of the criminal situation and activities in the main work areas are coordinated.
Description of measures	<p>In 2013 the LEA registered 5 crimes under CCU Art. 255 (Creation of a Criminal Organization) and 13 under CCU Art. 257; in 2014 there were 5 crimes registered under CCU Art. 255 and 12 under CCU Art. 257. In 2014 the LEA identified 166 sustainable criminal groups, of which 1 criminal organization versus 185, and 7 criminal organizations in 2013. The majority (139 or 83.7 %) of the criminal cases under CCU Art. 255, 257 were investigated by MIA investigative divisions, of which only 3 versus 6 last year by special divisions. The prosecution authorities investigated every thirteenth (12 or 7.2 %) criminal case in this category, and the security authorities – 9 or 5.4 %. The SFS financial investigation agencies investigated 6 or 3.6 % criminal cases.</p> <p>SBU Activities on combating organized crime is shown in Fig. 1.5.1.</p> <p>In 2013-2014, the staff of the organized crime combating units at the MIA detected 25 and 17 ML-related criminal offenses respectively, the material damages of which start at 100,000 UAH. 123 OCGs were detected in 2015.</p>		
Net risk level	8		
Description of measures proposed to be taken for risk management	<p>With the aim of efficient risk management, the following is proposed:</p> <ol style="list-style-type: none"> 1. Strengthen interaction between the LEA in combating organized crime. 2. Improve and step up measures to neutralize the factors which stipulate the OCG activities. 3. Strengthen international cooperation in combating transnational organized crime. 		

¹⁵⁸ On the National Security and Defense Council Decision of May 6, 2015 "On Measures To Strengthen the Combating of Crime in Ukraine": President of Ukraine Decree, June 16, 2015 No. 341/2015: [Electronic resource]. – Access mode: <http://zakon0.rada.gov.ua/laws/show/341/2015/paran5#n5>

Risk 4		Inefficient investigation of tax crimes	
Level of consequences	4	Comment	Social danger of tax offenses consists, first of all, in blocking the channels of revenues to the budgets of all levels. Tax crimes inflict the largest damage to the country's economy and budget.
Probability level	3	Comment	<p>The 2014 PGOU statistics confirms that the existing mechanism of applying CCU Art. 212 is limited only to a pressure mechanism. According to the statistical information¹⁵⁹, in 2013 the LEA registered 3,069 criminal cases on tax evasion (CCU Art. 212). The number of registered criminal cases under CCU Art. 212 was 1,899 in 2014 (38.1 % less), and 1,748 in 2015 (8 % less than in 2014). Given the existing limits of criminal responsibility, without their revision the number of criminal cases will continue growing.</p> <p>In 2013 the pretrial investigation agencies informed of suspicion in only 482 criminal cases (approximately 15.7 % of the total number), in 2014 – in 212 criminal cases (11,2 %), and in 2015 – 154 (8,8 %). Whereas at the stage of pretrial investigation, 3,662 criminal cases were dismissed under CCU Art. 212 in 2013, 1,318 in 2014, and 1,064 in 2015.</p> <p>According to the trial court reports, 96 criminal cases under CCU Art. 212 were submitted to court in 2013 (approximately 3 % of the criminal cases brought), 393 cases were reviewed by the courts, of which the courts passed 163 verdicts and dismissed 113 criminal cases. Further, 39 criminal cases under CCU Art.212 were submitted to court in 2014 (approximately 2% of the criminal cases brought), 134 cases were reviewed by courts, of which the courts passed 48 verdicts and dismissed 36 criminal cases. 372 criminal cases under CCU Art.212 were submitted to court in 2015 (approximately 21 % of the criminal cases brought), 359 cases were reviewed by courts, of which the courts passed 64 verdicts and dismissed 246 criminal cases.</p> <p>Thus, the fraction of convictions passed by courts versus the total number of criminal cases in the pretrial investigation agencies under CCU Art. 212 was 5.3% in 2013, 2.5 % in 2014, and 3.7 % in 2015. Such statistics testifies to inefficiency of the pretrial investigation agencies caused by the automatic mechanism to begin criminal cases following each audit of a tax payer.</p> <p>Thus, in the year summary only 5.3 % of the tax evasion criminal cases (2.5 % in 2014 and 3.7 % in 2015) investigated in 2013 concerned real crimes. The rest of the criminal cases under CCU Art. 212, which is 94.7 % of the total number of cases against tax payers, is nothing else but a means of influence and pressure on the tax payers to “fill” the state budget.</p>
Overall risk level	12		
Effectiveness of the	2	Comment	In 2015, the SFS focused on reduction of the administrative burden on bona fide tax payers and efficiency enhancement of the

¹⁵⁹ Source: official PGOU web-site.

available measures		<p>controlling and auditing measures in relation to risky economic entities¹⁶⁰.</p> <p>To provide the payers with a possibility to independently assess their own risk level, the official State Fiscal Service web-portal posted the Ministry of Finance Order “On Approving the Procedure for Developing a Schedule of Documentary Scheduled Audits of Tax Payers”¹⁶¹.</p> <p>Lately, there has been a steady tendency towards reduction in the number of controlling and auditing measures. In 2015, the State Fiscal Service agencies conducted 4.5 thous scheduled documentary audits of business entities, which is 1.7 thous or 28% less than in 2014. Further, there were conducted 21.2 thous ad hoc documentary audits (which is 11.9 thous or 36% less than in 2014) and 50.4 thous cross-audits (which is 15.3 thous or 23% less than the previous year).</p>
Description of measures	<p>Following the 2015 audits, the budget additionally redeemed 36.5 bln UAH of payables, including 18.5 bln UAH following scheduled documentary audits and 18.0 bln UAH following ad hoc audits. Of the additionally redeemed tax obligations, a tax compromise was used to settle 7.0 bln UAH (including 3.5 bln UAH following scheduled documentary audits and 3.5 bln UAH following ad hoc audits); 4.6 bln UAH were agreed (including 1.8 bln UAH following documentary audits and 2.8 bln UAH following ad hoc audits), of which the budget received 2.9 bln UAH (including 1.3 bln UAH following documentary audits and 1.6 bln UAH following ad hoc audits). The negative value of the taxation object was reduced by an income tax of 9.8 bln UAH, which prevented non-payment of 1.9 bln UAH. In 2015, about 28 thous beneficiaries involved in VAT evasion schemes to the total amount of almost 16 bln UAH were processed. Following the controlling and auditing measures: additionally charged tax obligations to the amount of 4.5 bln UAH; reduced negative value and budget reimbursement worth 535 mln UAH; established transit nature of transactions worth 5.1 bln UAH; self-reduced problem tax credit by tax payers worth 411 mln UAH. Continuous control is effected over the quality of processing the risk-category business entities.</p> <p>In 2015, a stop was put on the unlawful foreign economic activities of 61 risky importer companies which, by using the “cover group” of goods and declaring false information on the quantities of goods, developed a scheme tax credit for companies in the real sector of economy in the VAT amount of 760 mln UAH; VAT payer certificate was canceled for 33 importers. Following such controlling and auditing measures, the formation of a scheme tax credit through replacement of goods imported to Ukraine by risky importers was prevented to the amount of 257 mln UAH. The criminal cases for customs dues evasion were brought to the amount of 62 mln UAH.</p> <p>Also, 8,000 audits of tax payers who submitted applications on their suspension (closure) pursuant to Art. 78.1.7 of the Tax Code of Ukraine were performed, resulting in additional charges of 863 mln UAH of money liabilities.</p> <p>In pursuance of ordinances on ad hoc audits initiated by operative and investigative divisions of the State Fiscal Service, the agencies of prosecution, pretrial investigation, and judiciary performed 2.6 thous ad hoc documentary audits and 338</p>	

¹⁶⁰ Source: State Fiscal Service of Ukraine Report for 2015: Electronic resource]. – Access mode: <http://sfs.gov.ua/data/files/131201.pdf>

¹⁶¹ On Approving the Procedure for Developing a Schedule of Documentary Scheduled Audits of Tax Payers: Ministry of Finance Order, June 2, 2015 No. 524: Electronic resource]. – Access mode: <http://zakon5.rada.gov.ua/laws/show/z0751-15>

	<p>cross checks, resulting in additionally charged agreed tax obligations to the amount of 224.5 mln UAH; the budget received 178.3 mln UAH.</p> <p>Also, 9.5 thous audits were conducted resulting in penalties (financial sanctions) on business entities to the amount of 377.7 mln UAH, of which 233.7 mln UAH were agreed.</p> <p>304 documentary audits were performed to check the tax payers' compliance with the legislation on the state customs matters, resulting in additional charges to the amount of 120.6 mln UAH, of which 28.5 mln UAH were agreed.</p> <p>Also, 37 conducted audits were administered pursuant to the criminal procedure legislation, resulting in additionally charged 45.7 mln UAH of tax payments.</p> <p>In 2015, controlling and auditing measures were taken on the correctness of levying and transferring to the budget of the individual tax and social security tax related to citizens' salaries and other income.</p> <p>This resulted in establishing over 4,000 business entities (natural persons and legal entities) which violated the legislation when paying salaries and other citizens' incomes.</p> <p>627 mln UAH of the natural person income tax and 82 mln UAH of the social security tax were additionally charged to be paid to the budget.</p> <p>In 2015, there were identified over 102 thous hired employees whose labor was used by the employer without entering into labor agreements and who were paid salaries without paying the corresponding taxes on the natural person's income and social security tax to the budget.</p>
Net risk level	8
Description of measures proposed to be taken for risk management	<p>With the aim of efficient risk management, the following is proposed:</p> <ol style="list-style-type: none"> 1. Ensure agreed planning and procedural actions, operative, investigative, and other measures when checking applications and reports on crimes and during their detection and investigations. 2. Enhance the efficiency of interaction of the SFS with other LEA by means of: <ul style="list-style-type: none"> - information exchange; - carrying out joint actions to prevent, detect, and investigate crimes, as well as to eliminate the causes and conditions which contributed to their commitment; - conducting joint conferences and seminars; - developing joint orders, instructions, provisions, directions to coordinate actions. 3. Improve interaction and information exchange with the state authorities that have the right to control legal entities and natural persons for compliance with the legislation. 4. Address the issue of changes to the CCU regarding application of CCU Art. 212: <ul style="list-style-type: none"> - increased prosecution limit; - determine the grounds for and procedures of dismissing criminal cases at the pretrial investigation stage; - determine the grounds for and procedures of dismissing criminal cases at the court proceeding stage. 5. Adapt the tax legislation to the needs of ensuring its transparency and prevention of tax discrimination, increasing the probability of detecting facts of evasion. 6. Continue the policy of bringing up patriotic feelings among the payers on the need to maintain the state through their paying of taxes in exchange for social goods.

Risk 5		Inefficient investigation of terrorist crimes	
Level of consequences	4	Comment	The implications of the terrorist activities on the territory of the country are catastrophic, namely: human casualties, material losses, destabilization of normal life of the society, and what matters most, achievement of the goals set by terrorists. This is dangerous because each “victory” of the terrorist requirements encourages the existing and potential terrorists to further actions.
Probability level	2	Comment	Starting March 2014, Ukraine has been the place for unlawful activities of the terrorist organizations, so called “DNR” and “LNR”. In today's situation, there are incidents of terrorism in Ukraine, the majority of which is done by the citizens of Ukraine, Russian Federation, and legal entities registered and/or located in it territory. In 2014 there was a 293-fold increase (from 7 to 2,053) in the number of crimes of a terrorist nature over 2013 (CCU Art. 258, 258-1, 258-2, 258-3, 258-4, 258-5). The biggest increase was in the Luhansk (931), Donetsk (886), Odesa (45), Kharkiv (39), Dnipropetrovsk (22), Zaporizhya (15), and Mykolayiv (14) Regions.
Overall risk level	8		
Effectiveness of the available measures	2	Comment	The most important legal acts that regulate combating terrorism include the Laws of Ukraine “On the Security Service of Ukraine”, “On Intelligence Agencies of Ukraine”, “On Operative Investigative Activities”, “On Physical Protection of Nuclear Facilities, Nuclear Materials, Radioactive Waste, and other Sources of Ionizing Radiation” ¹⁶² , etc. The current issues of combating terrorism are regulated by the President of Ukraine Decrees “On the National Security and Defense Council of Ukraine Decision of Aug. 28, 2014 “On Urgent Measures to Protect Ukraine and Strengthen Its Defense Capabilities” ¹⁶³ , “On Measures to Further Strengthen Security, Protection of Citizens' Rights and Freedoms” ¹⁶⁴ . Most of the terrorism combating measures are taken within the framework of the ATO.
Description of measures	In 2014, LEA submitted 26 indictments to court under CCU Art. 258-3 “Creation of a terrorist group or terrorist organization” (Luhansk Region – 12, central administration – 3, Zaporizhya and Odesa Regions – 2 each, Dnipropetrovsk, Donetsk, Mykolayiv, Poltava, Kharkiv, Chernihiv Regions and city of Kyiv – 1 each), 5 – under CCR Art. 258-4 “Facilitating the commission of a terrorist act” (Kharkiv Region – 4, Chernihiv Region – 1) and 12 – under CCU Art. 258 “Terrorist Act”		

¹⁶² On Physical Protection of Nuclear Facilities, Nuclear Materials, Radioactive Waste, and other Sources of Ionizing Radiation: Law of Ukraine, October 19, 2000 No. 2064-III: [Electronic resource]. – Access mode: <http://zakon5.rada.gov.ua/laws/show/2064-14>

¹⁶³ On the National Security and Defense Council of Ukraine Decision of Aug. 28, 2014 “On Urgent Measures to Protect Ukraine and Strengthen Its Defense Capabilities”: President of Ukraine Decree, Sept. 24, 2014 No. 744/2014: [Electronic resource]. – Access mode: <http://zakon3.rada.gov.ua/laws/show/744/2014/paran5#n5>

¹⁶⁴ On Measures to Further Strengthen Security, Protection of Citizens' Rights and Freedoms: President of Ukraine Decree, Feb. 18, 2002 No. 143/2002: [Electronic resource]. – Access mode: <http://zakon0.rada.gov.ua/laws/show/143/2002>

	(Odesa– 6, Dnipropetrovsk – 3, Zaporizhyya, Kharkiv Regions and city of Kyiv – 1 each).
Net risk level	6
Description of measures proposed to be taken for risk management	<p>With the aim of efficient risk management, the following is proposed:</p> <ol style="list-style-type: none"> 1. Continue implementation of actions to identify the facts of providing financial support by representatives of international terrorist and extremist organizations to their supporters in Ukraine, including through criminal proceeds and non-profit sector. 2. Strengthen measures to detect financial transactions and criminally prosecute persons related to financing of terrorism and actions committed aimed at a violent change or overturn of the constitutional order or a change in the boundaries of the territory or state border. 3. Strengthen interagency coordination on detection and subsequent freezing of the assets of the persons involved in FT and proliferation of weapons of mass destruction, including those that use the non-profit sector. 4. Continue training and professional development of employees of LEA special units involved in detection, solving, and investigation of FT facts. 5. Establish efficient interaction and information exchange between competent foreign agencies and international organizations involved in preventing and countering terrorism and its financing.

Risk 6		Inefficient investigation of ML predicate crimes	
Level of consequences	4	Comment	Predicate crimes have negative implications for social relations that are adversely affected by crime. These adverse implications are so significant that cause public danger stemming from the acts committed.
Probability level	3	Comment	Fig. 1.5.2 illustrates that the first place among the predicate crimes committed in Ukraine is held by the activities of the subjects of fictitious entrepreneurship. In its turn, fictitious entrepreneurship is one of the key elements of the mechanisms of tax evasion and ML, the essence of which, on the one hand, is to create favorable conditions for committing crimes in the economic sphere and, on the other hand, to mask criminal activities, reduce the object of taxation from taxes, fees, and other mandatory payments, concealing the sources of origin and location of the criminal proceeds for the organizers to avoid liability. In the structure of the predicate crimes most commonly committed for ML, fictitious entrepreneurship is followed by tax evasion, fraud, and embezzlement.
Overall risk level	12		
Effectiveness of the available measures	2	Comment	<p>According to the SFMSU materials to the LEA:</p> <ol style="list-style-type: none"> 1) in 2013, 19 criminal cases were brought under CCU Art. 205 (“Fictitious Entrepreneurship”) related to ML, of which 5 were submitted to court, 9 criminal cases under CCU Art. 191 (“Misappropriation, embezzlement, or seizure of property by abuse of office”) related to ML, of which 7 were submitted to court, 1 criminal case under CCU Art. 190 (“Fraud”) related to ML. 2) in 2014, 14 criminal cases were brought under CCU Art. 205 related to ML, 7 criminal cases under CCU Art. 191 related to ML, of which 2

		<p>were submitted to court, 2 criminal cases under CCU Art. 190 related to ML, of which 1 criminal case was submitted to court.</p> <p>3) in 2015, 15 criminal cases were brought under CCU Art. 205 related to ML, 7 criminal cases under CCU Art. 191 related to ML, 3 criminal cases under CCU Art. 190 related to ML.</p> <p>The court received LEA-prepared criminal cases for review:</p> <p>1) under CCU Art. 190: in 2013 – 5,534 cases; in 2014 – 4,599 cases; in 2015 – 3,862 cases.</p> <p>2) under CCU Art. 191: in 2013 – 2,248 cases; in 2014 – 2,078 cases; in 2015 – 1,727 cases.</p> <p>3) under CCU Art. 212: in 2013 – 582 cases; in 2014 – 458 cases; in 2015 – 372 cases.</p>
Description of measures	<p>According to the State Judicial Administration statistics¹⁶⁵, in 2013 the courts reviewed:</p> <p>1) criminal cases under CCU Art. 190: In 2013, 4,341 cases (78%) were reviewed. Of these, 3,281 (76% of the reviewed) cases with a verdict. The review of cases resulted in conviction of 3,439 persons. In 2014, 4,448 (97%) cases were reviewed, of which 3,290 cases (74% of the reviewed) with a verdict. The review of cases resulted in conviction of 3,473 persons. In 2015, 3,600 (93 %) cases were reviewed, of which 2,652 cases (74% of the reviewed) with a verdict. The review of cases resulted in conviction of 2,707 persons.</p> <p>2) criminal cases under CCU Art. 191: In 2013, 1,731 cases (77%) were reviewed. Of these, 1,232 (71% of the reviewed) cases with a verdict. The review of cases resulted in conviction of 1,337 persons. In 2014, 1,900 cases (91%) were reviewed. Of these, 1,304 (69 % of the reviewed) cases with a verdict. The review of cases resulted in conviction of 1,362 persons. In 2015, 1,565 cases (91%) were reviewed. Of these, 1,000 (64% of the reviewed) cases with a verdict. The review of cases resulted in conviction of 1,019 persons.</p> <p>3) criminal cases under CCU Art. 212: In 2013, 469 cases (81%) were reviewed. Of these, 72 (15 % of the reviewed) cases with a verdict. The review of cases resulted in conviction of 71 persons. In 2014, 480 cases (104 %) were reviewed. Of these, 89 (19 % of the reviewed) cases with a verdict. The review of cases resulted in conviction of 82 persons. In 2015, 359 cases (97 %) were reviewed. Of these, 64 (18 % of the reviewed) cases with a verdict. The review of cases resulted in conviction of 52 persons.</p>	
Net risk level	8	
Description of measures proposed to be taken for risk management	<p>With the aim of efficient risk management, the following is proposed:</p> <ol style="list-style-type: none"> 1. Enhance the efficiency of LEA investigation of ML predicate crimes, including putting together of efficient evidence. 2. Develop proposals for making changes to the legislation which regulate LEA activities on investigating the crimes that precede ML. 3. Ensure studying and implementation of best international practices of investigating the crimes that precede ML. 	

