

Ukrainian NPL resolution agenda

April 2018



Sweden
Sverige



WORLD BANK GROUP
Finance, Competitiveness & Innovation

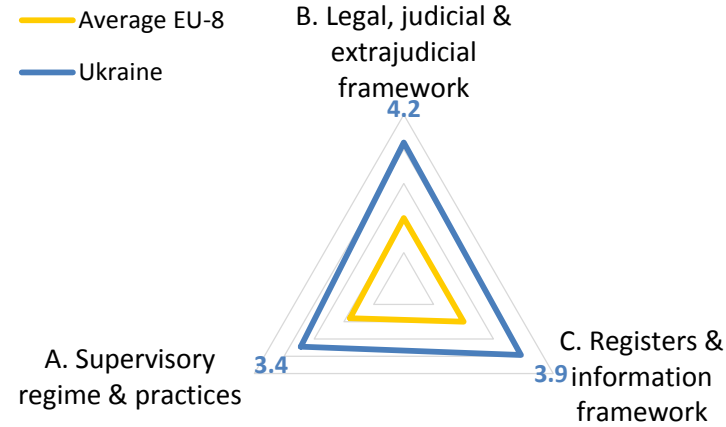
What has been done so far?

- The WB team organized a workshop on the NPL resolution framework in March 2017.
- Based on surveys, meetings, and data analysis, the WB team prepared a preliminary assessment of the NPL resolution framework, which was first presented to the Minister of Finance and the Governor of the National Bank, during the World Bank Spring Meetings in Washington, DC on April 21-23, 2017.
- The preliminary assessment analyzed seventeen areas, which are structured in three pillars, in line with the ECB's methodology for NPL resolution framework assessments. The assessment revealed the unfavorable regime for NPL resolution in Ukraine, with room for improvement in each of the seventeen areas.
- Eleven most problematic areas were identified as high priority reforms to create an enabling environment for effective NPL resolution.

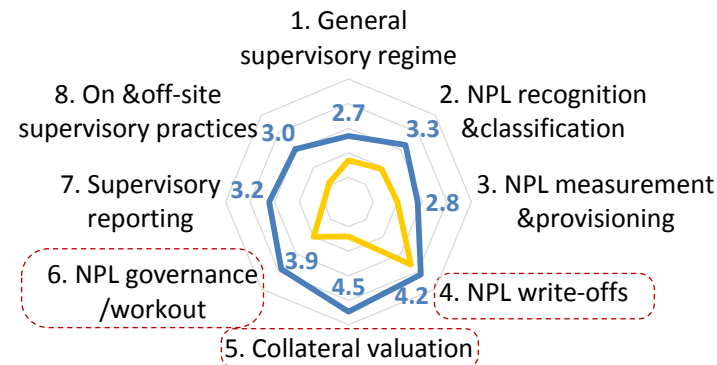
11 priority areas for improvement were identified in the preliminary assessment of the NPL resolution framework

- The assessment was conducted in March 2017
- It was based on the ECB approach and analysed the framework in 3 pillars and 17 areas
- 11 areas were identified with negative scores above 3.5 (circled with red)
- Priority status of recommended improvements was assigned to these areas

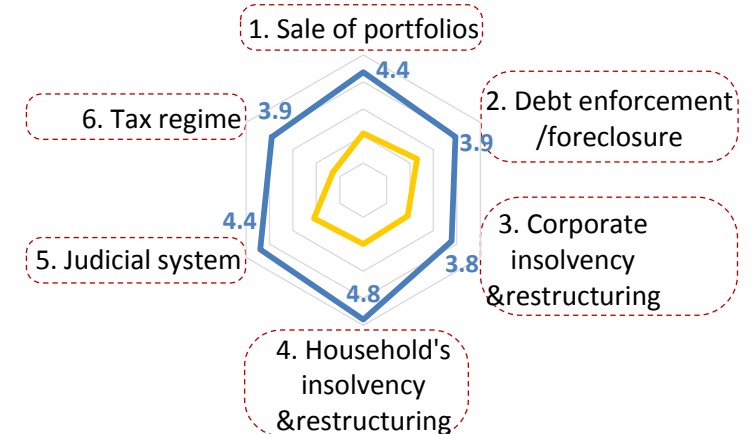
NPL framework assessment



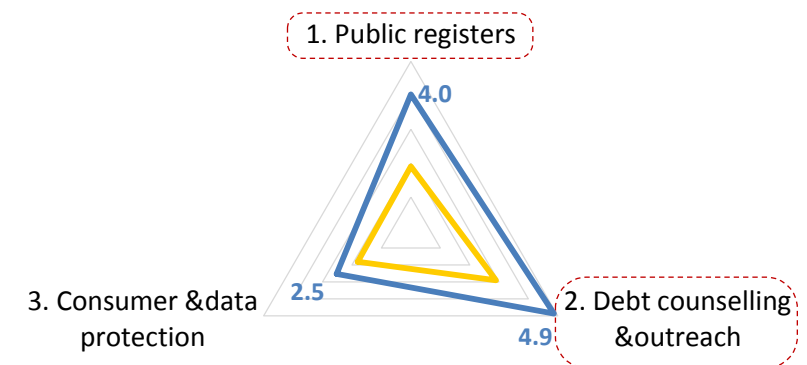
A. Supervisory regime & practices



B. Legal, judicial & extrajudicial



C. Registers & information framework



Source: ECB Stocktake of national supervisory practices and legal frameworks related to NPLs (November 2016), WB estimates
 Charts interpretation: score 5 stands for the worst NPL framework, whereas 0 score stands the best practice NPL framework

Prioritization of actions:

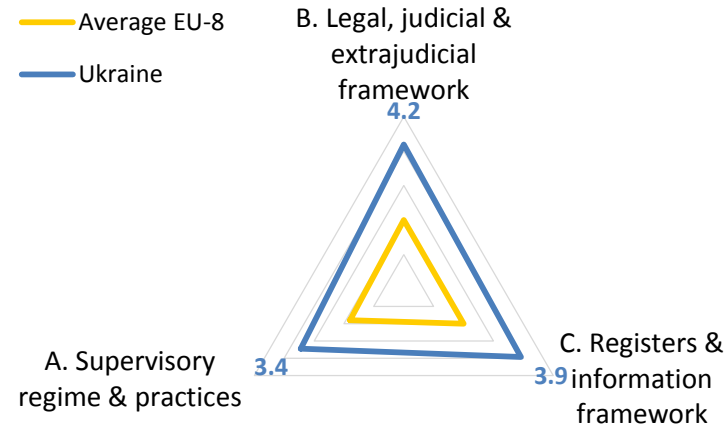
WB suggested to support eleven most problematic areas out of seventeen analyzed (in order of priority):

1. Judicial system: long and inefficient court processes, unprotected creditors' rights. The deficiencies arise from shortcomings in the legislation, under-staffing, corruption and other issues.
2. Tax regime: unfavorable regime that discourages banks from NPL resolution due to high tax risks and extra tax burden.
3. NPL write-offs: ambiguous bank practices mostly driven by tax treatment.
4. Collateral valuation: weak methodology and oversight.
5. Debt enforcement/foreclosure: long process with low recoveries.
6. Corporate insolvency and restructuring: insolvency recognition became a vehicle for debtors to retain control over assets and not to pay for liabilities.
7. NPL governance/workout: commercial banks have diverse practices and in some cases they are far from a prudent approach.
8. Sale of loans: lack of legislation.
9. Public registries: no single credit registry.
10. Household insolvency and restructuring: no specialized legislation.
11. Debt counselling and outreach: lack of financial counselling for indebted borrowers.

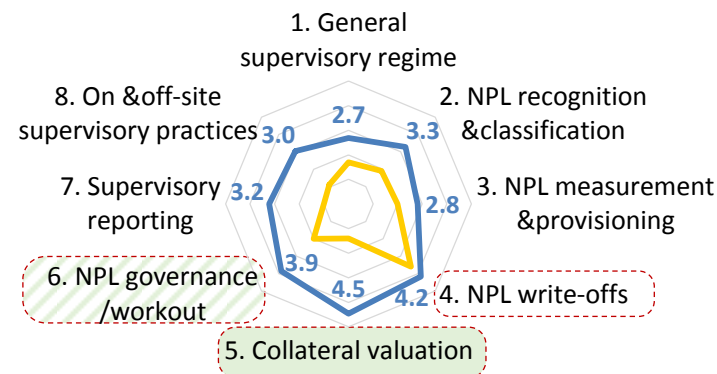
Progress in improving the NPL resolution framework

- 3 priority areas have definite progress since the assessment
- 5 priority areas have tentative progress and need further efforts for proper implementation
- Tentative progress is associated with some legislative and regulatory initiatives to be discussed further in the presentation
- Also there was progress in non-priority areas: A.1 General supervisory regime (LCR, regular stress-testing), A.7 Supervisory reporting (disclosures on credit quality and prudential requirements)

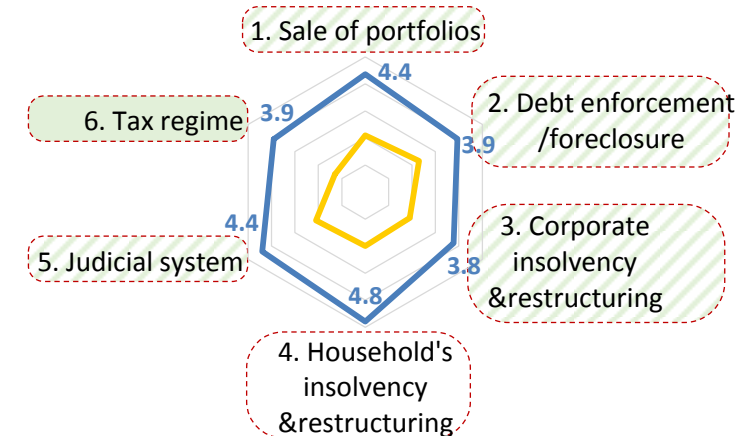
NPL framework assessment



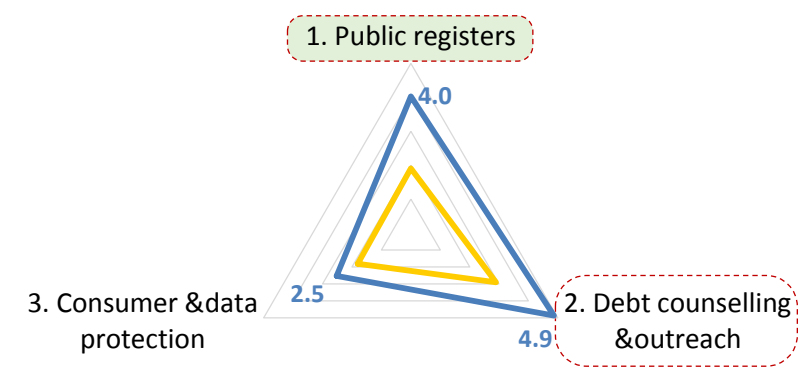
A. Supervisory regime & practices



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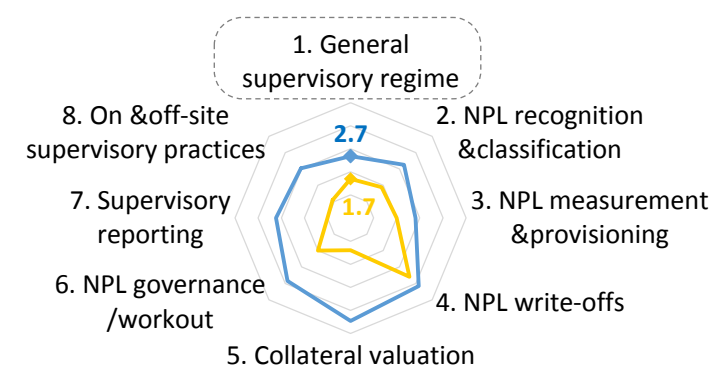


C. Registers & information framework



Progress and WB recommendations under Pillar 1 (A) –
supervisory regimes and practices

A.1 General supervisory regime - Credit risk / NPLs



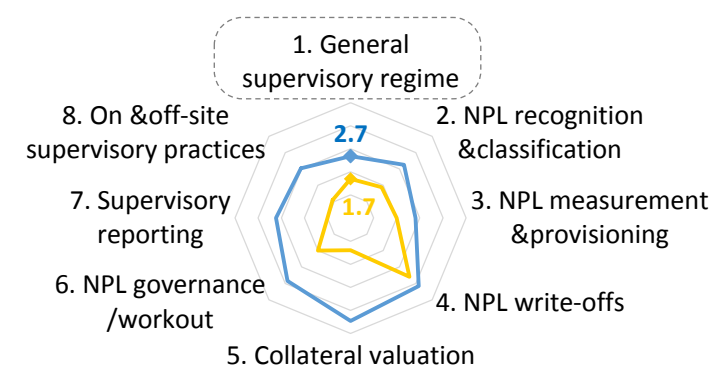
Assessment for Ukraine: 2.7 (March 2017)

- General supervisory regime was significantly improved with full transformation to IFRS reporting (December 2015) and implementation of the new credit risk regulation No.351 (January 2017)
- The NBU continues Comprehensive assessment (Diagnostics): top20 in 2015, top21-60 in 2016, other banks in 2017
- IFRS 9 is to be implemented by January 2018
- Transformation in progress
 - Rule-based regulation is being supplemented with principles
 - Previously dominant compliance based supervision is being replaced with risk-oriented

EU best practices: Cyprus, Ireland and Spain

- The national competent authority (NCA) additionally to CRR/CRD IV introduces binding regulation and recommendations on best practices for
 - Credit origination
 - Credit review
 - Loan impairment and provisioning
 - Arrears management (incl. NPLs)
 - Sales/ purchase of loans (incl. accounting and credit risk treatment)
 - Credit risk management
- This regulation insures that banks have system of limits (i.e. LTV, FX, max maturity) in line with credit strategy/policy and risk appetite

A.1 General supervisory regime - Credit risk / NPLs



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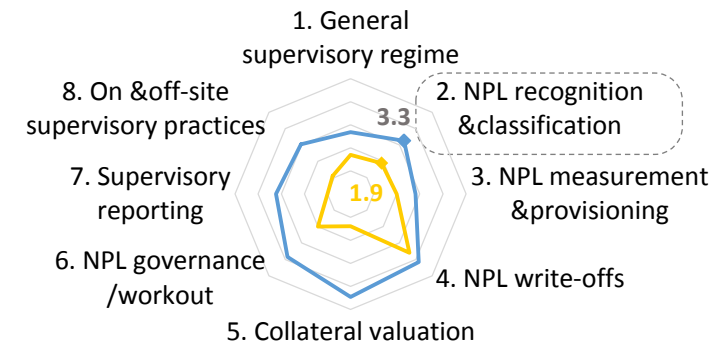
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Progress and tentative actions (April 2018)

- Regular stress-testing for large banks started from 2018, individual bank results are planned for disclosure
- The NBU introduced LCR to replace point-in-time liquidity requirements (2018). The NSFR is being developed (expected introduction in 2019)
- Prudential regulation on credit risk was softened (March 2018)
 - (1) immediate exits from default for out-of-court corporate restructuring (Kyiv approach)
 - (2) postponing start of collateral amortisation for all vintage NPLs (historical is replaced with vintage count starting from January 3, 2017 for all exposures)
- Capital adequacy and other prudential requirements are also subject to amendments in convergence to the EU regulation

A.1. Prudential regulation should assure sufficient stimulus for NPL resolution and high cost (on capital) for keeping unresolved NPLs. In this regard, postponing amortization of collateral for all vintage NPLs is a concerning amendment

A.2 NPL recognition and classification



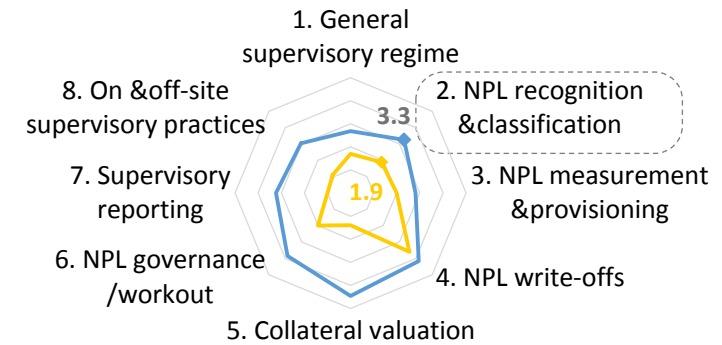
Assessment for Ukraine: 3.3 (March 2017)

- Ukraine is not fully compliant with NPL definition established by EBA ITS in 2013. NBU regulation No.351 has definition of non-performing assets equivalent to defaulted loans (it does not include “unlikely to repay” criteria which is broader than defaulted loans)
- Timely default recognition is stimulated by recommended non-exhaustive list of default triggers, including interest capitalisation and refinancing accrued during 90+ days
- The regulation No.351 defines minimum default exit requirements including at least 6 (12) months restored servicing for at least monthly (quarterly) repayments
- Also there is no definition and reporting requirement for forboren loans

EU best practices: Ireland and Spain

- In addition to full compliance with EBA ITS on NPLs, the NCA issued extra criteria for NPE and forboren exposures
- There are regulative requirements and recommendations for early warning system with additional loans subdivision, e.g.
 - Performing loans into performing without arrears, performing in arrears (1-30, 31-60, 61-90) and renegotiated loans (no financial difficulties) and cured loans (exited from NPL)
 - Non-performing loans into doubtful in arrears (DPD 90+), doubtful for other reasons, foreclosed loans and write-off loans
- Forboren loans have separate higher PD estimates and lower cure rates

A.2 NPL recognition and classification



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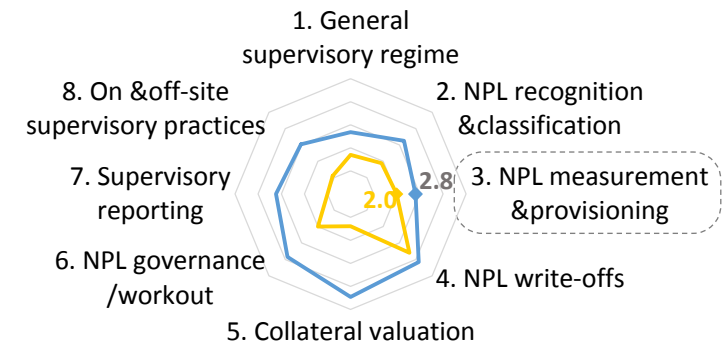
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Progress and tentative actions (April 2018)

- The NBU increased disclosure about NPLs based on prudential definition (regulation 351) and closely supervised strict adherence to prudential rules for large exposures
- NPLs are disclosed in breakdowns by bank, currency and customer type (retail, corporate)
- The NBU is drafting regulation and recommendations on risk management and NPL management, which includes framework on early warning indicators and watch lists
- Further improvement in NPL classification is expected with implementation of FINREP based on EBA templates (tentatively in 2020)

A.2. Recommended convergence in NPE/ NPL and forborne exposure definitions to the EBA ITS, improvement in early NPL identification with help of new NBU regulation and best practice recommendations.