¹⁶⁵ Source: information from the Judiciary of Ukraine official web-portal. [Electronic resource]. – Access mode: http://court.gov.ua/sudova_statystyka/

Threat 5. Inefficient court review of the ML/FT cases

Risk 1	Inconsistency of the punishment and the severity of the ML/FT crimes		
Level of consequences	4	Comment	The essence of the court decision is that it is the main and most important act of justice, always done in the name of the state and targets protection of the rights and legitimate interests of citizens, companies, institutions, and organizations. Inconsistency of the punishment and the severity of the committed crime increases the risk of repeated commitment of such a crime.
Probability level	3	Comment	<p>The state of the court system of Ukraine today is characterized by a growing mistrust of citizens in judicial institutions. The tumultuous events of the past years prompted a recognized request in the society for an effective mechanism of the responsibility of the state and its agencies to their citizens. The cornerstone of this mechanism is the court, which administers justice on the basis of legality, objectiveness, and impartiality, and resolves conflicts not only in all the spheres of social relations, but also in the relations between the state and the society in general and individual citizen in particular. The judiciary acquires special importance in the time of an exasperated internal political situation.</p> <p>According to the information of the Unified State Register of Judicial Decisions¹⁶⁶, in 2013 the courts reviewed with a verdict 91 criminal cases on the offenses under CCU Art. 209, 209-1 in relation to 127 persons. Of these, 66 persons were acquitted in 42 criminal cases (46.2%). In 49 criminal cases 61 persons were found guilty of the ML/FT crime, of which 19 (39 %) criminal cases (25 persons) resulted in probation, and in 30 criminal cases (36 persons) the average sentence was 6.27 years.</p> <p>In 2014, the courts reviewed with a verdict 74 criminal cases on the offenses under CCU Art. 209, 209-1 in relation to 97 persons. Of these, 39 persons were acquitted in 28 criminal cases (38 %). In 46 criminal cases 58 persons were found guilty of the ML/FT crime, of which 25 (54 %) criminal cases (33 persons) resulted in probation, and in 21 criminal cases (25 persons) the average sentence was 6.33 years.</p> <p>In 2015, the courts reviewed with a verdict 42 criminal cases on the offenses under CCU Art. 209, 209-1 in relation to 68 persons. Of these, 28 persons were acquitted in 17 criminal cases (40 %). In 25 criminal cases 40 persons were found guilty of the ML/FT crime, of which 12 (48 %) criminal cases (20 persons) resulted in probation, and in 13 criminal cases (20 persons) the average sentence was 6.11 years.</p>
Overall risk level	12		
Effectiveness of the available measures	3	Comment	Ukraine has been implementing a judicial reform. According to the newly adopted legislation, the court system should acquire more political independence and judges become less prone to corruption and bribery.

¹⁶⁶ Source: information from the Unified State Register of Court Decisions: [Electronic resource]. – Access mode: <http://www.reyestr.court.gov.ua/>

Description of measures	The Law of Ukraine “On Ensuring the Right for Fair Trial” was developed and adopted ¹⁶⁷ . Changes were made to the principles of formation and activities of the agencies responsible for formation of the judge corps (High Council of Justice and High Qualification Commission of Judges of Ukraine).
Net risk level	12
Description of measures proposed to be taken for risk management	With the aim of efficient risk management, the following is proposed: <ol style="list-style-type: none"> 1. Complete implementation of the judicial reform. 2. Improve the procedures for confiscation (special confiscation) of criminal proceeds. 3. Implement separate court statistics on application of confiscation (special confiscation). 4. Replace the judge corps. 5. Introduce an efficient electronic justice system. 6. Amend the legislation which regulates the bar. 7. Generalize court practices in the ML/FT cases and provide relevant recommendations to courts.

¹⁶⁷ On Ensuring the Right for Fair Trial: Law of Ukraine, February 12, 2015 No. 192-VIII: [Electronic resource]. – Access mode: <http://zakon0.rada.gov.ua/laws/show/192-viii>

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PRIVATE COMPONENT

3.1. Bank Sector

The data shown in Fig. 3.1.1 show the evolution of a significant reduction in the number of banks in the bank system of Ukraine in 2013-2015.

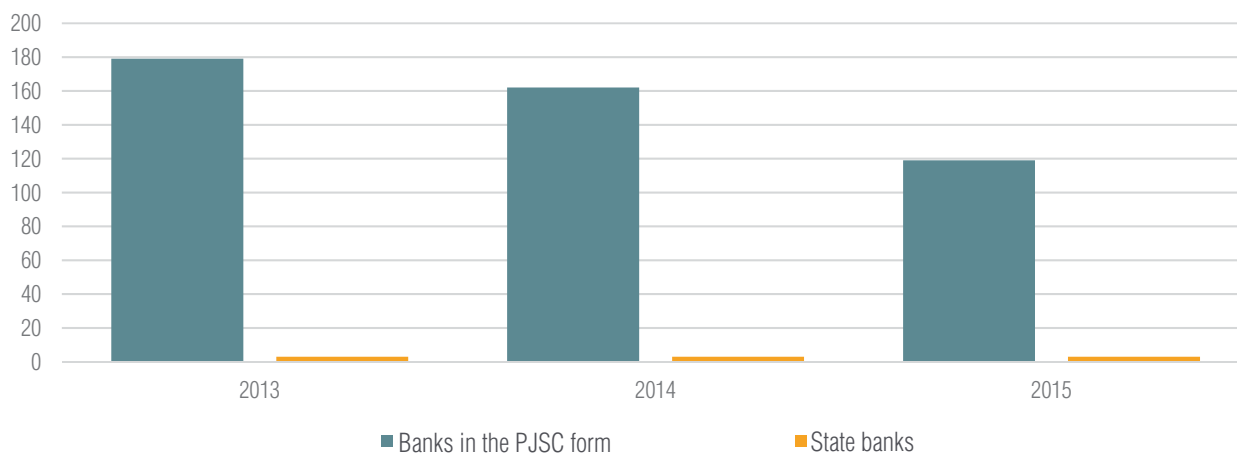


Fig. 3.1.1. Number of banks in Ukraine in 2013-2015

All the bank institutions arrange internal AML/CFT training on a continuous basis. The internal AML/CFT training is usually conducted according to the approved Training Plan for the current year. Further, bank employees take part in the trainings provided by the SFMSU and/or NBU.

Pursuant to the effective legislation, banks annually perform an internal AML/CFT-related audit.

Remote services are provided by banks, usually in the form of client-bank services for corporate clients and Internet banking for individuals.

Banks usually widely use software (technologies) to analyze financial transactions in order to identify possible AML/CFT risks.

The bank is obliged to independently classify its clients based on the risk criteria established by the Ministry of Finance and NBU and take precautionary measures against the customers whose activities testify to an increased risk in their effecting of such financial transactions.

Bank assigns a high risk level to clients by the Law and in the case of establishing:

- negative reputation of the client;
- the fact of inconsistency between the client's financial transaction and financial status and/or essence of activities;
- inability to ascertain the facts of consistency/inconsistency between the financial transaction and the financial status;
- ascertaining of the nature and purpose of the financial transaction based on the actions taken;
- doubts about the credibility or completeness of the client information provided, including for the period of an in-depth verification of the client.

In 2015, Ukraine adopted the Law “On Amending Certain Legislative Acts of Ukraine Regarding Liability of Persons Associated with the Bank¹⁶⁸”, which increased the powers of the NBU in relation to requirements for the banks to identify and reduce the excessive concentration of the risk arising from crediting of related persons. In particular, the concept of a “key participant” was introduced, which served the basis for detailing of the bank ownership structures and establishing their real controllers. The NBU for the first time applied sanctions to banks in case of failure to disclose their ownership structure as required by the NBU.

Currently, the Provision on Submittal of Data on the Bank Ownership Structure¹⁶⁹ regulates the procedure for disclosure of the ownership structure. This process aims not at formal disclosure of information, but at disclosure of the real bank controllers.

As of June 1, 2016, the bank structure of 79 out of 119 solvent banks is completely transparent. Regarding the ownership structure of 40 banks the work is underway; of these, the NBU officially recognized the structures of 13 banks as non-transparent.

¹⁶⁸ On Amending Some Legislative Acts of Ukraine regarding Liability of Persons Associated with the Bank: Law of Ukraine, March 02, 2015 No. 218-VIII: [Electronic resource]. – Access mode: <http://zakon2.rada.gov.ua/laws/show/218-19>

¹⁶⁹ Provision on Submittal of Data on the Bank Ownership Structure: NBU Board of Directors Resolution, May 21, 2015 No. 328: [Electronic resource]. – Access mode: <http://zakon4.rada.gov.ua/laws/show/v0328500-15>

The following table presents summary data on risk assessment by respondents related to the use of bank transactions for ML:

Bank transactions	Risk level		
	low	medium	high
Private Banking	26 %	57 %	17 %
International trade transaction settlements	12 %	52 %	36 %
Correspondent accounts	52 %	40 %	8 %
Electronic banking	8 %	60 %	32 %
Other	19 %	52 %	29 %

Table 3.1.1. Risks of using bank transactions for ML

Most respondents assigned a low risk level to correspondent accounts, medium – to electronic and private banking, as well as to international trade transaction settlements.

Within NRA, information on the most common suspicious financial transactions identified by the respondent banks was additionally verified and analyzed. To this end, the USIS data bases were used to perform an in-depth analysis of the codes of indicators of the mandatory (MFM) and internal financial monitoring (IFM) and identify which PFMS (starting 2015, 99% are banks) submit STRs to the SFMSU.

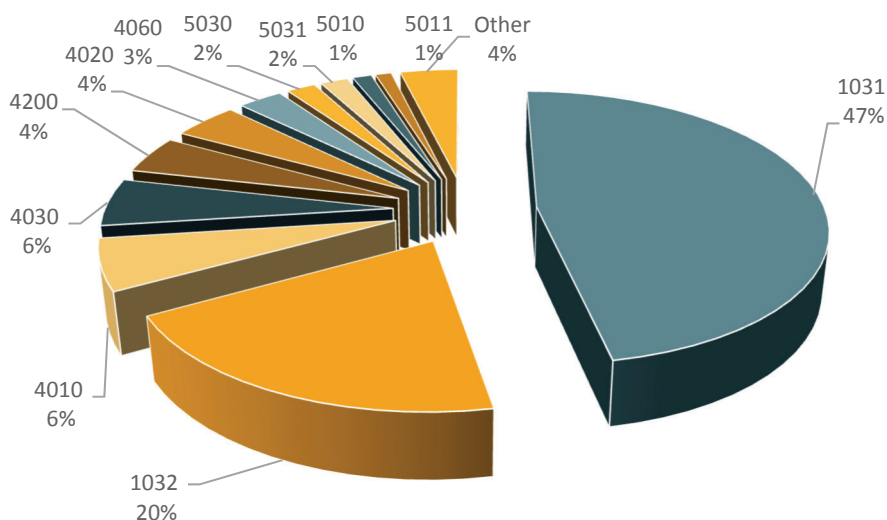


Fig. 3.1.2. Distribution of the reports from PFMS-banks by their quantity in terms of the mandatory financial monitoring (MFM) codes from Aug. 8, 2010 through Feb. 5, 2015 (effectiveness period of the revision of Law 2258)¹⁷⁰

¹⁷⁰ Source: based on the SFMSU data.

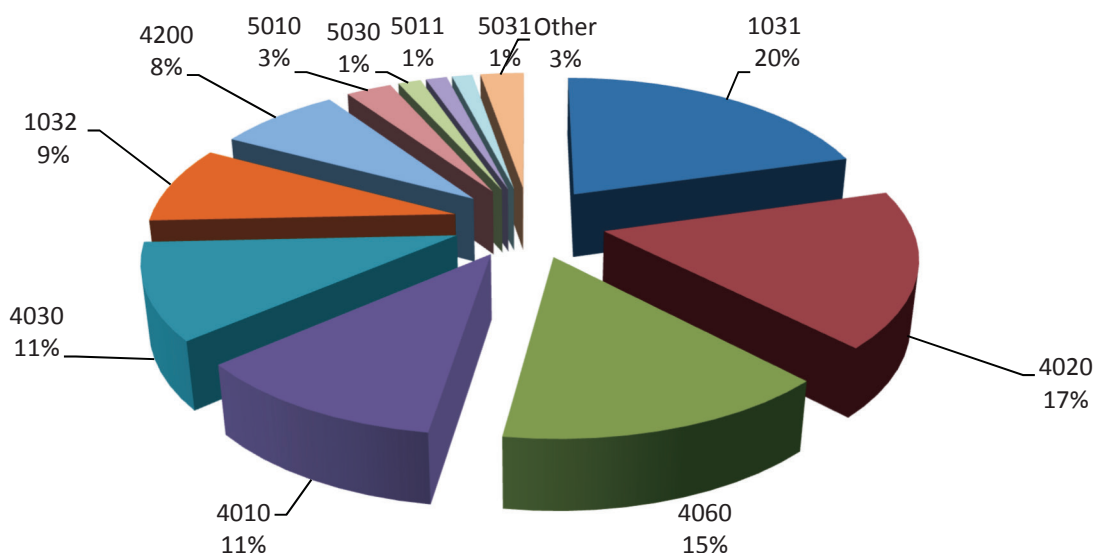


Fig. 3.1.3. Distribution of the amounts based on the reports from PFMS-banks in terms of the mandatory financial monitoring (MFM) codes from Aug. 21, 2010 through Feb. 5, 2015 (effectiveness period of the revision of Law 2258)¹⁷¹

No.	MFM indicator code	Comment to the MFM indicator code
1	1031	Crediting the account in cash with its subsequent transfer on the same operating day to another person
2	4020	Crediting the current account of a legal entity, provided financial transactions on the account were not effected since its opening
3	4060	Transfer of money abroad by a person in absence of a foreign economic agreement (contract)
4	4010	Crediting the current account of a legal entity whose period of activity does not exceed three months of the registration date
5	4030	Debiting the current account of a legal entity whose period of activity does not exceed three months of the registration date
6	1032	Crediting the account in cash with its subsequent transfer on the next operating day to another person
7	4200	Settlements under a foreign economic contract that does not include the actual delivery of goods, work, and services to the customs territory of Ukraine
8	5010	Effecting financial transactions with bearer securities not deposited in depository institutions
9	5030	Obtaining the insurance payment (insurance fee, insurance premium)
10	5011	Effecting financial transactions with promissory notes with blank endorsement or endorsement to bearer
11	5031	Payment, transfer of the insurance payment (insurance fee, insurance premium)

¹⁷¹ Source: based on the SFMSU data.