A.3 NPL measurement and provisioning



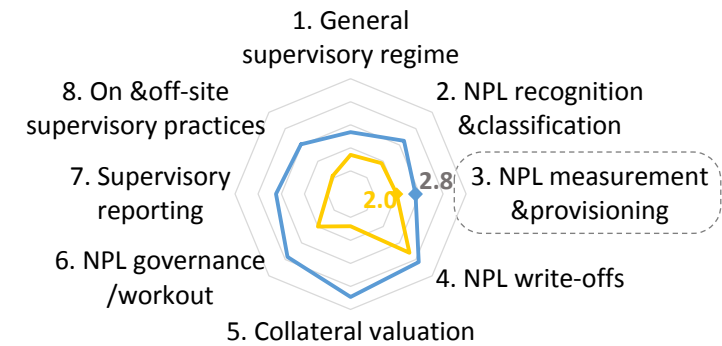
Assessment for Ukraine: 2.8 (March 2017)

- Correctness of NPL measurement and provisioning was significantly improved as a result of the Comprehensive Assessment (Diagnostics) conducted by the NBU for top60 banks during 2015-2016
- There is a requirement for at least annual external audit by an audit firm from the NBU registry.
- There is no NBU recommendations of best practices for IAS 39 and IFRS 9 application
- Incurred IFRS provisions are supplemented by capital adequacy adjustment for uncovered credit risk according to NBU regulation

EU best practices: Ireland and Spain

- All banks are required to be in full compliance with IAS / IFRS accounting standards. The NCA are applying prudential filter for capital adequacy purposes
- To insure loss event identification as early as possible the NCA issued specific guidelines on
 - factors that should be taken into account when assigning whether a loss event occurs, i.e. debt-service capacity (interest coverage), financial leverage (debt to EBITDA), financial performance, net worth and future prospects
 - non-exhaustive impairment triggers, including macroeconomic and portfolio-specific triggers
- The NCA non-binding guidance on IAS 39 works on the principle comply or explain

A.3 NPL measurement and provisioning



Assessment for Ukraine: 2.8 (March 2017)

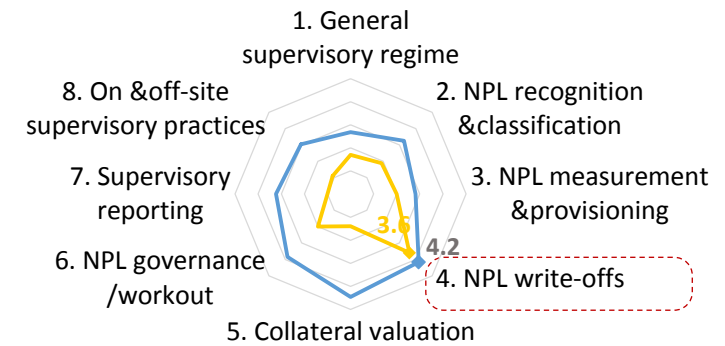
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Progress and tentative actions (April 2018)

- The banks have to fulfil provisioning requirements under IFRS9 starting from January 2018
 - The tax code was amended to provide full deductibility for provisions increase due to transition from IAS39 to IFRS9 and any further provisions increase under IFRS9
- The NBU introduced regular stress-testing for large banks including individual stress-testing of large exposures
 - AQR for data quality assurance to be executed by authorised audit firms
 - Stress-testing by the NBU in cooperation with the banks
 - Results for individual banks are planned to be public

A.3. Further NBU efforts are advisable on assurance of prudent application of IFRS9 and NBU credit risk regulation (e.g. with AQR and stress-test assessment). The NBU may follow approach of the EU regulators and issue minimum provisioning requirements

A.4 NPL write-offs



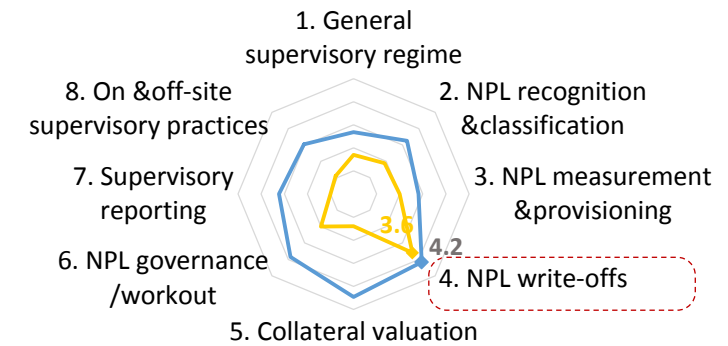
Assessment for Ukraine: 4.2 (March 2017)

- There is no NBU recommendations on best practices for NPL write-offs
- Write-offs are mainly driven by bank-specific accounting policies and tax burden optimisation
 - Tax-deductibility of provisioning expenses depends on provision coverage ratio (25%), which can be effectively reduced by write-offs
 - Tax-regime imposes extra write-off criteria, non-compliance with which may lead to an increase in taxable base (recently were softened)
- NPL write-offs are likely to be delayed due to tax regime impediments
- Massive NPL write-offs in UA GAAP was performed during 2011-2012 under NBU guidance with temporary tax write-off criteria withdrawal

EU best practices: Slovenia and Spain

- Guidance, issued by the regulator, includes a set of de-recognition rules and criteria based on individual analysis and respective conclusion about a remote probability of recovery, e.g.
 - Borrowers in bankruptcy process with liquidation phase (to be) declared
 - Borrowers with solvency unrecoverable deterioration
 - Secured exposures with overdue above 3-4 years, and unsecured exposures with overdue above 1 year
- The NCA may introduce additional write-off incentives like increased capital charges
- In tax treatment, write-offs are tax-deductible for banks that follow the NCA criteria (there are no other additional tax write-off criteria)

A.4 NPL write-offs



Assessment for Ukraine: 4.2 (March 2017)

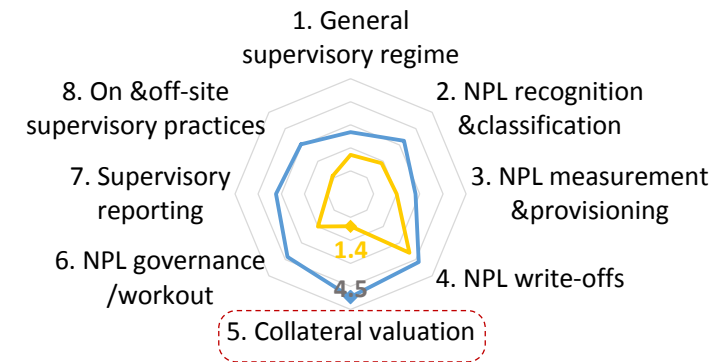
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Progress and tentative actions (April 2018)

- Tax impediments were eased: (1) eliminated limit (25%) on provisions deductibility, (2) clarified write-off tax criteria (360+)
- The WB prepared for the NBU a summary note on NPL write-off practices in other countries:
 - Albania (in 2015, BoA requires mandatory NPL write-off after 3 years in the lowest credit category)
 - Serbia (in September 2017, BoS requires accounting write-off of assets of a low degree of collectability – 100% provisioned)
 - ECB (March 2018, ECB will require the banks to provide full coverage for the unsecured portion of new NPLs after 2 years at the latest and for the secured portion after 7 years at the latest)

A.4. It is recommended to the NBU to follow the approach of European regulators in issuing best practice recommendations and imposing minimum prudential requirements. Such steps will facilitate NPL stock reduction on banks' balance sheets

A.5 Collateral valuation



Assessment for Ukraine: 4.5 (March 2017)

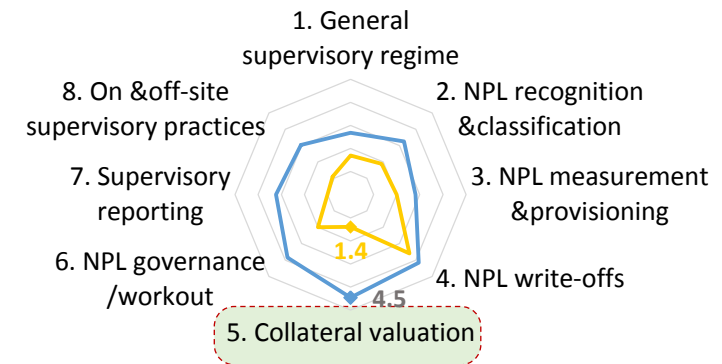
- Collateral acceptability and valuation were identified as key risks to credit assessment
- Though there is a requirement for independent appraisal of collateral, there is insufficient regulation and responsibility of appraisal firms (formalistically regulated by the State Property Fund)
- There is no NBU recommendation on best practices on independent appraisers selection and valuation methodology
- There is no uniform and approved valuation methodology by other authorities, particularly it turns highly uncertain for financial assets valuation
- Sound methodology on financial assets valuation is necessary for the DGF and the NBU

EU best practices: Germany, Portugal and Spain

- The NCA issued prudential guidance on collateral valuation that includes how the valuation process should be organised, selection of appropriate independent appraisers, dealing with conflict of interest and valuation assumptions
- White list or black list supervised by the NCA
- Valuation frequency follows CRR requirements: (1) commercial real estate ≤ 12 months, (2) residential real estate ≤ 3 years
- Valuation methodology is determined by reference to one or several international valuation standards^[1]
- Banks are required to collect and document information on collateral recoveries for LGD justification
- There are public registries with pricing information on real estate that can be used for valuation verification

[1] Royal Institution of Chartered Surveyors ("Red Book"), the European Valuation Standards ("Blue Book"), the International Valuation Standards ("White Book").