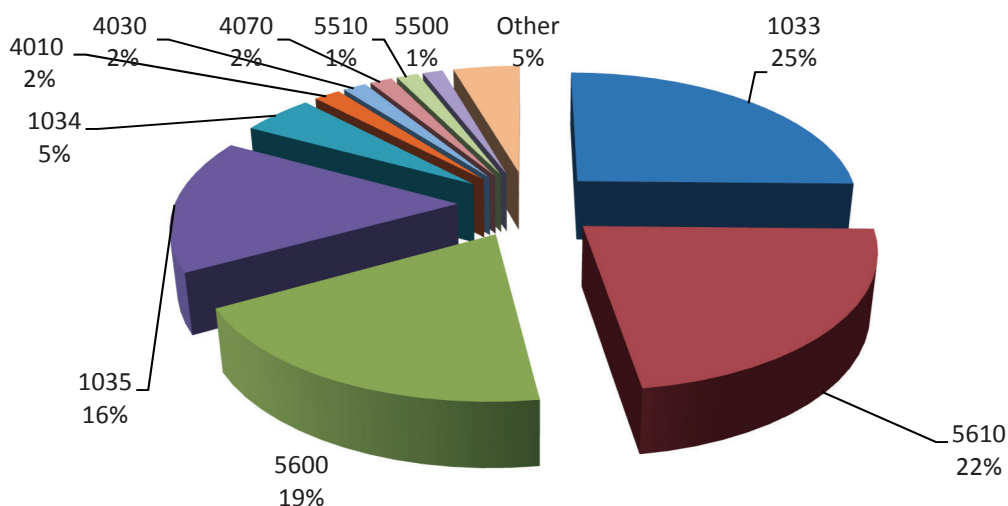


Fig. 3.1.4. Distribution of the reports from PFMS-banks by their quantity in terms of the mandatory financial monitoring (MFM) codes from Feb. 6, 2015 through Dec. 31, 2015 (effectiveness period of the revision of Law 1702)¹⁷²

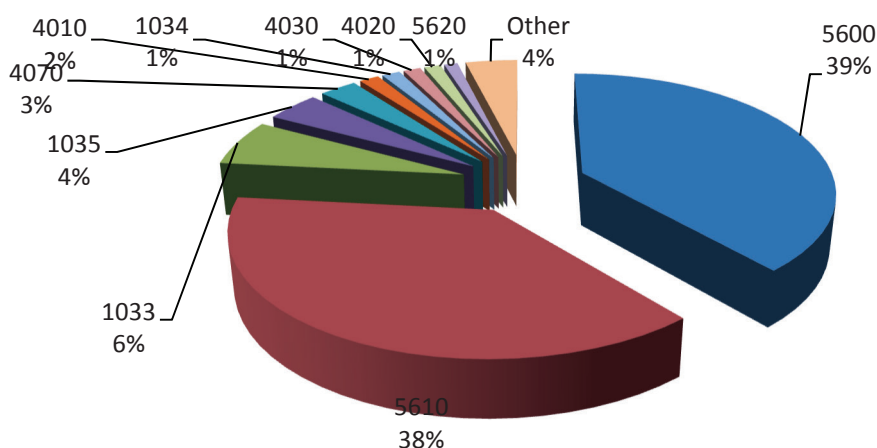


Fig. 3.1.5. Distribution of the amounts based on the reports from PFMS-banks in terms of the mandatory financial monitoring (MFM) codes from Feb. 6, 2015 through Dec. 31, 2015 (effectiveness period of the revision of Law 1702)

No.	MFM indicator code	Comment to the MFM indicator code
1	1033	Financial transactions of cash payments to be credited to the account of the initiator
2	5610	Financial transactions of transferring funds by the persons assigned a high risk level
3	5600	Financial transactions of receiving funds by the persons assigned a high risk level
4	1035	Financial transactions with receiving cash
5	1034	Financial transactions of transferring cash (without opening an account and/or without using the initiator's account)
6	4010	Crediting the current account of a legal entity whose period of activity does not exceed three months of the registration date
7	4030	Debiting the current account of a legal entity whose period of activity does not exceed three months of the registration date
8	4070	Transfer of funds abroad under foreign economic agreements (contracts), except for transfers under agreements (contracts) that provide for actual delivery of goods to the customs territory of Ukraine
9	5510	Receipt of funds by a non-profit organization
10	5500	Transfer of funds by a non-profit organization

¹⁷² Source: based on the SFMSU data.

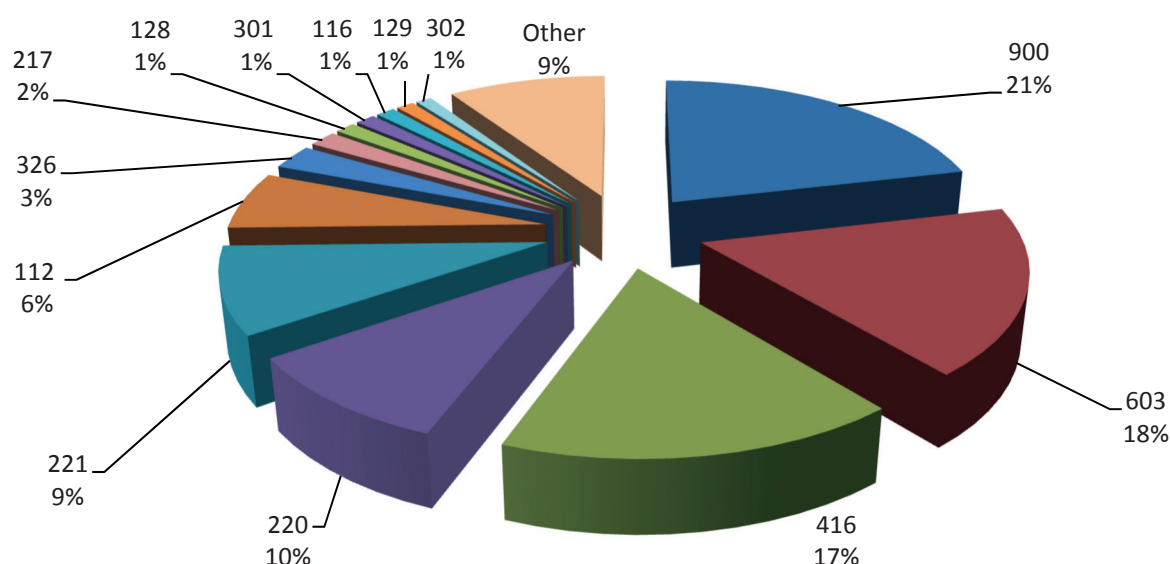


Fig. 3.1.6. Distribution of the reports from PFMS-banks by their quantity in terms of the internal financial monitoring (IFM) codes from Aug. 8, 2010 through Feb. 5, 2015 (effectiveness period of the revision of Law 2258)¹⁷³

No.	IFM indicator code	Comment to the IFM indicator code
1	900	Other financial transactions in relation to which the PFMS have reasons to believe that the financial transaction is effected for ML/FT
2	603	Monitoring of a relevant person's financial transactions on the SFMSU request
3	416	Regular receiving or submittal of financial assistance, including from non-residents, or providing financial assistance to non-residents
4	220	Regular admission to the client's account of funds that subsequently are withdrawn in cash by the client and/or by the client's authorized person
5	221	Regular withdrawal by the client and/or the client's authorized person of cash previously credited to the client's account
6	112	Provision by a person of information which is impossible to verify
7	326	Multiple financial transactions below the established limit which have mandatory financial monitoring indicators
8	217	Frequent transfers from bank accounts that have no economic sense
9	128	Unusually large transactions that do not meet the person's financial status
10	301	Regular crediting of the person's account in cash with subsequent transfer of the entire amount within one operation day to the client's account opened with another PFMS
11	116	Person's (client's) refusal to provide information stipulated by legislation and relevant internal PFMS documents
12	129	Apparent inconsistency in the purpose of the incoming/outgoing payments effected repeatedly (e.g., funds received as payment for construction materials are fully spent as payment for consulting services)
13	302	Regular crediting of the person's account in cash with subsequent transfer of the entire amount within one operation day in favor of a third person

¹⁷³ Source: based on the SFMSU data.

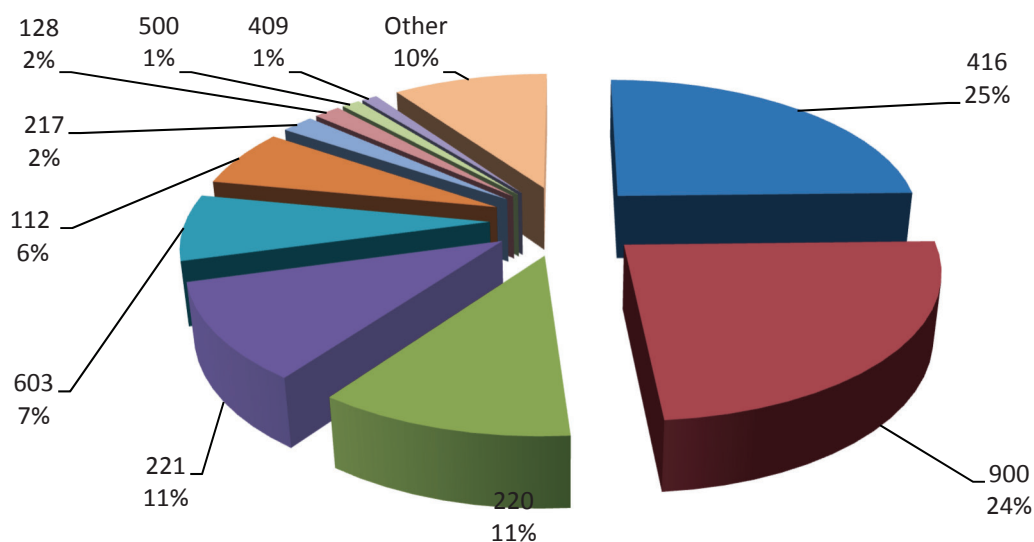


Fig. 3.1.7. Distribution of the amounts based on the reports from PFMS-banks in terms of the internal financial monitoring (IFM) codes from Aug. 21, 2010 through Feb. 5, 2015 (effectiveness period of the revision of Law 2258)¹⁷⁴

No.	IFM indicator code	Comment to the IFM indicator code
1	416	Regular receiving or submittal of financial assistance, including from non-residents, or providing financial assistance to non-residents
2	900	Other financial transactions in relation to which the PFMS have reasons to believe that the financial transaction is effected for ML/FT
3	220	Regular admission to the client's account of funds that subsequently are withdrawn in cash by the client and/or by the client's authorized person
4	221	Regular withdrawal by the client and/or the client's authorized person of cash previously credited to the client's account
5	603	Monitoring of a relevant person's financial transactions on the SFMSU request
6	112	Provision by a person of information which is impossible to verify
7	217	Frequent transfers from bank accounts that have no economic sense
8	128	Unusually large transactions that do not meet the person's financial status
9	500	Transactions according to the typologies of the international organizations involved in AML/CFT
10	409	Adding funds in cash on a large scale to be placed on deposit accounts in banks, united credit union

¹⁷⁴ Source: based on the SFMSU data.

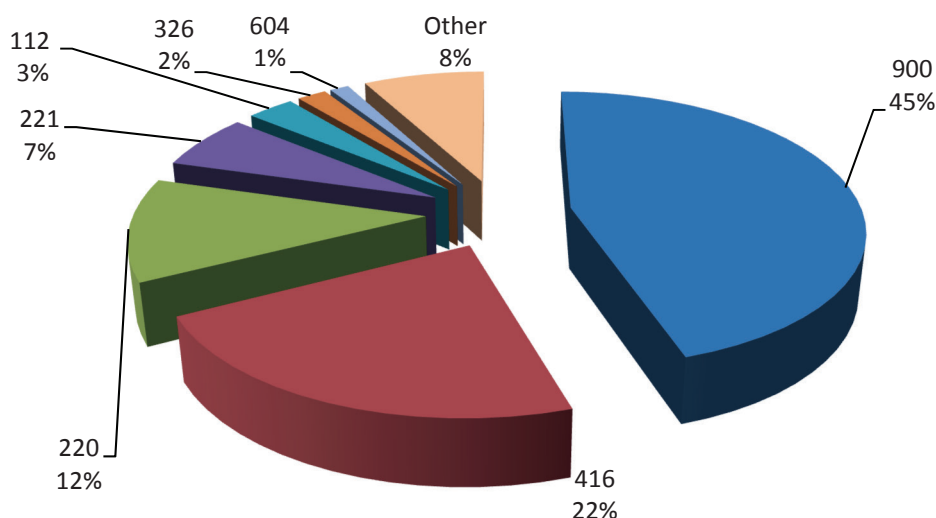


Fig. 3.1.8. Distribution of the reports from PFMS-banks by their quantity in terms of the internal financial monitoring (IFM) codes from Feb. 6, 2015 through Dec. 31, 2015 (effectiveness period of the revision of Law 1702)¹⁷⁵

No.	IFM indicator code	Comment to the IFM indicator code
1	900	Other financial transactions in relation to which the PFMS have reasons to believe that the financial transaction is effected for ML/FT
2	416	Regular receiving or submittal of financial assistance, including from non-residents, or providing financial assistance to non-residents
3	220	Regular admission to the client's account of funds that subsequently are withdrawn in cash by the client and/or by the client's authorized person
4	221	Regular withdrawal by the client and/or the client's authorized person of cash previously credited to the client's account
5	112	Provision by a person of information which is impossible to verify
6	326	Multiple financial transactions below the established limit which have mandatory financial monitoring indicators
7	604	Monitoring of receipt financial transactions under the SFMSU decision pursuant to Part 4, Art. 17 of the Law

¹⁷⁵ Source: based on the SFMSU data.

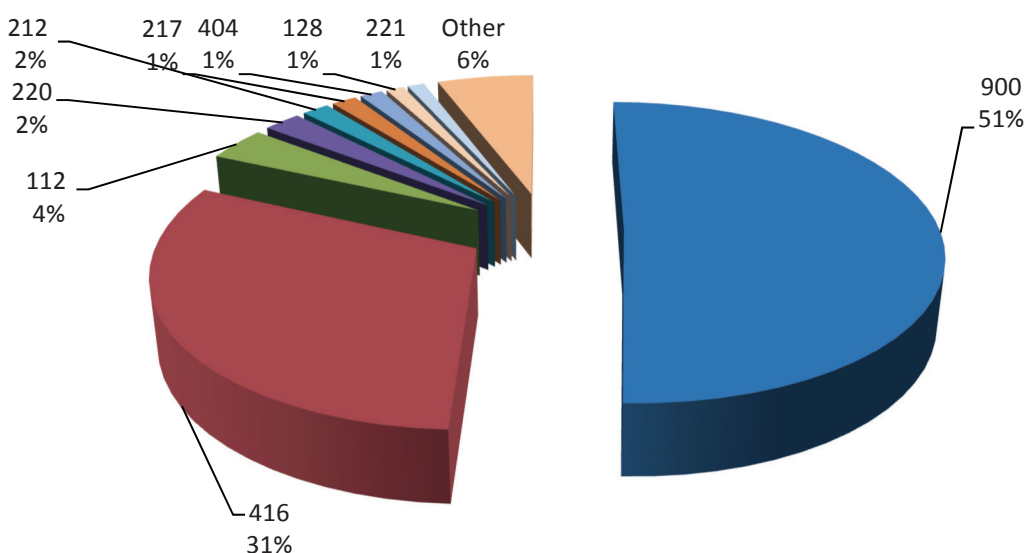


Fig. 3.1.9. Distribution of the amounts based on the reports from PFMS-banks in terms of the internal financial monitoring (IFM) codes from Feb. 6, 2015 through Dec. 31, 2015 (effectiveness period of the revision of Law 1702)¹⁷⁶

No.	IFM indicator code	Comment to the IFM indicator code
1	900	Other financial transactions in relation to which the PFMS have reasons to believe that the financial transaction is effected for ML/FT
2	416	Regular receiving or submittal of financial assistance, including from non-residents, or providing financial assistance to non-residents
3	112	Provision by a person of information which is impossible to verify
4	220	Regular admission to the client's account of funds that subsequently are withdrawn in cash by the client and/or by the client's authorized person
5	212	Single individual purchase of a large block of shares that are not freely circulated on a regulated market, provided that the person is not a securities market professional participant and the securities are not transmitted to the person to repay arrears of a counteragent to the person
6	217	Frequent transfers from bank accounts that have no economic sense
7	404	Effecting large-scale financial transactions of sale of goods (payment of services), the value of which is difficult or impossible to determine (e.g., items of intellectual property, some types of services that have no constant market value, consulting, legal, audit services, etc.)
8	128	Unusually large transactions that do not meet the person's financial status
9	221	Regular withdrawal by the client and/or the client's authorized person of cash previously credited to the client's account

The information from Fig. 3.1.2-3.1.9 suggests the following:

1. In the total number of the financial transactions with the MFM indicators registered by the SFMSU from banks during the effectiveness period of Law 2258 (from Aug. 21, 2010 through Feb. 5, 2015), cash financial transactions account for the highest specific weight (67%), during the effectiveness period of Law 1702 (from Feb. 6, 2015 through Dec. 12, 2015) – cash financial transactions (41%) and financial transactions effected by the persons assigned a high risk (publicly exposed persons) (41%).

The highest value in the total number of financial transactions with the MFM indicators registered by the SFMSU from banks during:

¹⁷⁶ Source: based on the SFMSU data.

- effectiveness period of Law 2258 (from Aug. 21, 2010 through Feb. 5, 2015) was demonstrated by financial transactions related to crediting a legal entity's account – 28% (MFM codes 4010-4020), foreign economic transactions – 15% (MFM code 4060), and cash transactions – 29% (MFM code 1031-1032);

- effectiveness period of Law 1702 (from Feb. 6, 2015 through Dec. 12, 2015) was demonstrated by financial transactions effected by the persons assigned a high risk – 77% (MFM code 5600-5610) and cash financial transactions – 11% (MFM code 1033, 1034, 1035).

In other words, the highest-risk financial transactions in terms of ML include:

- cash financial transactions;
- financial transactions related to foreign economic activities;
- financial transactions with replenishing accounts of newly established companies;
- financial transactions effected by high-risk clients (publicly exposed persons).

2. In the total number of financial transactions with the IMF indicators registered by the SFMSU from banks, the highest specific weight was demonstrated by financial transactions related to receiving or providing of financial assistance (IMF code: 416) – 17% (from Aug. 21, 2010 through Feb. 5, 2015) and 22% (from Feb. 6, 2015 through Dec. 31, 2015) and cash financial transactions (IMF code: 220, 221) – 19%.

The highest value in the total number of financial transactions with the IFM indicators registered by the SFMSU from banks was demonstrated by financial transactions related to receiving or providing of financial assistance – 25% (from Aug. 21, 2010 through Feb. 5, 2015) and 31% (from Feb. 6, 2015 through Dec. 31, 2015) and cash financial transactions 22% (from Aug. 21, 2010 through Feb. 5, 2015).