A.5 Collateral valuation



Assessment for Ukraine: 4.5 (March 2017)

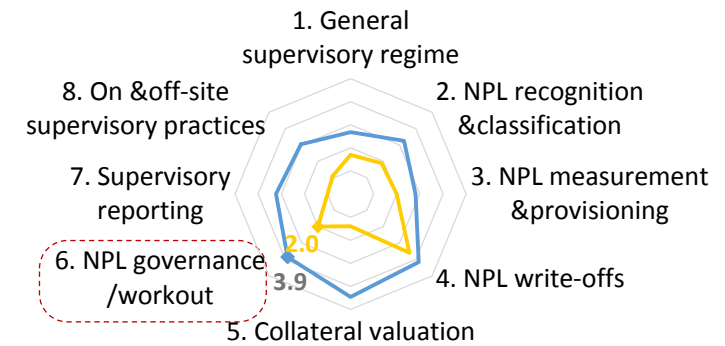
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Progress and tentative actions (April 2018)

- The WB prepare a summary note for the NBU on collateral valuation practices in the EU countries
- Main aspects of the note – supervisory guidance, data collection on asset transactions, direct and indirect regulation of appraisers
- The NBU Risk Management has initiated the work on a database for collateral values in the financial sector
- The NBU amended prudential regulation on credit risk (351) with additional requirements to appraisers on experience and reputation
- Acceptable appraising firms should not have negative reviews on their appraisal reports issued by the regulator (the SPF) or authorized expert councils
- The SPF and the NBU are to run registries of appraisers with negative reviews

A.5. The achieved progress in prudential regulation is insufficient and should be supplemented with (1) unification of assets valuation during court process, (2) tightening supervision by the SPF, (3) industry self-regulation (legislative changes required)

A.6 NPL governance /workout



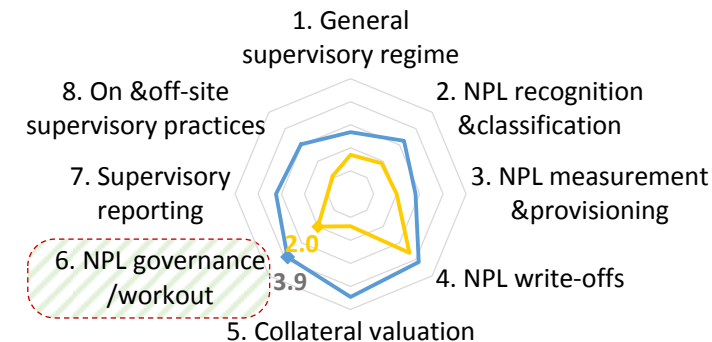
Assessment for Ukraine: 3.9 (March 2017)

- NPL governance has significantly improved recently in many banks. However, the practices stay diverse and not always adequate to NPL overburden. Questionable areas are
 - Workout unit subordination
 - Early warning system
 - Mandatory loan transfer to workout unit
- There is no NBU recommendations on best practices (document is in progress of designing)

EU best practices: Ireland, Spain

- The NCA issued recommendations on best practices related to
 - NPL workout units organisation and functions
 - Assessment of sustainable arrears solutions
 - Code of conduct in dealing with indebted borrowers (e.g. Greece, Ireland)
- There is definition of reasonable households minimum living expenses
- There is differentiation between short-term and long-term arrears solutions and regulators' strong preference for the latter as more sustainable approach
- The NCA also may require banks' internal audit functions to review strategies, policies and procedures for dealing with non-performing assets in order to identify operational deficiencies and develop action plans for improvement

A.6 NPL governance /workout



Assessment for Ukraine: 3.9 (March 2017)

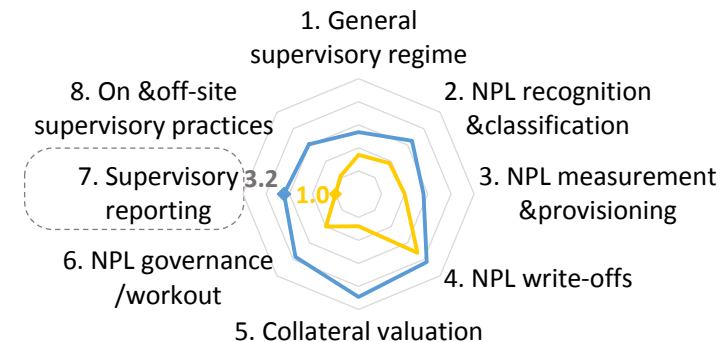
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 - Workout unit subordination
 - Early warning system
 - Mandatory loan transfer to workout unit
- There is no NBU recommendations on best practices.

Progress and tentative actions (April 2018)

- WB FinSAC drafted the Guidelines for Effective Management and Workout of NPLs in Ukraine. Submitted to the NBU in October 2017
- The Guidelines cover the following areas: i) early warning system, ii) identification of NPLs, iii) organization of workout units in the banks, iv) best practice for organizing workouts, including workout strategies, v) principles of segmentation
- The Guidelines include three detailed examples of corporate NPL restructuring
- Based on these Guidelines the NBU is drafting regulation and recommendations for the commercial banks
- Additionally, taking into account high stock of NPLs at SOBs legislative amendments on corporate governance at SOBs are recommended (draft law 7180)

A.6. The Guidelines are recommended for implementation at the commercial banks. The NBU may issue part of the Guidelines as mandatory requirement and recommended good practices. NBU steps to imposing sector-wide cross-defaults are also advisable

A.7 Supervisory reporting



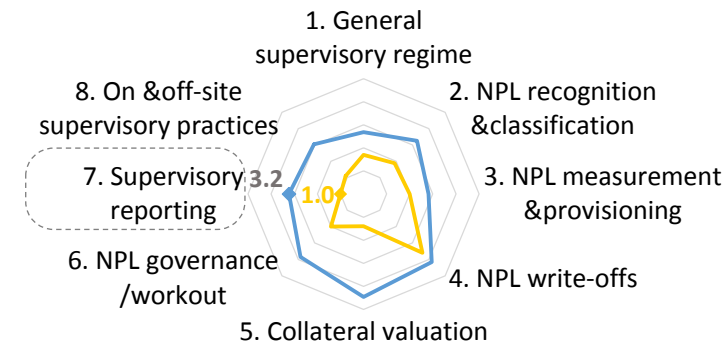
Assessment for Ukraine: 3.2 (March 2017)

- There is an extensive system for prudential and financial reporting to the NBU. However, it is not compliant with FinRep and CoRep (EU-funded project in process of implementation)
- Existing reporting standards have deficient disclosures: interest income is not segregated into received and due, no SME client group segregation, mortgage is segmented by collateral type not by the purpose of the loan
- The Comprehensive Assessment revealed some banks were conducting gross misreporting
- There is no NBU recommendation on best practices on IAS 39 and IFRS 9 application. The banks expressed interest in guidance on accounting for restructured loans, acquired loans and income recognition

EU best practices: Italy, Spain

- Taking into consideration volume and quality of NPL burden in the banking system the NCA may require additional to EBA ITS prudential disclosures on NPEs and forbore loans, e.g.
 - Monthly reporting instead of quarterly
 - Borrower-by-borrower basis for large exposures
 - Changes in debtor status in granular portfolio segments
- The NCA conducts off-site and on-site verification for accuracy and consistency of the reported data with strict sanctions for incorrect reporting
- NPL statistics are publicly available and presented in quarterly analytical issues and other EBA /NCA publications

A.7 Supervisory reporting



Assessment for Ukraine: 3.2 (March 2017)

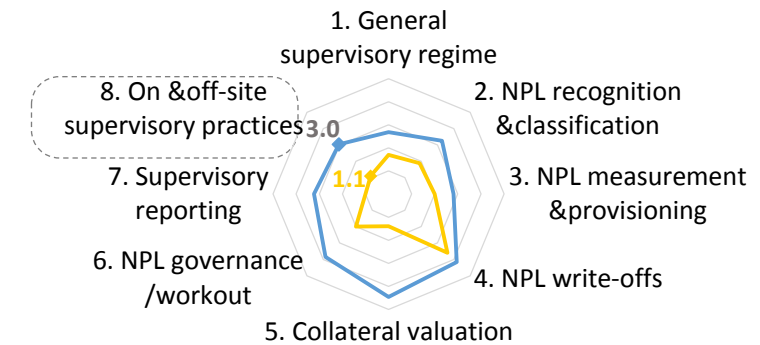
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Progress and tentative actions (April 2018)

- In addition to regular reporting the NBU requested from the commercial banks NPL resolution plans
 - Initial framework for NPL resolution was introduced in 2017, however it needs substantial strengthening and implementation enforcement
 - Quarterly fulfilment review is established
- The NBU significantly enhanced disclosures about individual banks
 - from September 2017 for detailed financial reporting in the form of trial balances
 - from February 2018 for detailed prudential requirements
- The NBU introduced new standard of mandatory chart of accounts from January 2018 that significantly facilitates transparency in financial and prudential reporting

A.7. Further improvement in supervisory reporting and disclosure recommended as for NPL breakdowns by collateral type and collateral coverage (e.g. LTV ratios). FinRep and CoRep implementation