In other words, the highest-risk financial transactions in terms of ML include:

- financial transactions related to receiving or providing financial assistance;
- cash financial transactions;

3.2. Non-Bank Financial Sector

In 2015, the number of non-bank financial institutions increased by 6.3 % over 2014.

The information on the number of non-bank financial institutions is provided in the following table.

Non-Bank Financial Institutions Supervised by the State Commission for Regulation of Financial Services Markets	Number of PFMS as of:		
	Dec. 31, 2013	Dec. 31, 2014	Dec. 31, 2015
Insurance companies	407	382	361
Credit institutions	739	711	728
Pawn Shops	479	477	482
Financial companies	377	415	571
Trust companies	2	2	2
Non-government pension funds	81	76	72
Administrators of non-government pension funds	28	24	23
Legal entities that are not financial institution but have the right to provide some financial services	254	267	268
Credit history bureaus	8	9	8
Insurance/reinsurance brokers	56	51	51
Non-resident insurance/reinsurance brokers who informed of their intention to pursue activities in Ukraine	7	10	10
Total:	2,438	2,424	2,576

Table 3.2.1. Number of non-bank financial institutions

The highest number of the STRs was submitted to the SFMSU by insurance companies (87 %)

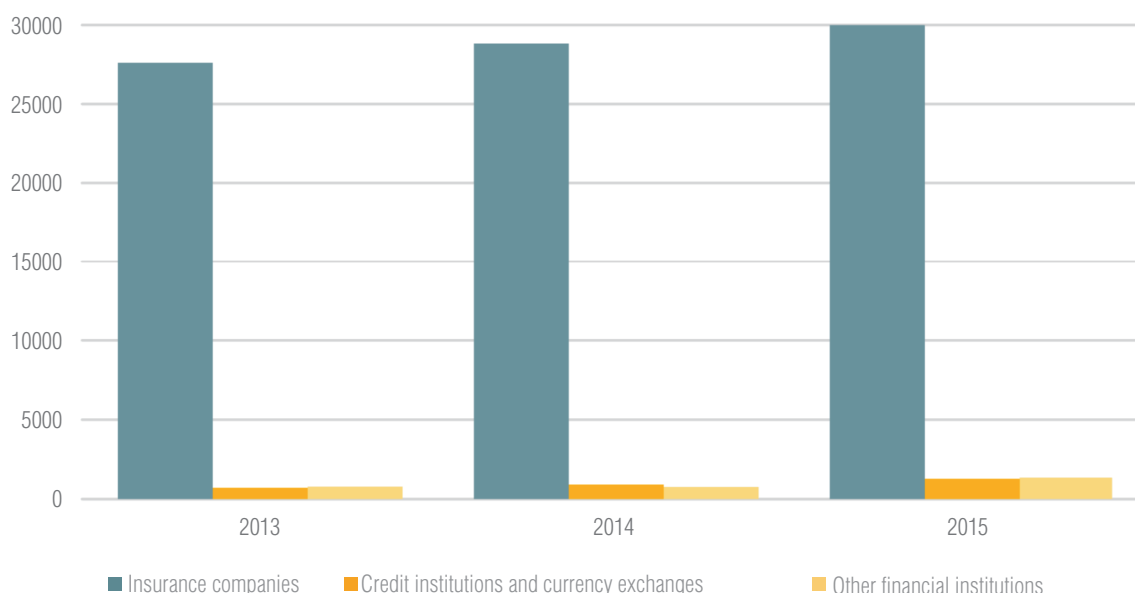


Fig. 3.2.1. STRs submitted to the SFMSU by non-bank financial institutions supervised by the SCRFMSU¹⁷⁷

Remote services in the non-bank financial sector are the most common among the insurers:

- mandatory insurance policies of the vehicle owners' civil liability are ordered by customers over the Internet with subsequent receipt of the policies at the insurer's;

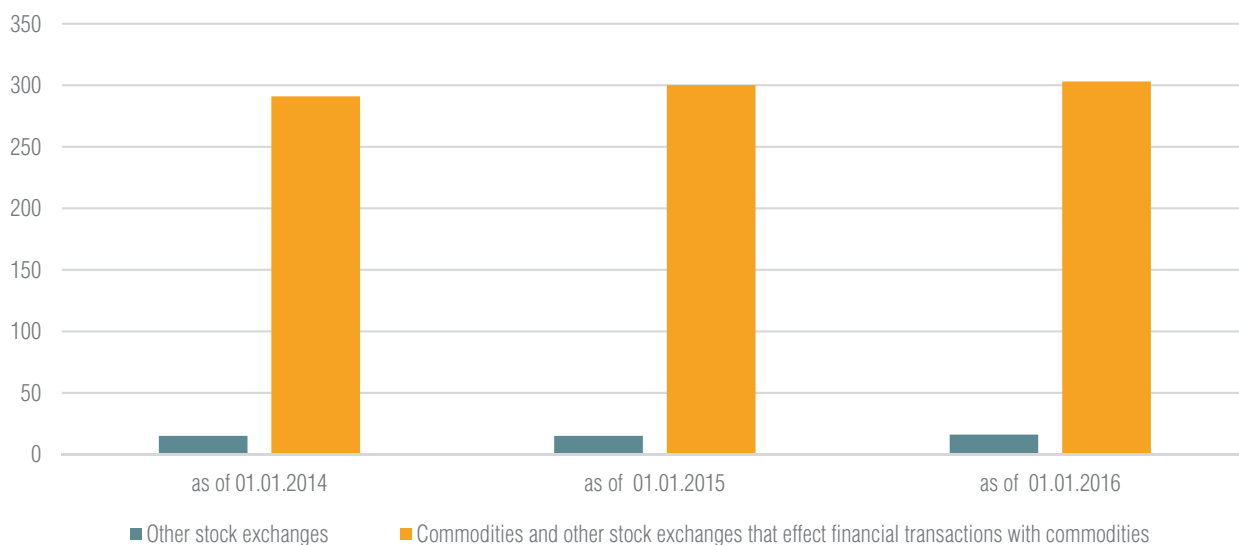
¹⁷⁷ Source: based on the SFMSU data.

- providing insurance services on insurance of tourism online over the Internet, etc.

Internal audits for compliance with the AML/CFT legislation are usually performed by the responsible employee.

Not all the institutions use software (technologies) to analyze financial transactions in order to identify possible AML/CFT risks.

The information on the number of commodity exchanges conducting financial transactions with goods and other exchanges registered with the SFMSU in 2013-2015 as PFMS is provided in the following figure.



*- number of the PFMS without separated divisions

Fig. 3.2.2. Information on the number of commodity exchanges involved in financial transactions with goods and other exchanges¹⁷⁸

At the same time, it should be noted that this category of the PFMS did not submit information on suspicious transactions to the SFMSU in 2013-2015.

¹⁷⁸ Source: based on the SFMSU data.

3.3. Securities Market

The past three years witnessed an almost double reduction in the general number of stock market professional participants (by 44 %): from 1,144 subjects in 2013 to 644 subjects in 2015. Statistics on the types of the PFMS supervised by the NSSMC is shown in the table.

PFMS Type Supervised by the NSSMC	Number of PFMS:		
	2013	2014	2015
Securities traders	499	166	132
Securities traders – depositary institutions	162	162	144
Depositary institutions	204	37	38
Asset management companies	349	345	320
Stock exchanges	10	10	10
Total:	1,144	720	644

Table 3.3.1. Types of the PFMS supervised by the NSSMC

The number of depositary institutions reduced almost 5 times (by 81 %) and the number of securities traders reduced almost 4 times (by 74 %); the fluctuations in the number of other stock market professional participants in 2013-2015 were insignificant.

In 2013-2015, the highest number of STRs were submitted to the SFMSU by the stock market professional participants in 2015.

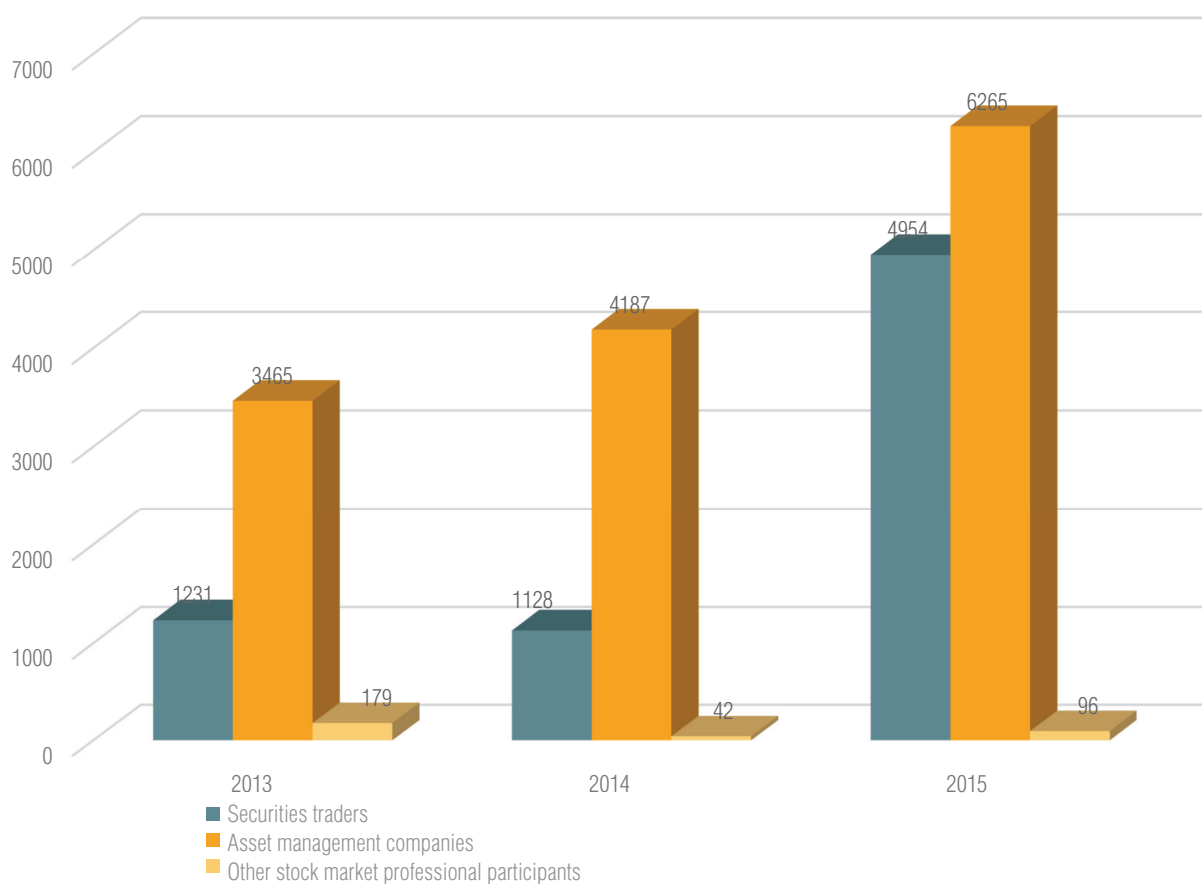


Fig. 3.3.1. STRs submitted to the SFMSU by the stock market professional participants¹⁷⁹

¹⁷⁹ Source: based on the SFMSU data.

Further, 55.4 % of STRs were submitted to the SFMSU by the asset management companies.

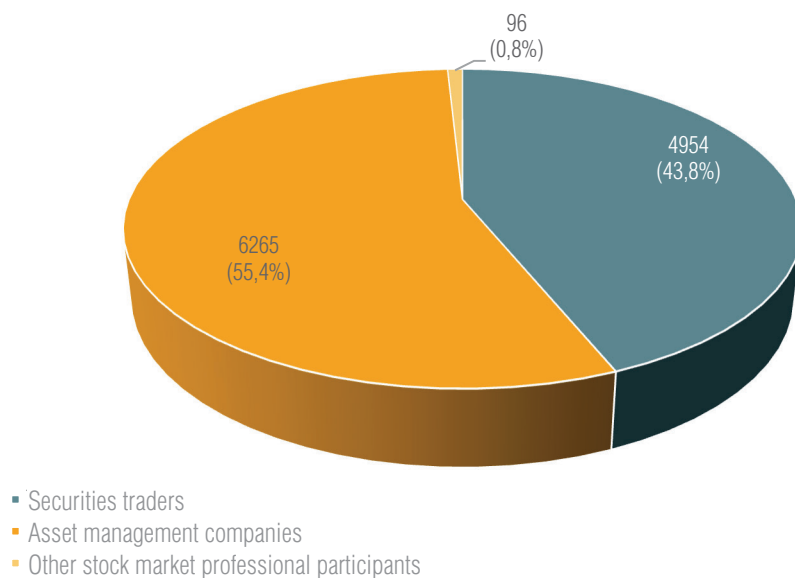


Fig. 3.3.2. Specific weight of the stock market professional participants in STRs¹⁸⁰

Clients (natural persons and legal entities) who use remote services of the PFMS – securities traders and persons who under the effective legislation have access to exchange trading.

The remote services used by exchange market participants include internet-trading at the stock exchange. The clients who use Internet-trading and submit trading orders remotely subsequently approve it by signing the register of orders and a broker report.

Not all the institutions use software (technologies) to analyze financial transactions in order to identify possible AML/CFT risks.

¹⁸⁰ Source: based on the SFMSU data.

3.4 Non-Financial and Business Professions

Pursuant to Art. 14 of the Law, state regulation and supervision in the AML/CFT sphere is effected in relation to:

- business entities that conduct lotteries or any other types of gambling, business entities trading in precious metals and stones and products therefrom, auditors, auditor firms, individual entrepreneurs who provide accounting services (except for persons that provide services under employment relations) – by the Ministry of Finance;
- notaries, barristers, barrister agencies and associations, and business entities, which provide legal services (except for persons that provide services under employment relations) – by the Ministry of Justice;
- entrepreneurs who provide intermediary services during real estate sales transactions – by the SFMSU.

The information on the number of NFBP representatives registered with the SFMSU as PFMS and their activity in the suspicious transaction reports STRs in 2013-2015 is shown in the following table.

NFBP type	Number of PFMS registered with the SFMSU			Number of STRs registered by the SFMSU		
	2013	2014	2015	2013	2014	2015
Entrepreneurs that provide intermediary services during real estate sales transactions (real estate brokers/realtors)	216	204	206	0	0	0
Economic entities involved in cash trade in precious metals and stones and goods made thereof	4	4	5	0	0	12
Lotteries	49	48	20	392	258	300
Economic entities involved in gambling, including casinos, electronic (virtual) casinos	-	-	-	-	-	-
Notaries	7,051	7,059	7,083	89	29	31
Attorneys	69	70	70	0	0	0
Auditors	10	9	9	0	0	0
Auditing firms	50	52	66	0	0	0
Individual entrepreneurs who provide accounting services	10	10	11	0	0	0
Economic entities that provide legal services	87	86	90	0	0	0
Individual entrepreneurs and legal entities that carry out financial transactions with goods (perform work, provide services) for cash	103	104	-	3	0	-

Table 3.4.1. Number of NFBP representatives registered with the SFMSU as PFMS and their activity in the suspicious transaction reports STRs in 2013-2015

The highest specific weight in the total number of NFBP representatives in 2013-2015 was taken by the notaries (about 93 % on the average) and entrepreneurs who provide intermediary services during real estate sales transactions (realtors) (about 2.8 % on the average).

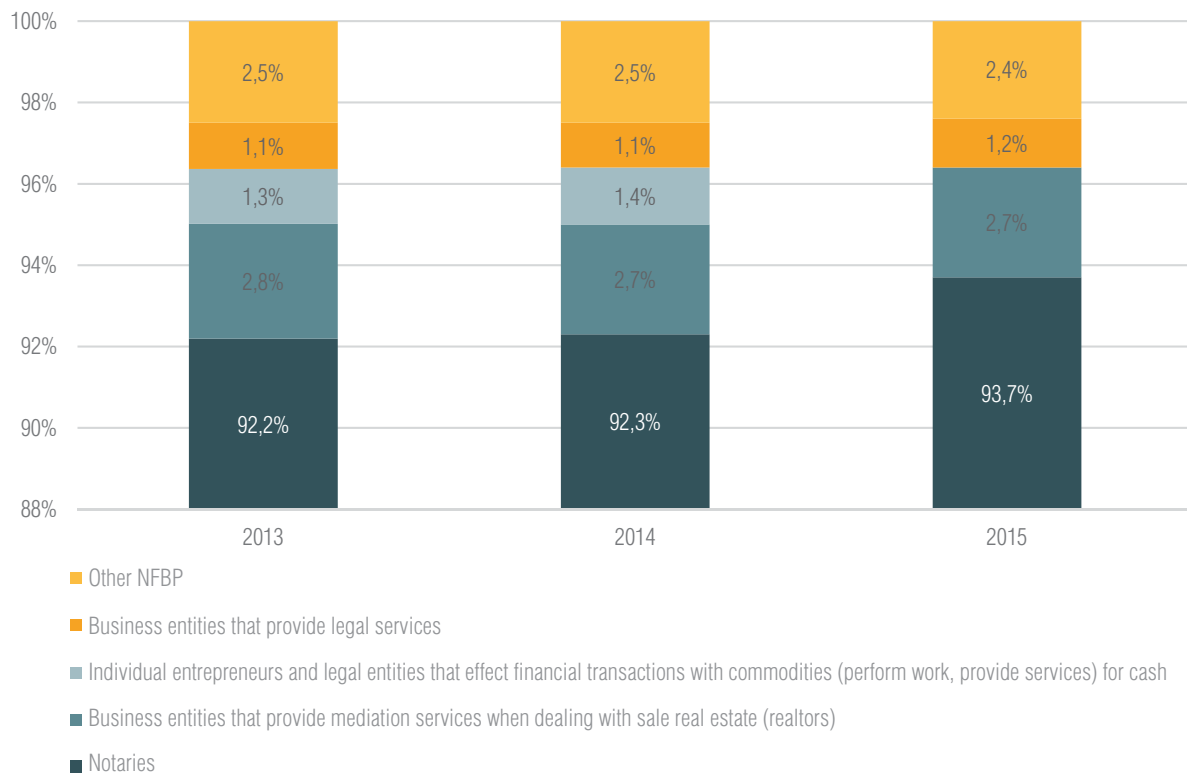


Fig. 3.4.1. Specific weight in the total number of NFBP representatives¹⁸¹

At the same time, activity in reporting to the SFMSU in 2013-2015 was shown only by the business entities involved in cash trade in precious metals and stones and goods made thereof, notaries, and lotteries.