A.8 On and off-site supervisory practices



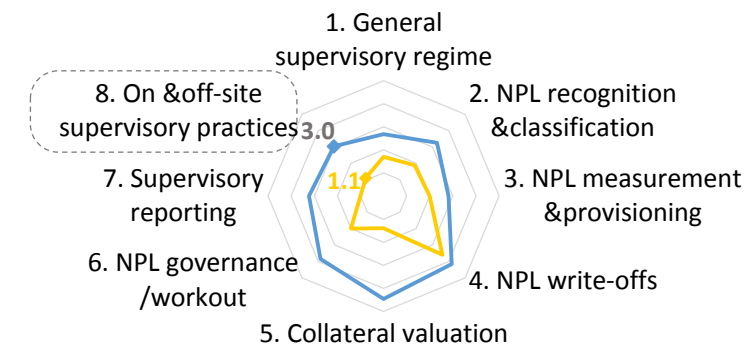
Assessment for Ukraine: 3.0 (March 2017)

- NBU supervisory practices were significantly revised and improved given the changes in the general supervisory regime
- The Comprehensive Assessment of top-60 banks was effectively utilised in understanding vulnerabilities of the banking sector and revealing deficiencies in the supervision process
- NBU aimed at gradual convergence to Supervisory Review and Evaluation Process (SREP), already organised oversight according to banks' significance and business models, established assessment of large corporates
- Off-site supervision to be transformed from planned each three year verification into risk-based and thematic analysis

EU best practices: Italy, Spain

- On-site and off-site supervision efforts are focused on the same issues identified by risk-oriented assessment
- The NCA has internal manuals that are comprehensive but non-exhaustive
- There is centralised assessment of large corporations with exposure across the whole banking system
- Bank specific NPL-related cases are analysed jointly by off and on-site teams
- Depending on NPL burden the NCA may conduct thematic reviews

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Progress and tentative actions (April 2018)

- NBU's supervisory practices are converging to the EBA framework on Supervisory Review and Evaluation Process (SREP)
- Qualitative assessment based on a comprehensive questionnaire will be launched in 2018
- On-site supervision is concentrated on CAMELSO assessment of commercial banks, but also becomes a part of the SREP assessment
- AQR for stress-testing is conducted by authorised audit firms, whereas during 2015-2017 it was conducted by on-site NBU supervision

A.8. Convergence to EBA supervision practices is recommended. AQR teams may also include NBU specialists from on and off-site supervision in order to collect insights and maintain comprehensive approach

A. Supervisory regime and practices: initial assessment and progress

Country evaluation results for NPL framework

	CY	DE	GR	IE	IT	PT	SI	ES	EU8 average	UA 2017	Progress
1. General supervisory regime	0.0	2.1	2.1	1.0	2.0	3.0	2.1	1.2	1.7	2.7	
2. NPL recognition & classification	2.6	3.2	2.6	0.1	2.6	2.5	1.9	0.0	1.9	3.3	
3. NPL measurement & provisioning	1.4	4.2	2.6	0.7	2.5	2.4	1.9	0.0	2.0	2.8	
4. NPL write-offs	3.5	5.0	3.2	3.7	5.0	5.0	1.8	1.9	3.6	4.2	
5. Collateral valuation	1.2	0.0	2.5	0.6	3.8	0.4	1.9	0.7	1.4	4.5	
6. NPL governance /workout	1.5	2.9	1.9	1.0	2.7	2.7	1.0	2.3	2.0	3.9	
7. Supervisory reporting	1.2	2.6	1.0	1.0	0.0	0.9	1.0	0.0	1.0	3.2	
8. On & off-site supervisory practices	1.9	1.1	1.5	0.7	0.1	1.0	2.0	0.3	1.1	3.0	

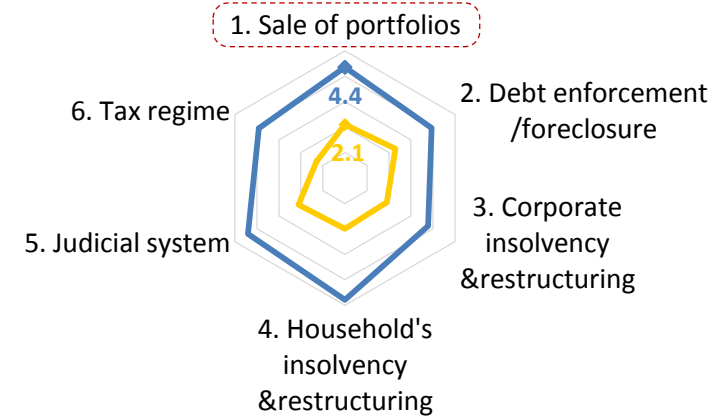
Score 5 stands for the worst NPL framework, whereas 0 score stands the best practice NPL framework

Source: ECB Stocktake of national supervisory practices and legal frameworks related to NPLs (November 2016)

There is progress in 4 out of 8 areas of the NPL framework in the first pillar. The progress was mainly result of central bank efforts

Progress and WB recommendations under Pillar II (B) –
legal, judicial and extrajudicial

B.1 Sale of portfolios



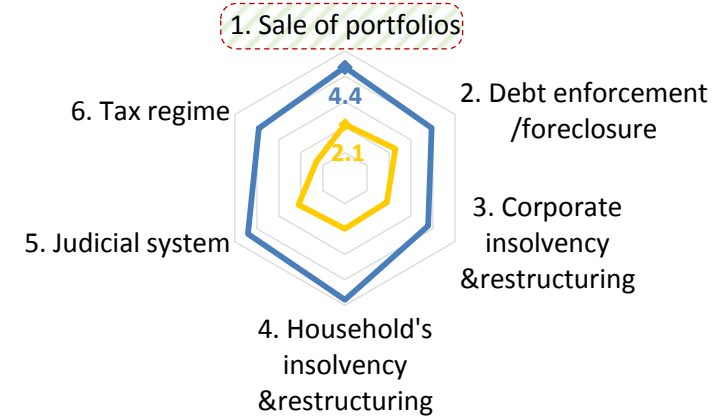
Assessment for Ukraine: 4.4 (March 2017)

- There are banks that consider NPLs assignments as an attractive resolution option (to third parties or to a related SPV)
- Loan assignments require notification to borrowers by a registered mail (consent is not required)
- Loan assignee can join court process on debt enforcement initiated by the assigner
- Loan assignments to non-residents are subject to registration at the NBU
- However, there is uncertainty in tax treatment for transactions with non-bank assignees
- There is no private or public-sponsored AMCs
- Some banks indicated interest in NPLs acquisitions to expand client base but they are constrained due to uncertainties in tax, accounting and prudential regulation treatment

EU best practices: Ireland, Spain

- There are no legal impediments to the sale of loans. Legal framework allows loans transfer to third parties together with linked collateral without debtor consent but with notification requirement
- There are private and in some countries public-sponsored asset management companies (AMC) with focus on distressed debt management
- There is strong interest for NPL acquisitions from various financial intermediaries and other investors
- Equal opportunities for local and foreign NPL investors in the country

B.1 Sale of portfolios



Assessment for Ukraine: 4.4 (March 2017)

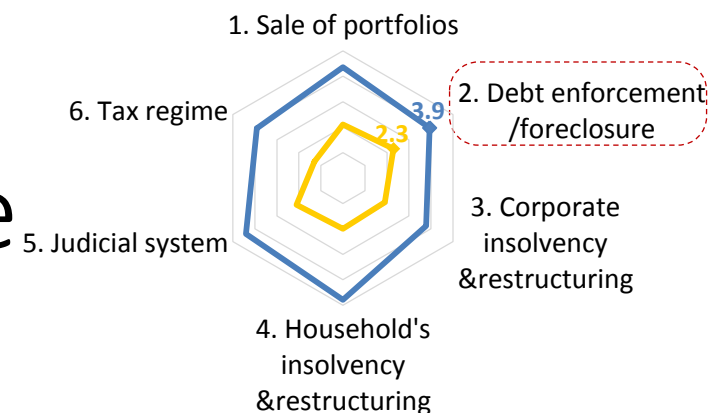
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Progress and tentative actions (April 2018)

- Draft tax interpretation to solve tax uncertainty for loan assignments (selling) has been submitted to the MOF
- The WB participated in reviewing the draft law on Asset Resolution Companies (ARCs) developed with support from the EBRD
 - The draft was widely discussed with the banking community and supported by the central bank
 - It is ready for submission and registration at the Parliament
- The Deposit Guarantee Fund (DGF) developed and successfully applied Dutch auctioning procedure on ProZorro.Sale platform for individual and bulk sales (mostly NPLs).
 - The DGF intends to sell stock of NPLs with total gross value of about UAH 400 bn

B.1. Supporting draft law on ARCs. DGF experience in loan sales is valuable for the banking sector in light of the idea of establishing a single NPL sale platform with unified NPL disclosure templates (discussed initiative by the European regulators)

B.2 Debt enforcement /foreclosure



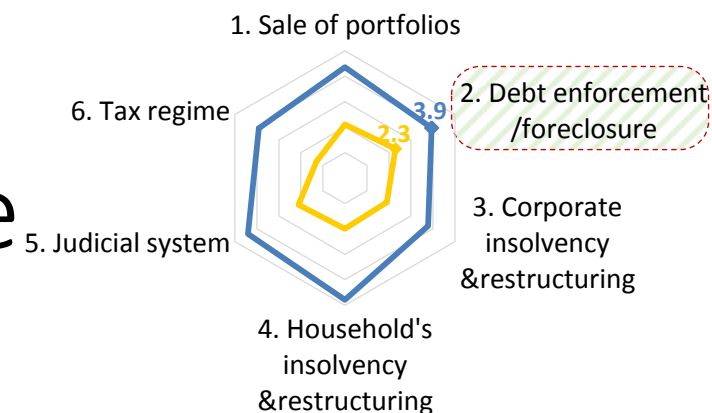
Assessment for Ukraine: 3.9 (March 2017)