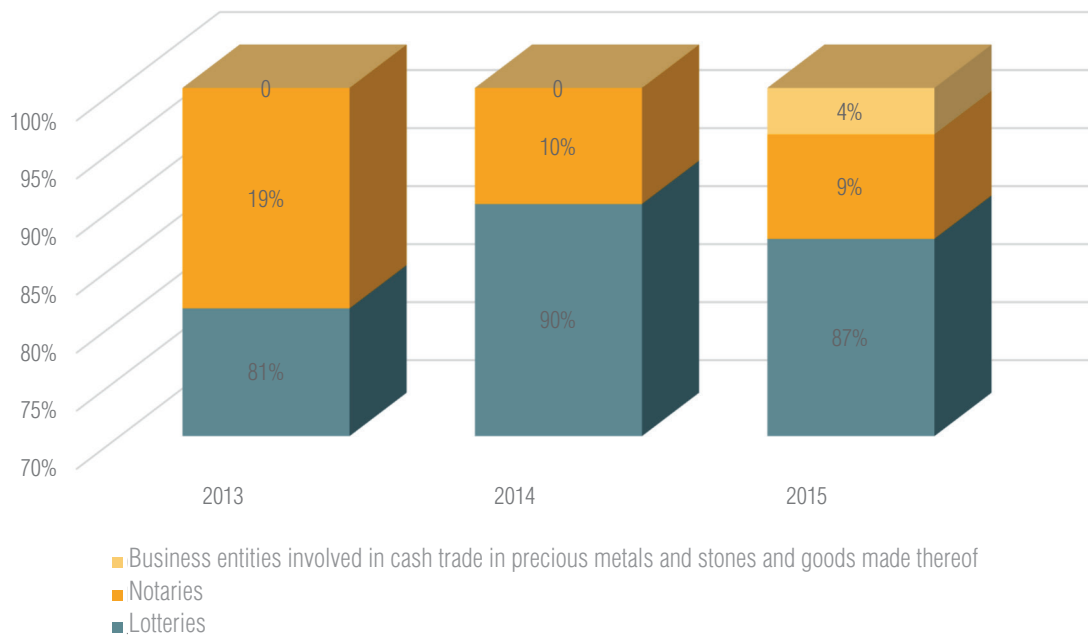


Fig. 3.4.2. Submittal of STRs by NFBP representatives¹⁸²

It was such NFBP representatives as lotteries that submitted the lion share of financial transaction reports (about 90 % of the total number of STRs by NFBP representatives) to the SFMSU in 2013-2015, given a low specific weight in the total number of the NFBP representatives (0.4 % on the average).

¹⁸¹ Source: based on the SFMSU data.

¹⁸² Source: based on the SFMSU data.

A simplified financial monitoring mechanism is envisaged for notaries and other NFBP which pursue their activities in person, since such PFMS pursue their activities without establishing a legal entity.

Software (technologies) to analyze financial transactions in order to identify possible AML/CFT risks are not used by notaries.

The legislation, inter alia, envisages notarial record keeping and provision of statistics by notaries. The report envisages that notaries provide information on certifying legal transactions on the sale of estate. When performing audits, including of the registers for registering notarial acts and documents in the notary's files, it is possible to establish absence/presence of certified legal transactions referred to in Part 1, Art. 8 of the Law.

The PFMS (except for designated PFMS that pursue their activities in person, without establishing a legal entity), with due regard for legislative requirements, develops, implements, and continuously, with due regard for legislation, updates the financial monitoring rules, financial monitoring programs, and other internal documents on financial monitoring (internal documents on financial monitoring), and appoints an employee responsible for its performance (responsible employee).

NFBP representatives reportable to the SFMSU (entrepreneurs that provide intermediary services during real estate sales transactions (realtors)) do not provide remote services.

Software (technologies) to analyze financial transactions in order to identify possible AML/CFT risks are not used by realtors.

Realtors use the following data bases:

- open register of national publicly exposed persons of Ukraine¹⁸³;
- Unified State Register of legal entities and individual entrepreneurs;
- Unified State Register of court decisions;
- list of persons related to terrorist activities or exposed to international sanctions, etc.

¹⁸³ The register was developed by the teams of the Anti Corruption Action Centre and the White-Collar Hundred in conjunction with the SFMSU and Ministry of Justice specialists with financial support of international donors: [Electronic resource]. – Access mode <https://pep.org.ua/uk/>

3.5. Non-Profit Organizations

As of Apr. 1, 2016, the number of civil associations registered by judicial authorities by their type is:

- political parties – 365;
- structural branches of political parties – 297,524;
- creative associations – 72;
- territorial centers of creative associations – 298.

As of Apr. 1, 2016, the Register of Non-Profit Institutions and Organizations¹⁸⁴ had 244,520 registered institutions and organizations, specifically including:

14,844 charity funds (organizations) duly established to pursue charity activities;

54,188 NGOs established to provide rehabilitation, physical culture and sports services for the disabled (disabled children), and social services; legal assistance, implementation of environmental, health, amateur sports, cultural, educational, educational and scientific activities; social organizations of the disabled, NGO unions of the disabled and their local branches established in accordance with the applicable law;

21,496 religious organizations, etc.

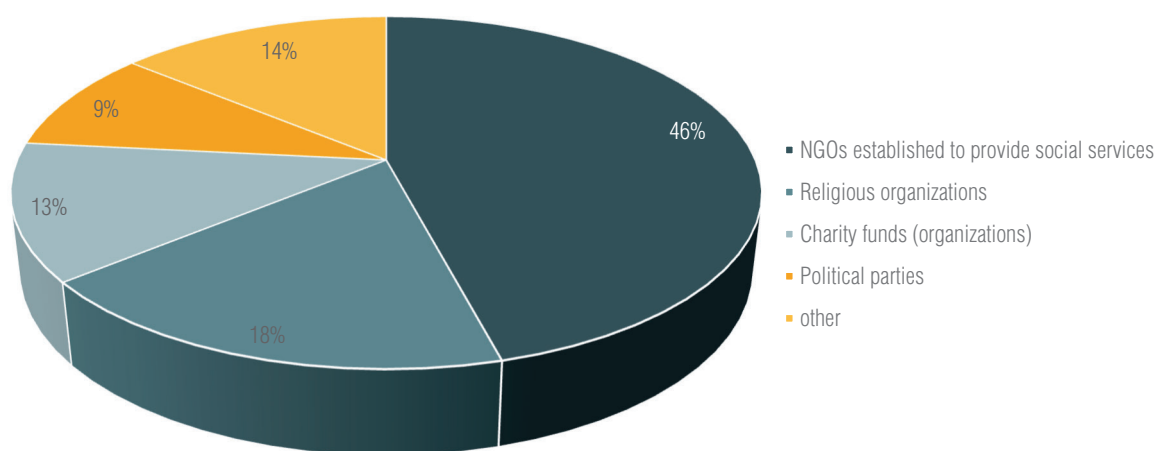


Fig. 3.5.1. Number of non-profit organizations, institutions, and organizations (selection) (as of Apr. 1, 2016)

According to the State Statistics Committee, in 2014 NGOs received 4.1 bln UAH for their activities from different sources. The revenues from charity amounted to 1.9 bln UAH or 45.7 % of the total amount of NGO funding; the revenues from the economic activities of companies and enterprises established by NGOs in pursuance of their objective and activity areas were 510.9 mln UAH or 12.5 %, from the membership fees – 454.6 mln UAH or 11.1 %.

Sources of NGO funding in 2014 (in percentage to the total amount)

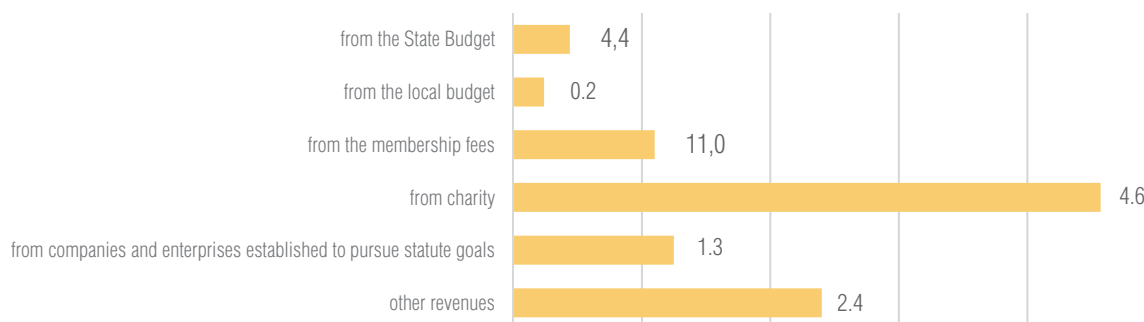


Fig. 3.5.2. Sources of NGO funding in 2014 (in percentage to the total amount)

¹⁸⁴ On Approving the Procedure for Maintaining the Register of Non-Profit Institutions and Organizations, Adding Non-Profit Companies, Institutions, and Organizations to the Register and Removal from the Register: Cabinet of Ministers of Ukraine Resolution, July 13, 2016 No. 440: [Electronic resource]. – Access mode: <http://www.kmu.gov.ua/control/uk/cardnpd?docid=249189426>

In 2014 NGOs used 84.4 % of the available funds; the remainder was 639.9 mln UAH. The highest specific weight in the structure of the funds used by NGOs was: charity expenses – 26.7 %, or 925 mln UAH, labor remuneration – 23.2 %, or 803.6 mln UAH, and payment for services – 17.9 %, or 621.1 mln UAH.

In January 2014 – March 2016 non-profit institutions and organizations paid income tax to the Consolidated Budget of Ukraine to the total amount of 87.9 mln UAH, including 33.5 mln UAH in 2014, 48.4 mln UAH in 2015, and 6.0 mln UAH in the Quarter I of 2016.

In the context of AML/CFT measures, non-profit organizations (such as civil associations), pursuant to Part 7, Art. 23 of the Law of Ukraine “On Civil Associations”¹⁸⁵, shall:

1. store their statutory documents, documents containing information on the activities completed for this purpose (aims) and objectives; store and regularly update the information sufficient for identification of the civil association end beneficiary owners (controllers) pursuant to the legal requirements and provide it to the state registrar in the cases and scope stipulated by the law. This information cannot be categorized as restricted;
2. draft annual financial reports with a detailed analysis of incomes and expenditures;
3. take control measures to ensure credit and spending of all the funds in a manner consistent with the aims and objectives of the declared activities of a civil association;
4. ensure keeping record and storage for at least five years of all the required account documents related to internal and international transactions, as well as information stated in Clauses 1 and 2 of this Part, and provide it to competent state agencies in response to a relevant request and in other cases stipulated by law.

According to the State Fiscal Service information resources, in January 2014 – March 2016, the territorial audit divisions audited 4.7 thous non-profit companies, institutions, and organizations, resulting in additional charges of 194 mln UAH.

According to the information available, the main (dominant) way of unlawful use of non-commercial organizations was channeling the funds to terrorists by non-profit organizations. The sector of non-profit organizations has a number of mutually dependent vulnerabilities and terrorist organizations try taking advantage of these vulnerabilities.

The peculiarities of non-profit organizations that may also be attractive for use in criminal schemes include: a possibility of accumulating funds through membership fees, donations, and so-called non-profit activities, and using cash to implement projects or buy the required equipment.

It is rather difficult to trace the schemes in this sphere, preclude them due to the nature of such organizations (especially statute functions) and loyal system of their state regulation and supervision in different countries. Having received the charity status and having been relieved of taxation, they can be used for territorial transfer of funds through branches or to provide material and technical support to terrorists and separatists (directly or as a cover up for their actions).

¹⁸⁵ On Civil Associations: Law of Ukraine, March 22, 2012 No. 4572-VI: [Electronic resource]. – Access mode: <http://zakon3.rada.gov.ua/laws/show/4572-17>

3.6. Threats and Risks

Threat 1. Use of innovative technologies for ML/FT

Risk 1	ML/FT through remote services		
Level of consequences	3	Comment	<p>Unauthorized writing off funds from bank accounts, payment card fraud, interference in Internet-banking, spreading of computer viruses, DDoS attacks on Internet-resources, fraud in information networks – this is a non-exhaustive list of cybercrimes, i.e. crimes in the sphere of information and computer technologies.</p> <p>Preparation and committing of a cybercrime is done virtually without leaving the “work place”, i.e. such crimes are accessible, since computer equipment is becoming ever cheaper, crimes can be committed from any point on the planet, in any town, whereas the objects of crime may be located thousands of kilometers from the criminal.</p>
Probability level	2	Comment	<p>At the current stage of equipment and technology development, new bank products and services have been successfully developing. One of the most promising areas of development in the bank activities is development of remote bank services. This points to the need of improving the mechanism of cashless money turnover which should provide for the ever growing needs of business entities to expedite the speed of transactions. The said issue can be resolved in the case of mass use of the existing forms of bank services. The main method of resolution is to use innovative technologies based on the advanced experience of industrially developed countries in the sphere of interactive bank services. This led to development and mass use of innovative technologies in banking aimed at providing remote services, the prospects of which have not received unambiguous assessment.</p> <p>Remote service:</p> <ul style="list-style-type: none"> - “client bank” systems (primarily for corporate clients); - internet banking; - ATMs and self-service terminals - on the phone through an operator (call center – contact center); - interactive television; - mobile devices which use the WAP protocol, mobile telephones of the GSM standard with an inbuilt Internet browser. <p>Remote services are provided by banks, usually in the form of client-bank services for corporate clients and Internet banking for individuals. Remote services in the non-bank financial sector are the most common among the insurers:</p> <ul style="list-style-type: none"> - mandatory insurance policies of the vehicle owners' civil liability are ordered by customers over the Internet with subsequent receipt of the policies at the insurer's; - providing insurance services on insurance of tourism online over the Internet, etc.
Overall risk level	8		

Effectiveness of the available measures	2	Comment	<p>Any software complex should ensure reliable protection of information during its transit through communication channels.</p> <p>The information protection and security system in Ukraine is regulated on the State level. To this end, the State Communications and Data Protection Service was established, which determines the requirements for creating systems to protect technical and cryptographic information which belongs to the State. Bank institutions, however, are allowed to establish and use only those information protection means which were certified by the State Communications and Data Protection Service and comply with the State standard. The versatility of software complexes that have the functionality of the Internet-banking system and establish a contact center technological platform allows banks to implement remote services for both, small and corporate clients. An increasing number of the services that are offered in the remote mode evidences the technological intensity of the bank institution and bank area, and reduces expenses.</p>
Description of measures	<p>Remote servicing is an important component of the modern bank system. Therefore, one of the most important bank objectives during provision of remote services is ensuring the highest level of safety of the e-banking, which minimizes the risks of unauthorized access to client information and accounts.</p> <p>To ensure the required level of safety, banks involved in remote servicing cooperate not only with developers of the remote system services, but also with the companies that deal with information protection and security. The safety issues of remote services are important not only for banks, but also for their clients. Appropriate protection must be provided not only for the bank part of the system which provides remote services, but also for the client's technical and software means used by the client to access the services.</p>		
Net risk level	6		
Description of measures proposed to be taken for risk management	<p>With the aim of efficient risk management, the following is proposed:</p> <ol style="list-style-type: none"> 1. Address the issue of implementing remote identification of clients with due regard for modern information products and requirements of the AML/CFT standards. 2. Develop unified recommendations for clients regarding their taking precautionary measures when using remote bank services. 3. Implement continuous use of security systems when using remote services with due regard for protection from possible offenders' attacks. 		