- There are improvements in legislation and judicial system as for debt enforcement and foreclosure, but a serious legislative barrier is the moratorium on residential mortgages foreclosure (for FX loans)
- Contractual provisions authorizing collateral foreclosure are permitted. However, banks have different experience during borrowers' appeals likely depending on quality of the contracts
- Many banks indicate high risks in court foreclosure related to disputable pre-auction valuation that makes the process long-lasting.
- Another concern is a slow and ineffective service of public bailiffs. Enforcement procedure reform introducing private bailiffs is called to ease this impediment (effective from November 2016), but still not fully developed

EU best practices: Germany, Ireland, Spain

- There are certain out-of-court contractual arrangements that enable fast foreclosures
- Simplified enforcement systems implemented by specialised enforcement courts that largely control the formalities of the process (where substance cannot be discussed). If debtor considers that its rights are violated, the debtor can start an ordinary complain, where substantive discussion is admitted.
- Every enforcement procedure requires an enforcement title confirming executed receivable in order to protect rights of the creditor and the debtor
- There are acceptable time limits for foreclosure procedures (up to 18 months) and these time limits are respected in practice

B.2 Debt enforcement /foreclosure



Assessment for Ukraine: 3.9 (March 2017)

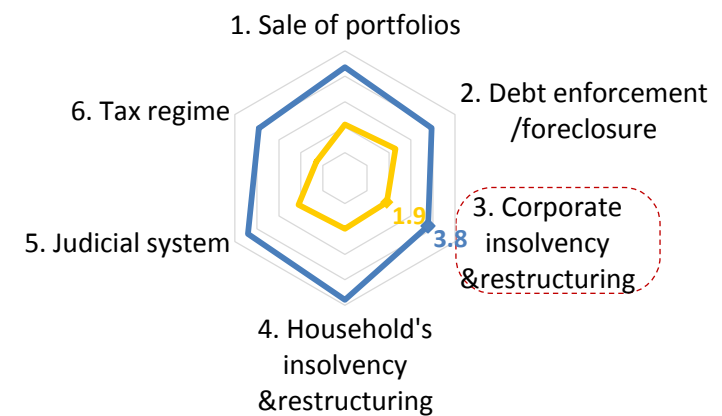
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Progress and tentative actions (April 2018)

- The introduction of the private bailiff reform is considered as a step forward but it's too early to evaluate its impact, especially given the as of yet insufficient number of private bailiffs
- Draft law #6027, which promises to improve the debt enforcement regime, was registered with the Parliament but appears to lack sufficient traction
- The WB team that analysed the legal environment, apart from the legal aspects, also identified non-legislative impediments to effective debt enforcement:
 - MOJ regulation limits out-of-court foreclosure by requiring original title documents for title transfer
 - Notification restrictions, as well as domiciliation restrictions on notaries add unnecessary hurdles to the debt-enforcement system

B.2. Much efforts should be invested in the improvement of legislative and non-legislative framework for debt enforcement and foreclosure. The leading role of MOJ in this agenda is critical

B.3 Corporate insolvency and restructuring



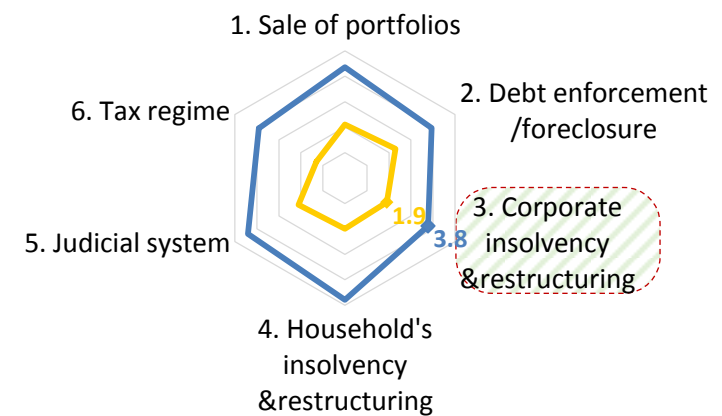
Assessment for Ukraine: 3.8 (March 2017)

- Corporate insolvency law was recently supplemented with a new law on financial restructuring (“Kyiv approach”). It regulates out-of-court restructuring with multiple creditors.
- There are many deficiencies that make insolvency processes long and complex:
 - Creditors’ role, particularly secured creditors, would benefit from being strengthened;
 - The process of selling assets in liquidation has reported to be non-transparent, leading to sales at undervalue in prejudice of creditors;
 - insolvency processes are lengthy
 - Insolvency practitioners are not qualified or transparent in performing their role;
 - There are no quick and simplified procedures for SME cases

EU best practices: Several countries

- There are a number of solutions to deal with insolvent companies:
 - Promoting pre-insolvency processes, and creating incentives to tackle insolvency cases on time;
 - Setting strict time limits, with default consequences in cases of non-compliance;
 - Strengthening creditor’s roles;
 - Promoting transparent auctions in liquidation procedures;
- Also, the EU has promoted recently legislation and practices on out-of-court and pre-pack restructuring to enable early rehabilitation for distressed companies;
- Accelerated, less formal SME insolvency processes are being encouraged.

B.3 Corporate insolvency and restructuring



Assessment for Ukraine: 3.8 (March 2017)

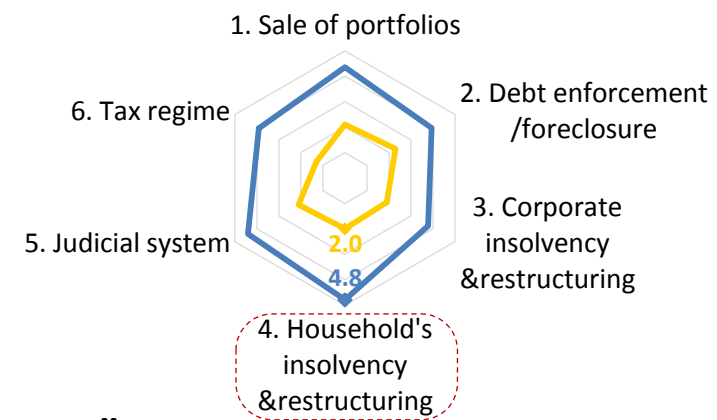
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 - The process of selling assets in liquidation has reported to be non-transparent, leading to sales at undervalue in prejudice of creditors;
 - insolvency processes are lengthy
 - Insolvency practitioners are not qualified or transparent in performing their role;
 - There are no quick and simplified procedures for SME

Progress and tentative actions (April 2018)

- Draft code on insolvency procedures #8060, which passed voting in first reading, replaced draft #3132d. Draft #8060 improves corporate insolvency framework including e-auctioning, increasing rights of creditors and eliminating provisions of abuse (e.g. article 95), however, it includes controversial personal insolvency provisions (see slide 32).
- “Kyiv approach” to corporate restructuring still has a limited application (mostly one SOB and one creditor transactions)
- There are limited or no cases of multilateral restructuring due to lack of cooperation and efficient coordination between the banks
- Key players in the insolvency system require intensive training. Local pro-debtor perceptions have to be recalibrated into a more balanced approach

B.3. Legislative amendments incorporating best insolvency practices together with capacity training are recommended. Also, the development of a new mechanism for creditor coordination for the Law on Financial Restructuring is recommended (NBU).

B.4 Household's insolvency and restructuring



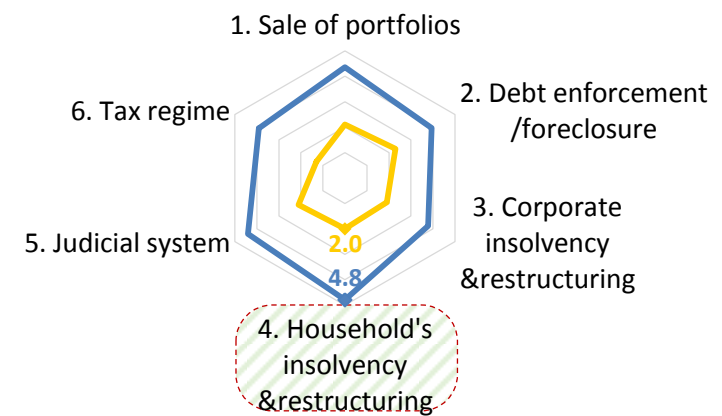
Assessment for Ukraine: 4.8 (March 2017)

- While Ukraine has an insolvency system for individual entrepreneurs, it does not have a consumer's insolvency regime
- Strong negative impact on retail NPL resolution has the legislative moratorium on foreclosure of residential mortgages in FX (law #1304-VII,03.06.14)
- Moratorium eligibility criteria are soft: only single dwelling (no other), flats below 140 m² or houses below 250 m². Banks indicate that 50-90% of retail mortgages meet with criteria
- Such eligible borrowers are not interested in restructuring their overdue loans that freezes unresolved status for these loans –incentives should be created for both parties to achieve a fair solution to these cases

EU best practices: “Fresh start”

- There is no consolidated opinion on best practices in household's insolvency and restructuring
- As per multiple studies, it is strongly advised to have a personal insolvency system that, at least, contemplates
 - A discharge period (immediate or up to 5 years) that allows the person to “clean” the past debts and facilitating to a “fresh start” once certain conditions are met – this encourages the person to return to an economically productive activity
 - General regime for out-of-court settlements and expedite procedures compared to corporate insolvency
 - Provision of debt counselling to individuals
- Personal insolvency regime covers all debts assumed by households and consumers. Some regimes include individual entrepreneurs (which are currently contemplated in the existing corporate insolvency law)