Threat 2. Non-detection of suspicious financial transactions

Risk 1	Insufficient level of understanding of the ML/FT risks		
Level of consequences	4	Comment	Insufficient level of understanding by PFMS of the ML/FT risks is the reason for low-quality performance by the PFMS of the AML/CFT-related legislative requirements. This, in turn, leads to PFMS failure to submit STRs to the SFMSU and to take appropriate precautions, which makes such an PFMS attractive for ML/FT purposes.
Probability level	2	Comment	Low level of submittal of STRs by designated PFMS (NFBP representatives) to the SFMSU, and in some cases failure to submit any STR to the SFMSU in 2013-2015, evidences an insufficient level of understanding of the ML/FT risks by the NFBP representatives. On the other hand, banks, financial institutions, and securities market professional participants better understand the ML/FT risks (and submit STRs to the SFMSU on a more regular basis).
Overall risk level	8		
Effectiveness of the available measures	2	Comment	1. Art. 6 of the Law determines the PFMS obligation to perform ML/FT risk assessment and client risk monitoring. The PFMS shall independently perform risk assessment of its clients based on the risk criteria established by the Ministry of Finance and State Financial Monitoring Subjects which effect state regulation and supervision over the activities of the relevant PFMS during their identification and in other cases stipulated by the law and internal documents on financial monitoring, and use precautions towards the clients assigned a high risk level. Pursuant to Art. 16 of the Law, the PFMS shall inform the SFMSU in case of any suspicions, specifically based on: - risk criteria determined by the PFMS independently with due regard for the risk criteria established by the Ministry of Finance; - analytically established inconsistency between the client's financial transaction(s) and the client's financial status and/or essence of the client's activities; - typological research on AML/CFT or FPWMD prepared and published by the SFMSU. 2. AML/CFT training of NFBP representatives 3. Provision of explanations to the PFMS.
Description of measures	In 2013, the SFMSU Training and Methodological Center arranged 32 training events and 4 workshops for the PFMS, in 2014 – 33 training events and 9 workshops, and in 2015 – 40 training events and 21 workshops. In the past three years the SFMSU developed 18 recommendatory documents on the PFMS financial monitoring and approved 5 regulatory and recommendatory documents on countering FT, specifically Recommendations for the PFMS on the risks related to financing of separatist and terrorist acts in Ukraine.		
Net risk level	6		
Description of measures proposed to be taken for risk management	With the aim of efficient risk management, the following is proposed: 1. Continue trainings for PFMS representatives to explain the AML/CFT-related legislative requirements, including on ML/FT risk management; 2. Perform audits to check the extent of the PFMS compliance with the legislative requirements in the AML/CFT sphere regarding performing of the ML/FT or FPWMD risk assessment and perform client risk monitoring.		

Risk 2	NFBP failure to provide information on suspicious financial transactions		
Level of consequences	4	Comment	Failure to submit STRs, if any, is concealing the fact of possible ML/FT.
Probability level	3	Comment	Such representatives of the sector of designated PFMS as entrepreneurs who provide intermediary services during real estate sales transactions (realtors), barristers, auditors, auditor firms, individual entrepreneurs who provide accounting services, business entities that provide legal services failed to submit a single STR to the SFMSU in 2013-2015. According to the Ministry of Finance, auditors may be used to provide a positive conclusion on the activities of the companies which, in fact, evade taxes or are potential bankrupts.
Overall risk level	12		
Effectiveness of the available measures	2	Comment	1. Auditing the designated PFMS for compliance with the AML/CFT-related legislation. 2. Training of NFBP representatives.
Description of measures	<p>In 2013-2015, the SFMSU Training and Methodological Center provided training to 585 representatives of the designated PFMS.</p> <p>The Ministry of Finance performed 35 PFMS audits in 2013 and 4 in 2014.</p> <p>The Ministry of Justice of Ukraine performed 1,142 audits of the PFMS in 2013; 1,783 violations were identified in the activities of 881 PFMS; 878 fines to the amount of 330,284 UAH were imposed. In 2014, 1,482 audits were performed and 856 fines applied to the amount of 363,680 UAH. In 2015, the Ministry of Justice of Ukraine and its territorial agencies performed 1,331 audits of the PFMS – notaries, barristers, barrister bureaus and associations and business entities that provide legal services (except for persons that provide services under employment relations) and in 596 (45 %) of them identified AML/CFT-related violations.</p> <p>In 2013, the SFMSU performed 40 audits of the PFMS, and violations were identified in the activities of 34 of the PFMS; in 2014, 18 audits were performed, and violations were identified in the activities of 5 PFMS.</p> <p>The SFMSU continuously carries out explanatory work for the PFMS by sending explanatory letters and providing consultations over the SFMSU “hotline” phone number.</p>		
Net risk level	8		
Description of measures proposed to be taken for risk management	<p>With the aim of efficient risk management, the following is proposed:</p> <ol style="list-style-type: none"> 1. Continue development and publication of methodological recommendations for NFBP representatives on standard of reporting on suspicious financial transactions. 2. Continue training of the designated PFMS representatives on the AML/CFT issues, including with a focus on reporting aspects. 3. Provide consultations to NFBP representatives on the issues of cooperation with the FIU and providing reports on suspicious financial transactions. 		

Threat 3. Use of NFBP for ML/FT

Risk 1	Absence of legal regulation of the activities of some NFBP representatives		
Level of consequences	4	Comment	Absence of the legislative framework for regulation of the PFMS professional activities increases the risk of effecting risky transactions by them and their use for ML/FT purposes.
Probability level	2	Comment	According to the Civil Code of Ukraine ¹⁸⁶ , the activities of real estate agents can be categorized as intermediary. Ukraine has no legal regulation of the real estate agencies' activities, which precludes sufficiently efficient state policy in the sphere of the national real estate market. Today realtor activities on the real estate market do not require mandatory certification, licensing or patenting, thus they are little controlled by the State both in terms of the conditions and effects of their pursuance.
Overall risk level	8		
Effectiveness of the available measures	3	Comment	According to the Civil Code of Ukraine, the activities of realtors can be categorized as intermediary. It is very indirectly regulated by Ch. 68 of the Civil Code "Agency": under agency agreements one party (agent) commits to take some legal actions in the name and at the expense of the other party (grantor), and the agent shall be entitled to remuneration for performing his/her commitment under this agreement. Pursuant to Art. 14 of the Law, the SFMSU effects state regulation and supervision in the AML/CFT sphere in relation to entrepreneurs who provide intermediary services during real estate sales transactions. In its AML/CFT-related supervision, SFMSU uses a risk-oriented approach to the supervised subjects, i.e. the SFMSU in its activities is governed by the Ministry of Finance Order "On Approving the Criteria for Risk Assessment of the Primary Financial Monitoring Subject to Be Used for Legalization (Laundering) of Proceeds of Crime or Financing of Terrorism" ¹⁸⁷ . Also, the SFMSU developed Typologies of Legalization (Laundering) of Proceeds of Crime through the Real Estate Market ¹⁸⁸ .
Description of measures	<p>Legal regulation on the real estate market is currently planned to be done along the following lines: market legitimization; assisting information support; standardization of the requirements on real estate agreements and certification of their validity; enhancing agreement efficiency and security; reducing risks during economic transactions with real estate; facilitating rational use of real estate during economic activities.</p> <p>In 2013, the SFMSU as the State regulator of the realtor activities in the AML/CFT area, pursuant to the Law, performed 11 realtor audits, following which the SFMSU Commission on Application of Sanctions for Violation of the Requirements of the Law and/or Regulatory-Legal Acts which Govern Activities in the AML/CFT Sphere passed 3 resolutions on imposition of penalties on the entrepreneurs who provide intermediary services during real estate sales transaction to the amount of 510 UAH. In 2014, the SFMSU performed 17 realtor audits, resulting in 3 resolutions on imposition of penalties on the entrepreneurs who provide intermediary services during real estate sales transaction to the amount of 510 UAH.</p>		
Net risk level	12		

¹⁸⁶ Civil Code of Ukraine: Code, Feb. 16, 2003 No. 435-IV: [Electronic resource]. – Access mode: <http://zakon3.rada.gov.ua/laws/show/435-15>

¹⁸⁷ On Approving the Criteria for Risk Assessment of the Primary Financial Monitoring Subject to Be Used for Legalization (Laundering) of Proceeds of Crime or Financing of Terrorism: Ministry of Finance Order, March 5, 2012 No. 325 (effective until March 31, 2016). Starting March 31, 2016, the effective Order is that of the Ministry of Finance of Jan. 26, 2016 No. 18: [Electronic resource]. – Access mode: <http://zakon5.rada.gov.ua/laws/show/z0482-16/paran7#n7>.

¹⁸⁸ Typologies of Legalization (Laundering) of Proceeds of Crime through the Real Estate Market: [Electronic resource]. – Access mode: www.sdfm.gov.ua/articles.php?cat_id=114&art_id=998&lang=uk

Description of measures proposed to be taken for risk management	With the aim of efficient risk management, the following is proposed: <ol style="list-style-type: none"> 1. Develop the Law of Ukraine “On Realtor Activities” and ensure its adoption by the VRU. 2. Implement licensing of the realtor activities and determine the legal status of the real estate market professional participants. 3. Clearly formulate the criteria of professions intermediary activities on the real estate market. 4. Implement realtor liability for violations during intermediary activities and provision of intermediary services.
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Risk 2	Impossibility to properly check the client-provided information by the NFBP representatives		
Level of consequences	4	Comment	Impossibility of full-fledged implementation of the requirements of the Law by NFBP representatives. High risk for NFBP representatives to be used for ML. Absence of a possibility of efficient regulation and supervision in the AML/CFT sphere over the activities of NFBP representatives.
Probability level	2	Comment	According to the NFBP, they are facing the following issues during client identification: <ul style="list-style-type: none"> absence of a unified state electronic register of persons related to ML (register of criminal cases based on the facts of ML); absence of the right to require documents that are not related to the effected notarial act; impossibility to check the sources of origin of the costs used in a relevant financial transaction; in many cases, absence of information in the Unified State Register of Legal Entities and Individual Entrepreneurs about end beneficiary owners; impossibility to establish unified indicators for detecting suspicions on FT and separatism; absence of access to the data base of lost passports; complications in the process of establishing the end beneficiary owner when it concerns founders of foreign legal entities. <p>The legislation does not require mandatory record keeping and provision of reports, from which the provision of the services by barristers, barrister bureaus and associations, business entities that provide legal services can be seen. In view of this, it is impossible to verify whether these subjects properly meet their PFMS obligations.</p>
Overall risk level	8		
Effectiveness of the available measures	2	Comment	The Ministry of Justice adopted a Provision on Performance of Financial Monitoring by the Primary Financial Monitoring Subjects, Whose State Regulation and Supervision Is Effected by the Ministry of Justice of Ukraine ¹⁸⁹ . Also, the Ministry of Finance adopted relevant regulatory acts for its own supervised NFBP and the NFBP supervised by the SFMSU.
Description of measures	The Law stipulates that the documents on identification and verification of the persons that are participants of a financial transaction subject to financial monitoring, as well as all the documents on business relations with the client shall be stored by the subject for at least five years after completion of business relations with the client, and all the documentation on such a financial transaction – for at least five years after its completion. Pursuant to the Standard Inventory of Files of a State Notary Office and Private Notary ¹⁹⁰ , the documents (cards, notifications, data), copies of documents on identification of the persons that		

¹⁸⁹ On Approving the Provision on Performance of Financial Monitoring by the Primary Financial Monitoring Subjects, Whose State Regulation and Supervision Is Effected by the Ministry of Justice of Ukraine: Ministry of Justice Order, June 18, 2015 No. 999/5: [Electronic resource]. – Access mode: <http://zakon2.rada.gov.ua/laws/show/z0735-15>

¹⁹⁰ On Approving the Rules of Notarial Records Management: Ministry of Justice Order, December 22, 2010 No. 3253/5: [Electronic resource]. – Access mode: <http://zakon5.rada.gov.ua/laws/show/z1318-10>

	<p>effected a financial transaction subject to financial monitoring, and the documents on business relations with a client shall be put together into a brief and stored for 5 years.</p> <p>The legislation, inter alia, envisages notarial record keeping and provision of statistics by notaries. The report envisages that notaries provide information on certifying legal transactions on the sale of estate. When performing audits, including of the registers for registering notarial acts and documents in the notary's files, it is possible to establish absence/presence of certified legal transactions referred to in Part 1, Art. 8 of the Law.</p>
Net risk level	6
Description of measures proposed to be taken for risk management	<p>With the aim of efficient risk management, the following is proposed:</p> <ol style="list-style-type: none"> 1. Establish a legislative requirement for record keeping and submittal of statistical reports to the SFMS, including on the number of financial transactions, established in Part 1, Art. 8 of the Law, which involved barristers, barrister offices and associations that provide legal services, and realtors. 2. Legislatively regulate granting NFBP access to the data bases of lost passports. 3. Continue training of NFBP representatives on compliance with the AML/CFT-related legislation.

Risk 3		ML/FT through gambling business	
Level of consequences	4	Comment	<p>Versatility, frequency, and scopes of transactions make the casino sector extremely favorable for ML. Casino is a business which actively uses cash and most transactions are done in cash.</p> <p>The shadow gambling business masks as internet cafes and internet clubs.</p> <p>The identified risk can result in movement of cash to other gambling jurisdictions for purposes of laundering of criminal proceeds.</p>
Probability level	2	Comment	<p>After banning gambling in Ukraine, the business stayed in the shadow.</p> <p>According to the information of the Unified Report on Criminal Offenses, in 2013 the LEA brought 1,248 criminal cases under CCU Art. 203-2 "Engaging in Gambling", of which in 428 criminal cases a suspicion note was served. 382 criminal cases were submitted to court with an indictment. In 2014, the LEA brought 1,084 criminal cases, in 187 of which a suspicion note was served. 140 criminal cases were submitted to court with an indictment. In 2015, the LEA brought 735 criminal cases, in 41 of which a suspicion note was served. 38 criminal cases were submitted to court with an indictment.</p> <p>This statistics demonstrates a tendency towards reduction in the illegal gambling business in Ukraine, however confirms existence of such business in the shadow and the ML/FT risk because of this business.</p>
Overall risk level	8		
Effectiveness of the available measures	1	Comment	<p>On May 15, 2009, the VRU adopted the Law of Ukraine "On Prohibition of the Gambling Business in Ukraine"¹⁹¹.</p> <p>The LEA detect, stop, and prosecute persons involved in the gambling business.</p>
Description of measures	<p>The Law of Ukraine "On Prohibition of the Gambling Business in Ukraine" restricted the gambling business in Ukraine based on the constitutional principles of the priority of rights and freedoms of the person and citizen, protection of the population morality and health, prohibition on the use of property to the detriment of the individual and society.</p>		
Net risk level	3		
Description of measures proposed to be taken for risk management	<p>With the aim of efficient risk management, the following is proposed:</p> <ol style="list-style-type: none"> 1. The LEA should continue activities to prevent, detect, stop, and prosecute the persons involved in the gambling business in Ukraine. 2. Develop mechanisms to monitor online internet gambling (internet casinos) and investigate the relevant ML risks. 		

¹⁹¹ On Prohibition of the Gambling Business in Ukraine: Law of Ukraine, May 15, 2009 No. 1334-VI: [Electronic resource]. – Access mode: <http://zakon2.rada.gov.ua/laws/show/1334-17>

Threat 4. ML/FT through non-profit organizations

Risk 1	Use of non-profit organizations for ML/FT		
Level of consequences	4	Comment	Non-profit organizations can be used as a channel for money transfer to terrorist organizations. Ukraine has a significant number of differently organized companies and organizations, whose activities are non-profit, without a tendency towards reduction.
Probability level	3	Comment	According to the information available, the main (dominant) way of unlawful use of non-commercial organizations was channeling the funds to terrorists by non-profit organizations. The sector of non-profit organizations has a number of mutually dependent vulnerabilities and terrorist organizations try taking advantage of these vulnerabilities. The peculiarities of non-profit organizations that may also be attractive for use in criminal schemes include: a possibility of accumulating funds through membership fees, donations, and so-called non-profit activities, and using cash to implement projects or buy the required equipment. In order to involve funds in the form of charity assistance, information resources are created on the Internet, with posting of the details that can be used to donate funds.
Overall risk level	12		
Effectiveness of the available measures	2	Comment	<ol style="list-style-type: none"> 1. Availability in Ukraine of the legislative framework on the activities of companies and organizations in the non-profit sector. 2. Implementation of FATF Standards into Ukrainian legislation on application of due diligence measure to the non-profit sector. 3. Typological research by the relevant Ukrainian authorities on the risks and examples of financing of terrorism using non-profit organizations; 4. Practical work by the state authorities of Ukraine to counter financing of terrorism using non-profit organizations. 5. In 2014, the SFMSU, jointly with the State Financial Monitoring Subjects, as well as government authorities, including LEA prepared a typological research about the "Current Methods, Approaches, and Financial Tools for Financing Terrorism and Separatism" posted on the SFMSU official web-site.
Description of measures	<p>According to the State Fiscal Service information resources, in January 2014 – March 2016, the territorial audit divisions audited 4.7 thous non-profit companies, institutions, and organizations, resulting in additional charges of 194 mln UAH.</p> <p>In January 2014 – March 2016 non-profit institutions and organizations payed income tax to the Consolidated Budget of Ukraine to the total amount of 87.9 mln UAH, including 33.5 mln UAH in 2014, 48.4 mln UAH in 2015, and 6.0 mln UAH in the Quarter I of 2016.</p> <p>One of the SFMSU priority areas is focused on identifying non-profit organizations, among financial transaction participants, in relation to which there are suspicions that their activities or financial transactions are used as a channel for FT and/or separatism. Statistical data on the summarized and additional summarized materials related to financing of terrorism and/or separatism submitted to the law enforcement and intelligence agencies are provided in Table 1.5.2.</p> <p>The list of persons related to pursuance of terrorist activities or subjected to international sanctions (changes thereto) is made known to the PFMS by posting it on the SFMSU official web-site¹⁹².</p>		
Net risk level	8		

¹⁹² List of Persons Related to Terrorist Activities or Subjected to International Sanctions: [Electronic resource]. – Access mode: http://www.sdfm.gov.ua/articles.php?cat_id=126&art_id=319&lang=uk

Description of measures proposed to be taken for risk management	<p>With the aim of efficient risk management, the following is proposed:</p> <ol style="list-style-type: none"> 1. State agencies: <ul style="list-style-type: none"> - continue implementation of actions to identify the facts of providing financial support by representatives of international terrorist and extremist organizations to their supporters in Ukraine, including through criminal proceeds and non-profit sector; - strengthen measures to detect financial transactions and criminally prosecute persons related to financing of terrorism and actions committed aimed at a violent change or overturn of the constitutional order or a change in the boundaries of the territory or state border; - strengthen interagency coordination on detection and subsequent freezing of the assets of the persons involved in FT and proliferation of weapons of mass destruction, including those that use the non-profit sector. 2. PFMS: <ul style="list-style-type: none"> - continue taking actions to limit the risk of using charity and non-profit organization for purposes of ML/FT; - identify the purpose of the financial transaction, whose participants are non-profit organizations; - establish the sources of origin and the means of transferring (depositing) of the money used in the financial transactions; - submit, pursuant to the Law, STRs on the financial organizations of non-profit organizations to the SFMSU. 3. Non Profit Organization: <ul style="list-style-type: none"> - strengthen up the measures to identify persons when admitting them as participants (members) of such organizations, specifically, contributors of charity funds, and pay special attention to the sources of property acquired by non-profit organizations with the aim of precluding them from involvement in terrorism; - take actions for unconditional compliance with Part 7, Art. 23 of the Law of Ukraine “On Civil Associations” in relation to document storage and financial control.
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The background features a series of overlapping, parallel lines in orange and teal, creating a sense of depth and movement. The lines are arranged in a way that suggests a 3D perspective, with some lines receding into the distance. The overall aesthetic is modern and clean.