B.4 Household's insolvency and restructuring



Assessment for Ukraine: 4.8 (March 2017)

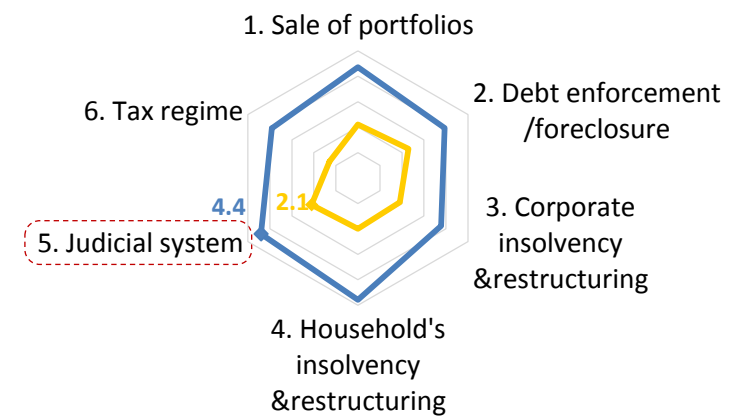
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- Moratorium eligibility criteria are soft: only single dwelling (no other), flats below 140 m² or houses below 250 m². Banks indicate that 50-90% of retail mortgages meet with criteria
- Such eligible borrowers are not interested in restructuring their overdue loans that freezes unresolved status for these loans –incentives should be created for both parties to achieve a fair solution to these cases.

Progress and tentative actions (April 2018)

- The draft Code on insolvency procedures registered at the Parliament (#8060) assumes introduction of personal insolvency for the first time in Ukraine
- Transition clauses include
 - possibility for FX mortgage debtors enter into a loan restructuring (for loans issued before June 2009)
 - mandatory restructuring terms (eg partial debt forgiveness)
 - cancelation of the moratorium on debt enforcement in one year after putting in force the restructuring provisions
- The personal insolvency chapter has important shortcomings which need to be addressed (eg the insolvency test, duty to file, debts eligible for restructuring, etc.)
- If a personal insolvency law is introduced, massive capacity building efforts will be needed.

B.4. Efforts to strengthen the personal insolvency chapter of the draft law are much needed – including on the FX issue. Capacity building efforts on 'good practices related to personal insolvency are strongly suggested.

B.5 Judicial system



Assessment for Ukraine: 4.4 (March 2017)

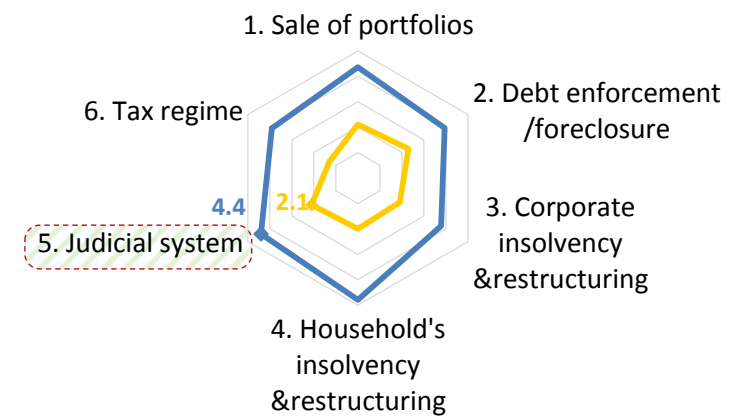
- There are improvements in judicial system mainly related to reforming (reducing administrative pressure) and judges' resignation due to refusal to fill-in e-declarations
- Judicial system impediments are
 - Legal timelines are not met
 - High bailiff charge (5%+10% of claim amount)
 - Judges are reportedly not experts in some of the commercial matters they resolve
- The Supreme Court rulings has created problems with early termination of personal warranties
 - request for debt repayment was replaced with court claim
 - banks have to file a court claim not later than 6 months since first non-payment

EU best practices: Several jurisdictions

- There are specialised courts dealing with commercial matters, and sometimes further specialisation of either judges or courts (such as specialised judges for insolvency or for small claims, etc.).
- Also, in Civil procedure laws, there are legal provisions that stipulate certain protection to individual borrowers, e.g. an amount exempt from execution in order to secure minimum living wage for the debtor or certain “exemptions” of property that cannot be seized by creditors
- Notifications to companies are predictable and simple: A notification to a company served in their registered domicile, is valid. Similarly, notifications served in contractually agreed domiciles are also valid.
- Court process has certain time limits and they are complied with by the parties and the court.

[1] Supreme Court resolutions dated 23/05/2012, 17/09/2014, and 14/06/2017 on personal warranty termination according to the article 599 of the Civil Code

B.5 Judicial system



Assessment for Ukraine: 4.4 (March 2017)

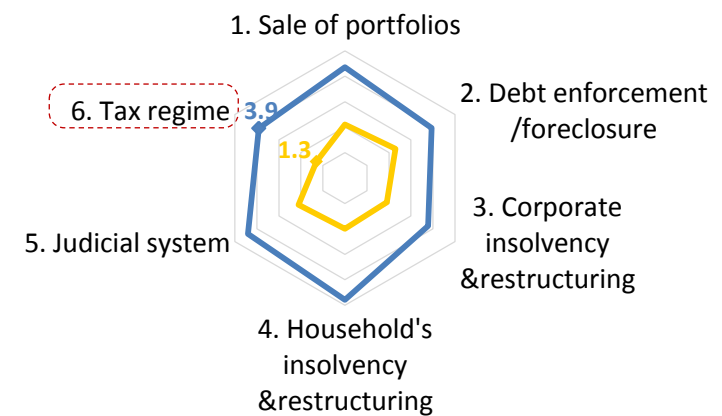
- There are improvements in judicial system mainly related to reforming (reducing administrative pressure) and judges' resignation due to refusal to fill-in e-declarations
- Judicial system impediments are
 - Legal timelines are not met
 - High court fees (1,5% of the claim)
 - High bailiff charge (5%+10% of claim amount)
 - Judges are reportedly not experts in some of the commercial matters they resolve
- The Supreme Court rulings has created problems with early termination of personal warranties
 - request for debt repayment was replaced with court claim
 - banks have to file a court claim not later than 6 months since first non-payment

Progress and tentative actions (April 2018)

- The new Supreme Court (established in 2017) is an encouraging development to improve the judicial system
- Concerns remain on the interpretation of legal rules (for instance, terms of termination for sureties), often defying the logic of contractual relationships.
- The National School of Judges (NSJ) is responsible for organised mandatory training for judges.
- The WB is working with the NSJ on developing initiatives for mandatory judges training with participation of international experts
 - Particularly such training should be beneficial in light of legislative changes in the credit legal infrastructure framework (debt enforcement, corporate and personal insolvency)

B.5. Effective judicial training should facilitate the convergence into best international practices and adapting a pro-debtor culture to a more balanced approach which respects creditors' rights

B.6 Tax regime



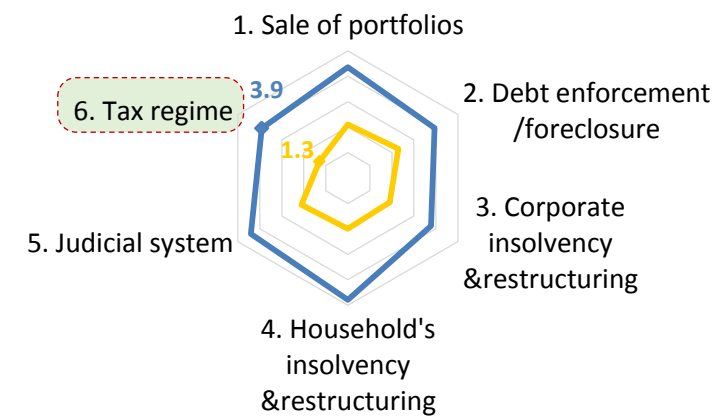
Assessment for Ukraine: 3,9

- Tax regime also has been improving but mostly via legislative changes, whereas tax authorities inconsistent arbitrary interpretations still is the main concern of the banking system
- Currently outstanding issues include
 - Tax treatment for loan sales to financial intermediaries (claimed invalid transaction result in increased taxable base)
 - Uncertain interpretations for write-off tax criteria
 - Restrictive 25% limit on provisions stock for tax-deductibility purposes
- It is expected that tax regime reform will eliminate the individual interpretations and the Finance Ministry will actively provide public explanations to decrease risks of uncertain interpretations

EU best practices: Germany, Ireland and Italy

- Tax regime in general is not an obstacle to private debt resolution
 - There are no limits and very soft limits for on tax-deductibility for provisioning expenses
 - Tax-loss carrying forward mechanism is provided (deferred tax assets)
 - Tax-deductibility is granted for loan full or partial write-offs, with very few exceptions in some counties for secured loans for real estate projects, land developers
 - Only financial result from loan sales is taxable

B.6 Tax regime



Assessment for Ukraine: 3.9 (March 2017)

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 - Uncertain interpretations for write-off tax criteria
 - Restrictive 25% limit on provisions stock for tax-deductibility purposes
- It is expected that tax regime reform will eliminate the individual interpretations and the Finance Ministry will actively provide public explanations to decrease risks of uncertain interpretations







Progress and tentative actions (April 2018)