THREATS AND RISKS OF THE AML/CFT SYSTEM

Processing of information provided by the AML/CFT system participants allows identifying external and internal AML/CFT threats.

External threats are the threats that can cover any events on the financial market or in the economy. External threats are formed outside the AML/CFT system and cannot be countered only through efforts of the national financial monitoring system participants.



Fig. 4.1. External threats of the national AML/CFT system

Internal threats are the threats that may cover events related to the functioning of the AML/CFT system.

Internal threats are formed inside the AML/CFT system and are countered by own efforts of the financial monitoring system participants.

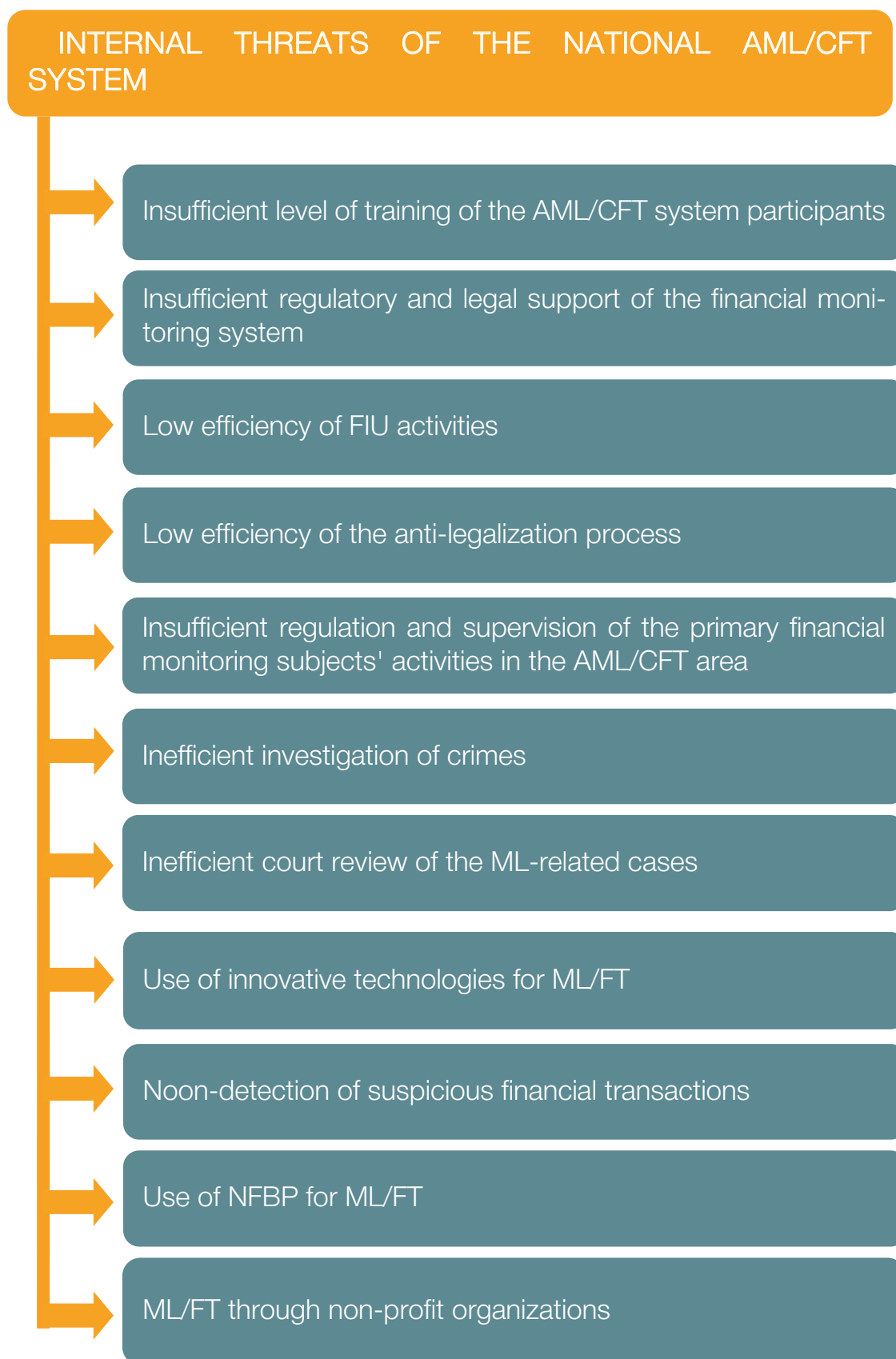


Fig. 4.2. Internal threats of the national AML/CFT system

Based on the analysis of the identified AML/CFT system threats, the AML/CFT system risks were determined.

Threats and risks of the AML/CFT system

No.	Threat	Risk	Level of consequences	Probability level	Overall risk level	Effectiveness of the available measures	Net risk level	Agency responsible for risk management
General component								
1.	Political instability	Progressing of the political risk and political instability	4	4	16	2	8	VRU, Presidential Administration of Ukraine, CMU
2.		Non-transparent funding of political parties	2	2	4	2	4	NACP
3.	High corruption level	Inadequate identification and sanctioning of suspicious financial transactions of the national publicly exposed persons	4	4	16	2	8	NACP, State Financial Monitoring Subjects, LEA, SFMSU, National Agency for Detection, Search, and Management of Proceeds of Corruption and Other Crimes
4.		Inefficient measures to identify end beneficiary owners (controllers) and establish control over them	4	3	12	2	8	Ministry of Justice, SFMSU
5.	High level of the shadow financial system	Inappropriate identification and inappropriate elimination of the factors which contribute to the growing size of the shadow and off-shore financial system	4	4	16	2	8	SFS, NSSMC
6.		Low level of population income	4	4	16	4	16	MEDTU, Ministry of Finance, NBU, Ministry of Social Policy
7.		Low level of confidence in the financial system	4	4	16	3	12	NBU, Ministry of Finance, SFS, MEDTU
8.		High level of cash circulation	4	4	16	2	8	NBU
9.		Outflow of the financial capital from the country	4	4	16	2	8	NBU, MEDTU, LEA

Threats and risks of the AML/CFT system

10.	Insufficient regulatory and legal support of the financial monitoring system	Incomplete implementation in the national legislation of the provisions of Directive EU 2015/849 of the European Parliament and of the Council on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing	4	1	4	1	2	SFMSU, State Financial Monitoring Subjects, LEA, IA
11.	Unstable security situation in the country	Growing organized crime	3	3	9	2	6	LEA, IA
12.		Acts of terrorism and separatism	4	4	16	3	12	LEA
13.		Inefficiently efficient actions by competent authorities to counter financing of terrorism and separatism	4	4	16	2	8	LEA, State Financial Monitoring Subjects, SFMSU
14.	Insufficient level of training of the AML/CFT system participants	Non-compliance of the SFMSU Training and Methodical Center organizational and legal form with the requirements of the Law	4	2	8	3	9	SFMSU, Ministry of Finance
15.		Insufficient level of training of the AML/CFT system participants	4	1	4	2	4	SFMSU, State Financial Monitoring Subjects
Government Component								
16.	Insufficient efficiency of the FIU activities	Insufficient material and technical support of the FIU	4	3	12	4	16	Ministry of Finance, SFMSU
17.		Low salary of the FIU staff	4	3	12	4	16	Ministry of Finance, SFMSU
18.	Low efficiency of the anti-legalization process	Inefficient system of initial detection of suspicious financial transactions	2	2	4	2	4	SFMSU, Ministry of Finance, NABU, National Agency of Ukraine on Civil Service
19.		Outdated (inefficient) suspicious financial transaction information analysis system	4	4	16	3	12	Ministry of Finance, SFMSU
20.		Inefficient system of investigation of materials by the FIU	4	3	12	3	12	LEA, SFMSU
21.	Insufficient regulation and supervision of the primary financial	Inefficient sanctions for violation of the AML/CFT-related legislation	4	2	8	3	9	SFMS

Threats and risks of the AML/CFT system

22.	monitoring subjects' activities in the AML/CFT area	Insufficient staff and resources for efficient supervision	4	2	8	2	6	SFMS
23.		Lack of the PFMS sectoral risk assessment in the AML/CFT sphere	2	2	4	2	4	SFMS
24.	Inefficient investigation of ML and predicate crimes	Insufficient interaction between the law enforcement authorities and the FIU	4	3	12	2	8	LEA, SFMSU
25.		Inefficient investigation of ML crimes	4	3	12	2	8	LEA, IA
26.		Inefficient investigation of organized crime	4	4	16	2	8	LEA, IA
27.		Inefficient investigation of tax crimes	4	3	12	2	8	LEA
28.		Inefficient investigation of terrorist crimes	4	2	8	2	6	LEA, IA
29.		Inefficient investigation of ML predicate crimes	4	3	12	2	8	LEA, IA
30.	Inefficient court review of the ML/FT cases	Inconsistency of the punishment and the severity of the ML/FT crimes	4	3	12	3	12	Judicial authorities, Ministry of Justice
Private Component								
31.	Use of innovative technologies for ML/FT	ML/FT through remote services	3	2	8	2	6	SFMS
32.	Non-detection of suspicious financial transactions	Insufficient level of understanding of the ML/FT risks	4	2	8	2	6	State Financial Monitoring Subjects, SFMSU
33.		NFBP failure to provide information on suspicious financial transactions	4	3	12	2	8	State Financial Monitoring Subjects, SFMSU
34.	Use of NFBP for ML/FT	Absence of legal regulation of the activities of some NFBP representatives	4	2	8	3	12	SFMSU, Ministry of Finance, MEDTU, Ministry of Justice
35.		Impossibility to check the client-provided information by the NFBP representatives	4	2	8	2	6	Ministry of Finance, SFMSU, Ministry of Justice
36.		ML/FT through gambling business	4	2	8	1	3	LEA
37.	ML/FT through non-profit organizations	Use of non-profit organizations for ML/FT	4	3	12	2	8	LEA, SFMSU, Ministry of Justice

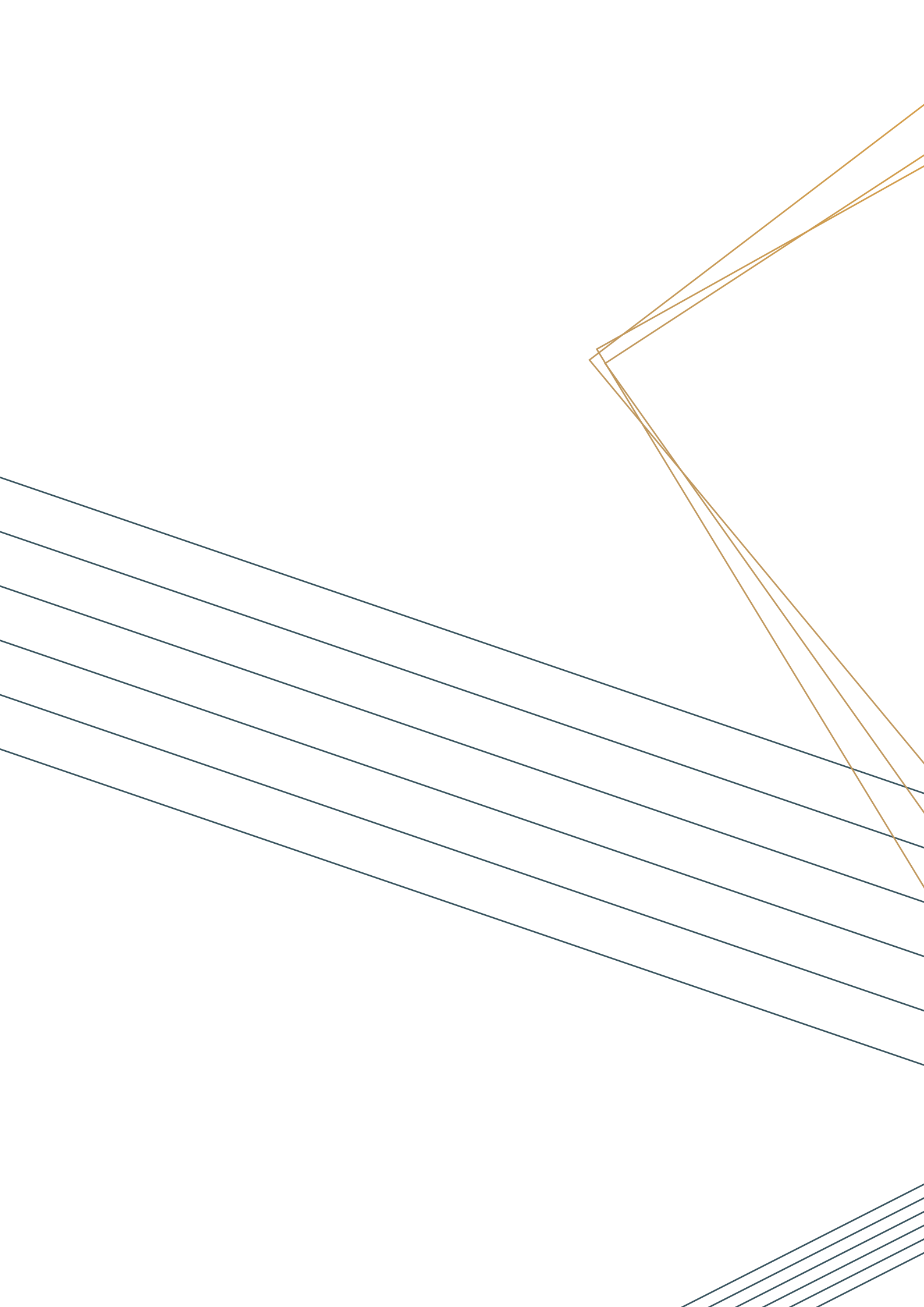
Table 4.1. Threats and risks of the AML/CFT system

Threats and risks of the AML/CFT system

As a result – identified risks ranged by the values “high”, “major”, “moderate”, “minor”.

No.	Risk evaluation			Risk level reduction
	Risk	Overall risk level	Net risk level	
1.	Low level of population income	16	16	High
2.	Insufficient material and technical support of the FIU	12	16	High
3.	Low salary of the FIU staff	12	16	High
4.	Low level of confidence in the financial system	16	12	High
5.	Outdated (inefficient) suspicious financial transaction information analysis system	16	12	High
6.	Inefficient system of investigation of materials by the FIU	12	12	High
7.	Inconsistency of the punishment and the severity of the ML/FT crimes	12	12	High
8.	Absence of legal regulation of the activities of some NFBP representatives	8	12	High
9.	Acts of terrorism and separatism	16	12	High
10.	Progressing of the political risk and political instability	16	8	Major
11.	Inadequate identification and sanctioning of suspicious financial transactions of the national publicly exposed persons	16	8	Major
12.	Inefficient measures to identify end beneficiary owners (controllers) and establish control over them	12	8	Major
13.	Inappropriate identification and inappropriate elimination of the factors which contribute to the growing size of the shadow and off-shore financial system	16	8	Major
14.	High level of cash circulation	16	8	Major
15.	Outflow of the financial capital from the country	16	8	Major
16.	Inefficiently efficient actions by competent authorities to counter financing of terrorism and separatism	16	8	Major
17.	Non-compliance of the SFMSU Training and Methodical Center organizational and legal form with the requirements of the Law	8	9	Major
18.	Insufficient interaction between the law enforcement authorities and the FIU	12	8	Major
19.	Inefficient sanctions for violation of the AML/CFT-related legislation	8	9	Major
20.	Inefficient investigation of ML crimes	12	8	Major
21.	Inefficient investigation of organized crime	16	8	Major
22.	Inefficient investigation of tax crimes	12	8	Major
23.	Inefficient investigation of ML predicate crimes	12	8	Major
24.	NFBP failure to provide information on suspicious financial transactions	12	8	Major
25.	Use of non-profit organizations for ML/FT	12	8	Major
26.	Growing organized crime	9	6	Major
27.	Insufficient staff and resources for efficient supervision	8	6	Major
28.	Inefficient investigation of terrorist crimes	8	6	Major
29.	ML/FT through remote services	8	6	Major
30.	Insufficient level of understanding of the ML/FT risks	8	6	Major
31.	Impossibility to check the client-provided information by the NFBP representatives	8	6	Major
32.	Inefficient system of initial detection of suspicious financial transactions	4	4	Moderate
33.	Non-transparent funding of political parties	4	4	Moderate
34.	Insufficient level of training of the AML/CFT system participants	4	4	Moderate
35.	Lack of the PFMS sectoral risk assessment in the AML/CFT sphere	4	4	Moderate
36.	ML/FT through gambling business	8	3	Moderate
37.	Incomplete implementation in the national legislation of the provisions of Directive EU 2015/849 of the European Parliament and of the Council on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing	4	2	Minor

Table 4.2. ML/FT risk ranging





ANNEXES

ANNEX 1

LIST OF RESOURCES USED IN THE NRA

1. Questionnaires completed by NRA participants and SFMSU administrative reports

2. Legislation of Ukraine:

2.1. Constitution of Ukraine. June 28, 1996 No. 254k/96-VR

2.2. Codes of Ukraine:

- Criminal Code of Ukraine. April 05, 2001 No. 2341-III
- Civil Code of Ukraine. February 16, 2003 No. 435-IV
- Tax Code of Ukraine. December 02, 2010 No. 2755-IV
- Code of Criminal Procedure of Ukraine. April 13, 2012 No. 4651-VI

2.3. Laws of Ukraine:

- On Preventing and Countering Legalization (Laundering) of Proceeds of Crime, Financing of Terrorism, and Financing of Proliferation of Weapons of Mass Destruction. October 14, 2014 No. 1702-VII
- On Changes to the Constitution of Ukraine (regarding Justice). June 2, 2016 No. 1401-VIII (effective as of Sept. 30, 2016)
- On Operative Investigative Activities. February 18, 1992 No. 2135-XII
- On Organizational and Legal Principles of Combating Organized Crime. June 30, 1993 No. 3341-XII
- On the Constitutional Court of Ukraine. October 16, 1996 No. 422/96-VR
- On the All-Ukrainian Population Census. October 19, 2000 No. 2058-III
- On Physical Protection of Nuclear Facilities, Nuclear Materials, Radioactive Waste, and other Sources of Ionizing Radiation. October 19, 2000 No. 2064-III
- On Banks and Bank Activity. December 07, 2000 No. 2121-III
- On Political Parties in Ukraine. April 05, 2001 No. 2365-III
- On Preventing and Countering Legalization (Laundering) of Proceeds of Crime. November 28, 2002 No. 249-IV
- On Counterintelligence Activities. December 26, 2002 No. 374-IV
- On Combating Terrorism. March 20, 2003 No. 638-IV
- On Changes to the Criminal Code and Code of Criminal Procedure of Ukraine regarding Prevention of Terrorism. September 21, 2006 No. 170-V
- On Prohibition of the Gambling Business in Ukraine. May 15, 2009 No. 1334-VI
- On the Rules of Procedure of the Verkhovna Rada of Ukraine. February 10, 2010 No. 1861-VI
- On Preventing and Countering Legalization (Laundering) of Proceeds of Crime or Financing of Terrorism. May 01, 2010 No. 2258-VI
- On the Judiciary and the Status of Judges. July 07, 2010 No. 2453-VI
- On Ratification of the Council of Europe Convention on Laundering, Search, Seizure and Confiscation of the Proceeds from Crime and on the Financing of Terrorism. November 17, 2010 No. 2698-VI
- On Civil Associations. March 22, 2012 No. 4572-VI
- On Changes to Some Legislative Acts of Ukraine regarding Identification of End Beneficiaries of Legal Entities and Publicly Exposed Persons. October 14, 2014 No. 1701-VII
- On Purging of the Authorities. October 16, 2014 No. 1682-VII
- On Amending Some Legislative Acts of Ukraine regarding Reforming of the Mandatory General State Social Insurance and Legalization of the Labor Compensation Fund. December 28, 2014 No. 77-VIII
- On Amending the Tax Code of Ukraine and Some Legislative Acts of Ukraine with Regards to the Tax Reform. December 28, 2014 No. 71-VIII
- On Amending and Declaring Null and Void Some Legislative Acts of Ukraine. December 28, 2014 No. 76-VIII
- On the State Budget of Ukraine for 2015. December 28, 2014 No. 80-VIII
- On Ensuring the Right for Fair Trial. February 12, 2015 No. 192-VIII

- On Amending Some Legislative Acts of Ukraine regarding Liability of Persons Associated with the Bank. March 02, 2015 No. 218-VIII
- On Amending Article 5 of the Law of Ukraine “On Social Assistance to Needy Families” regarding Social Protection of Children. March 02, 2015 No. 221-VIII
- On Changes to Some Laws of Ukraine Related to Information on the Legal Entity's End Beneficiary Owner (Controller). May 21, 2015 No. 475-VIII
- On Changes to Some Legislative Acts of Ukraine on Preventing and Countering Political Corruption. October 08, 2015 No. 731-VIII
- On Changes to Article 87 of the Budget Code of Ukraine” (on the funding of political parties). October 08, 2015 No. 732-VIII
- On Public Service. December 10, 2015 No. 889-VIII

2.4. President of Ukraine Decrees:

- On Measures to Further Strengthen Security, Protection of Citizens' Rights and Freedoms. February 18, 2002 No. 143/2002
- On the State Policy Concept in the Sphere of Combating Organized Crime. October 21, 2011 No. 1000/2011
- The Issue of Judicial Reform Council. October 27, 2014 No. 826/2014
- On the National Security and Defense Council of Ukraine Decision of Aug. 28, 2014 “On Urgent Measures to Protect Ukraine and Strengthen Its Defense Capabilities”. September 24, 2014 No. 744/2014
- On the National Security and Defense Council of Ukraine Decision of May 6, 2015 “On the National Security Strategy of Ukraine”. May 26, 2015 No. 287/2015
- On the National Security and Defense Council Decision of May 6, 2015 “On Measures To Strengthen the Combating of Crime in Ukraine”. June 16, 2015 No. 341/2015
- On the National Security and Defense Council of Ukraine Decision of Sept. 2, 2015 “On the New Revision of the Military Doctrine of Ukraine”. 24 September 2015 No. 555/2015
- On Measures to Counter Tax Base Reduction and Transfer of Revenues Abroad. June 28, 2016 No. 180/2016

2.5. Cabinet of Ministers of Ukraine Resolutions:

- On Implementation of the UN Security Council Resolution regarding Usama bin Laden, Al-Qaida Organization, and the Taliban Movement (Afghanistan). June 01, 2002 No. 749
- On Approving the Procedure for Providing Benefits to Some Categories of Citizens Based on the Average Monthly Aggregate Family Income: June 04, 2015 No. 389
- On Approving the Procedure for Organization and Coordination of Work on Advanced Training and Professional Development of Specialists on Financial Monitoring. August 19, 2015 No. 610
- On Approving the Procedure for National Risk Assessment on Preventing and Countering Legalization (Laundering) of Proceeds of Crime, Financing of Terrorism, and Financing of Proliferation of Weapons of Mass Destruction. September 16, 2015 No. 717
- On Approving the Procedure for Compiling of the List of Persons Related to Terrorist Activities or Subjected to International Sanctions. October 25, 2015 No. 966
- On approving an Action Plan for 2016 on preventing and countering legalization (laundering) of proceeds of crime, financing of terrorism, and financing of proliferation of weapons of mass destruction. February 11, 2016 No. 103
- Some Issues of Remuneration of Civil Servants in 2016. April 6, 2016 No. 292
- On Approving the Procedure for Maintaining the Register of Non-Profit Institutions and Organizations, Adding Non-Profit Companies, Institutions, and Organizations to the Register and Removal from the Register. July 13, 2016 No. 440

2.5. Cabinet of Ministers of Ukraine Ordinances:

- On Establishing a Training and Methodological Center for Advanced Training and Professional Development of Financial Monitoring Specialists in the Sphere of Countering Legalization (Laundering) of Proceeds of Crime and Financing of Terrorism. December 13, 2004 No. 899-r
- On the All-Ukrainian Population Census in 2020. April 09, 2008 No. 581-r
- On Approving the Poverty Reduction Strategy. March 01, 2016 No. 161-r

- On Approving the Strategy of Reforming the Reporting System on Preventing and Countering Legalization (Laundering) of Proceeds of Crime, Financing of Terrorism, and Financing of Proliferation of Weapons of Mass Destruction. August 23, 2016 No. 608-r

2.6. State Financial Monitoring Subjects' regulatory-legal acts:

2.6.1. NBU Board of Directors Resolutions:

- On Approving the Provision on the Procedure of Organizing and Conducting Audits on Preventing and Countering Legalization (Laundering) of Proceeds of Crime, Financing of Terrorism, and Financing of Proliferation of Weapons of Mass Destruction. June 20, 2011 No. 197
- On Approving the Provision on the Use of Measures of Influence by the National Bank of Ukraine. August 17, 2012 No. 346
- On Establishing the Limiting Amount of Cash Payments. June 06, 2013 No. 210
- Provision on Submittal of Data on the Bank Ownership Structure. May 21, 2015 No. 328
- Comprehensive Development Program for the Financial Sector of Ukraine until 2020. June 18, 2015 No. 391
- On Amending the Provision on the Procedure of Organizing and Conducting Audits on Preventing and Countering Legalization (Laundering) of Proceeds of Crime, Financing of Terrorism, and Financing of Proliferation of Weapons of Mass Destruction. December 23, 2015 No. 920
- On Approving the Instruction on the Procedure of Register Compiling by Authorized Banks and Amending Some Regulatory Acts of the National Bank of Ukraine on the Issues of Register Compiling by Authorized Banks. April 07, 2016 No. 247

2.6.2. Ministry of Finance Orders:

- On Approving the Procedure for Developing a Schedule of Documentary Scheduled Audits of Tax Payers. June 2, 2015 No. 524
- On Approving the Criteria for Risk Assessment by the Ministry of Finance of Ukraine of the Primary Financial Monitoring Subject to Be Used for Legalization (Laundering) of Proceeds of Crime, Financing of Terrorism, and Financing of Proliferation of Weapons of Mass Destruction. Jan. 26, 2016 No. 17
- On Approving the Criteria for Risk Assessment of the Primary Financial Monitoring Subject to Be Used for Legalization (Laundering) of Proceeds of Crime or Financing of Terrorism. March 05, 2012 No. 325 (effective until March 31, 2016; starting March 31, 2016, the Ministry of Finance Order of Jan. 26, 2016, No. 18 has been in effect)
- On Approving the Procedure for Informing the Primary Financial Monitoring Subjects of the List of Persons related to Terrorist Activities or Subjected to International Sanctions, and Instruction on Adding Information to the List. May 05, 2016 No. 475

2.6.3. NSSMC Decisions:

- On Approving the Criteria for Risk Assessment of the Primary Financial Monitoring Subject - Stock Market (Securities Market) Professional Participant to Be Used for Legalization (Laundering) of Proceeds of Crime, Financing of Terrorism, and Financing of Proliferation of Weapons of Mass Destruction. May 31, 2016 No. 617

2.6.4. Ministry of Justice Orders:

- On Approving the Rules of Notarial Records Management. December 22, 2010 No. 3253/5
- On Approving the Provision on Performance of Financial Monitoring by the Primary Financial Monitoring Subjects, Whose State Regulation and Supervision Is Effected by the Ministry of Justice of Ukraine. June 18, 2015 No. 999/5
- On Approving the Criteria for Risk Assessment of the Primary Financial Monitoring Subject to Be Used for Legalization (Laundering) of Proceeds of Crime, Financing of Terrorism, and Financing of Proliferation of Weapons of Mass Destruction. October 06, 2015 No. 1899/5

2.6.5. Ministry of Infrastructure Orders:

- On Approving the Criteria for Risk Assessment of the Primary Financial Monitoring Subjects, Whose State Regulation and Supervision is Effected by the Ministry of Infrastructure of Ukraine to Be Used for Legalization (Laundering) of Proceeds of Crime, Financing of Terrorism, and Financing of Proliferation of Weapons of Mass Destruction. November 02, 2015 No. 437

2.6.6. SCRFMSU Ordinances:

- On Approval of the Criteria for Risk Assessment of the Primary Financial Monitoring Subjects, Whose State Regulation and Supervision is Effected by the State Commission for Regulation of Financial Services Markets of Ukraine. October 13, 2015 No. 2481

3. Recommendations and Reports:

- FATF issues new Mechanism to Strengthen Money Laundering and Terrorist Financing Compliance
- National money laundering and terrorist financing risk assessment (2013)
- The FATF Recommendations
- European Commission Expert Report on the Visa Liberalization Action Plan with reference to money laundering, financing of terrorism, and return of assets (Sept. 27 – Oct. 2, 2015), (Block 3, Public Order and Security)
- IMF Report on technical assistance related to application of measures to counter legalization of criminal proceeds in support of the counter-corruption efforts (the Financial Intelligence Unit component)
- State Fiscal Service of Ukraine Report for 2015
- NABU Report (February – August 2016)

4. Open registers and data bases:

- Unified State Register of court decisions
- Unified State Register of Legal Entities, Private Entrepreneurs, and Civil Associations
- Unified portal on public spending
- Open register of national publicly exposed persons of Ukraine

5. Official web-pages:

- SFMSU official web-site
- PGOU official web-site
- MEDTU official web-site
- NABU official web-site
- Judiciary of Ukraine official web-portal
- State Financial Inspectorate official web-site
- SFS official web-site
- NBU official internet office
- official SFMSU Training and Methodological Center web-site
- 6. Other open resources:
- Ilko Kucheriv Democratic Initiatives Foundation information
- Transparency International information
- “The Week” newspaper information
- TNS Ukraine LLC information

ANNEX 2

LIST OF NRA RESPONDENTS

To receive information for the NRA, branch questionnaires were submitted to all the AML/CFT system participants, among which:

1. FINANCIAL INTELLIGENCE UNIT (SFMSU)

2. STATE FINANCIAL MONITORING SUBJECTS:

- Ministry of Finance of Ukraine
- National Bank of Ukraine
- State Commission for Regulation of Financial Services Markets of Ukraine
- National Securities and Stock Market Commission
- Ministry of Infrastructure of Ukraine
- Ministry of Justice of Ukraine
- Ministry of Economic Development and Trade of Ukraine

3. LAW ENFORCEMENT AUTHORITIES:

- Security Service of Ukraine
- Prosecutor General's Office of Ukraine
- Ministry of Internal Affairs of Ukraine
- National Anti-Corruption Bureau of Ukraine
- State Fiscal Service of Ukraine

4. INTELLIGENCE AUTHORITIES:

- Main Intelligence Directorate of the Ministry of Defense of Ukraine
- Foreign Intelligence Service of Ukraine
- Administration of the State Border Guard Service of Ukraine

5. OTHER STATE AUTHORITIES:

- State Statistics Service of Ukraine
- Ministry of Foreign Affairs of Ukraine
- State Regulatory Service of Ukraine
- Ministry of Social Policy of Ukraine
- State Judicial Administration of Ukraine
- Supreme Court of Ukraine

6. PRIMARY FINANCIAL MONITORING SUBJECTS:

- banks
- insurers (reinsurers)
- credit unions
- pawn shops and other financial institutions
- payment organizations, participants or members of payment systems
- commodity and other exchanges involved in financial transactions with commodities
- stock (securities) market professional participants
- postal operators
- entrepreneurs who provide intermediary services during real estate sales transactions
- economic entities involved in cash trade in precious metals and stones and goods made thereof
- economic entities involved in conducting lotteries
- notaries
- attorneys
- economic entities that provide legal services
- auditing firms
- economic entities that provide accounting services

7. NGOs:

- Federation of Trade Unions of Ukraine
- All-Ukrainian NGO "Sociological Association of Ukraine"

ANNEX 3 LIST OF ABBREVIATIONS

AML/CFT	Anti-Money Laundering and Countering the Financing of Terrorism
ASM	Additional summarized materials
ATO	Anti-Terrorist Operation
CCPU	Code of Criminal Procedure of Ukraine
CCU	Criminal Code of Ukraine
CP	Criminal proceeding
DNFBP	Designated Non-Financial Businesses and Professions
EPS	Electronic Payment System
FIS	Foreign Intelligence Service
FIU	Financial Intelligence Unit
FPWMD	Financing of proliferation of weapons of mass destruction
FT	Financing of Terrorism
GDP	Gross Domestic Product
GNI	Gross National Income
HCJ	High Council of Justice
IA	Intelligence authorities
IMF	International Monetary Fund
Law	Law of Ukraine “On Preventing and Countering Legalization (Laundering) of Proceeds of Crime, Financing of Terrorism, or Financing of Proliferation of Weapons of Mass Destruction”
LEA	Law Enforcement Authorities
MEDTU	Ministry of Economic Development and Trade of Ukraine
MIA	Ministry of Internal Affairs of Ukraine
MIU	Ministry of Infrastructure of Ukraine
ML	Legalization (laundering) of proceeds of crime
NABU	National Anti-Corruption Bureau of Ukraine
NACP	National Agency on Corruption Prevention
NBU	National Bank of Ukraine
NRA	National Risk Assessment
NSSMC	National Securities and Stock Market Commission
OC	Organized crime
OCG	Organized groups and criminal organizations

PFMS	Primary financial monitoring subjects
PGOU	Prosecutor General's Office of Ukraine
POC	Proceeds of Crime
SACPO	Specialized Anti-Corruption Prosecutor's Office
SBGS	State Border Guard Service of Ukraine
SBU	Security Service of Ukraine
SCRFSMU	State Commission for Regulation of Financial Services Markets of Ukraine
SFMS	State Financial Monitoring Subjects
SFMSU	State Financial Monitoring Service of Ukraine
SFSU	State Fiscal Service of Ukraine
SJAU	State Judicial Administration of Ukraine
SM	Summarized materials
SSSU	State Statistics Service of Ukraine
STR	Suspicious transaction report (information on financial transactions with indicators of mandatory and internal financial monitoring)
UN	United Nations Organization
URPI	Unified Register of Pretrial Investigations
USIS	Unified State Information System on preventing and countering legalization (laundering) of proceeds of crime, financing of terrorism, and financing of proliferation of weapons of mass destruction
VRU	Verkhovna Rada of Ukraine
Abbreviations of bank codes for currencies	
EUR	Euro
RUB	Russian ruble
UAH	Ukrainian hryvnya
USD	US dollar