- Progress achieved in improving legislative tax framework
 - Eliminated the limit on provisions tax deductibility
 - Introduced a legal provision for debt forgiveness through the use of provisions
 - Introduced transitional clauses to assure full tax deductibility for provisions increase due to IFRS 9 and over-limit provisions
- The MOF established a new practice on tax interpretations
 - The Expert council of public and private sector practitioners was established
 - 6 tax interpretations were issued on provisions tax-deductibility, defining write-off /debt forgiveness and application of tax criteria for write-off (360+)
 - 4 draft interpretation are under consideration, including 1 on loans assignments and 3 on debt restructuring

B.6. Further work of the MOF is required on issuance of the outstanding Tax interpretations needed to decrease tax uncertainty related to loan sales (assignments) and corporate debt restructuring (“Kyiv approach”)

B. Legal, judicial and extrajudicial: initial assessment and progress

Country evaluation results for NPL framework

	CY	DE	GR	IE	IT	PT	SI	ES	EU8 average	UA 2017	Progress
1. Sale of portfolios	3.4	2.0	5.0	0.7	2.0	1.4	1.6	1.0	2.1	4.4	
2. Debt enforcement /foreclosure	3.1	0.0	5.0	1.4	3.2	2.7	1.8	1.5	2.3	3.9	
3. Corporate insolvency & restructuring	3.7	1.1	3.6	0.8	2.0	0.4	2.0	1.4	1.9	3.8	
4. Household's insolvency	2.7	1.1	5.0	2.0	3.0	0.0	2.1	0.0	2.0	4.8	
5. Judicial system	4.1	0.0	4.1	1.1	2.7	2.1	2.7	0.0	2.1	4.4	
6. Tax regime	2.0	0.0	3.8	0.0	0.0	2.2	1.3	0.9	1.3	3.9	

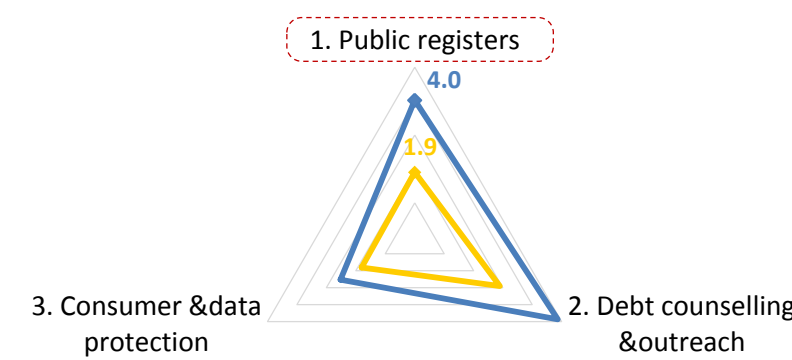
Score 5 stands for the worst NPL framework, whereas 0 score stands the best practice NPL framework

Source: ECB Stocktake of national supervisory practices and legal frameworks related to NPLs (November 2016)

There is progress in 3 out of 6 areas of the NPL framework in the second pillar. The contributors to the progress are the MOF (tax regime), the Supreme court and the MOJ

Progress and WB recommendations under Pillar III (C) –
registers & information framework

C.1 Public registers (central credit registers, asset register, cadastre)



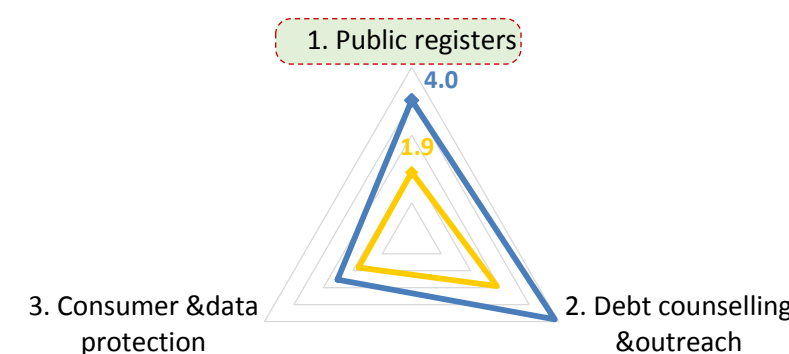
Assessment for Ukraine: 4.0 (March 2017)

- There are well functioning public central electronic registries for
 - pledged movable assets
 - ownership, pledge, leasing and other rights on immovable assets
- But there is no single public credit registry, respective draft law is not yet voted

EU best practices: Germany, Spain and Italy

- There are well-functioning centralised electronic
 - Central credit registry (CCR)
 - Asset registry with information on pledges
 - Cadastral system
- Digital access to the registries is well authorised and controlled
- The NCA and the banks have access to the registries and use the information in risk management
- CCR records debt quality according to EBA ITS NPL and forbearance definitions. It has sufficient coverage and granularity of information for micro –prudential and macro-prudential supervision purposes

C.1 Public registers (central credit registers, asset register, cadastre)



Assessment for Ukraine: 4.0 (March 2017)

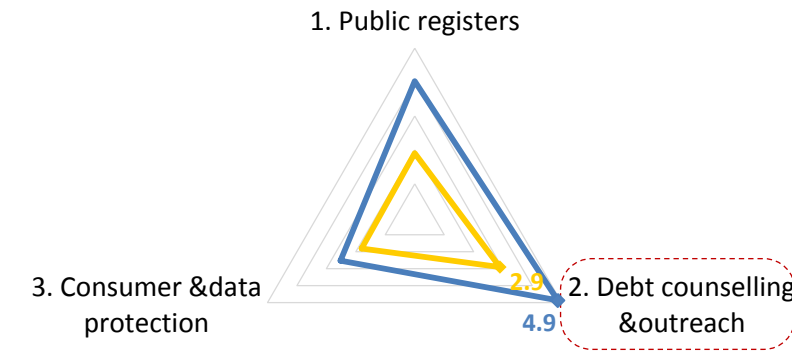
- There are well functioning public central electronic registries for
 - pledged movable assets
 - ownership, pledge, leasing and other rights on immovable assets
- But there is no single public credit registry, respective draft law is not yet voted

Progress and tentative actions (April 2018)

- The Law of Ukraine on Single Credit Registry was adopted on November 9, 2017 (№7114)
- This is a substantial step in the right direction. However, further work is recommended on equalizing risk categories in different banks of a borrower who services debt in one banks but defaults in other bank
- Additionally, the credit registry may become a good source of data for macro level credit risk assessment producing estimates that can significantly enhance early risk identification and measurement

C.1. The NBU is now well equipped for implementing prudential smoothing of credit assessment among the banks with purpose to stimulate creditors' cooperation in debt resolution strategies

C.2 Debt counselling and outreach



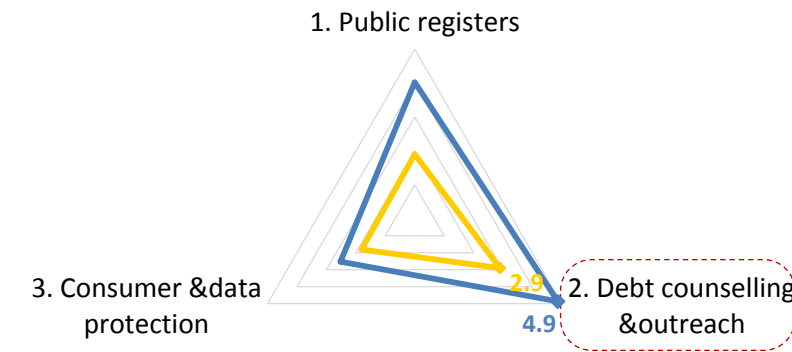
Assessment for Ukraine: 4.9 (March 2017)

- There is no debt counseling for indebted households and SME borrowers
- There are initiatives for financial literacy increase, but not sufficient

EU best practices: Portugal, Spain, Germany

- There are debt counselling support to households and SME borrowers with high credibility and outreach
 - sponsored and authorised by public agencies
 - free of charge or at low cost
 - improves financial literacy of the borrowers
- Effective debt counselling and outreach facilitates out-of-court restructuring benefiting the creditors and debtors
- In some countries regional authorities and municipalities included debt counseling in the services provided to their citizens (Germany, Portugal, Ireland, Italy, Spain)

C.2 Debt counselling and outreach



Assessment for Ukraine: 4.9 (March 2017)

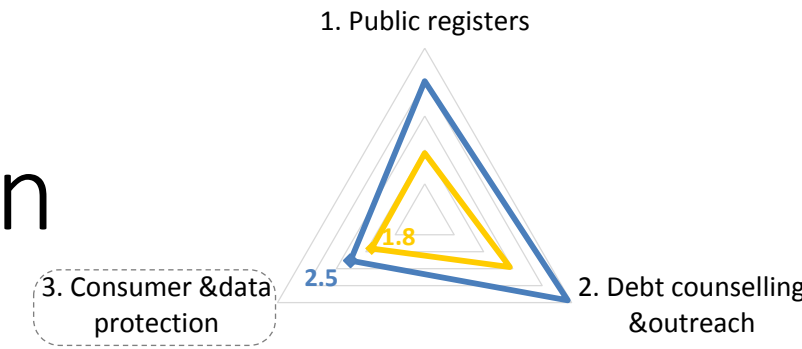
- There is no debt counseling for indebted households and SME borrowers
- There are initiatives for financial literacy increase, but not sufficient

Progress and tentative actions (April 2018)

- The Law of Ukraine on Free legal counselling establishes provisions for legal counselling for indebted individuals
- In addition, financial counselling is recommended
- Debt counselling and outreach becomes particularly important with possible implementation of personal insolvency legislation

C.2. Implementation of personal insolvency provisions in the legislation will dramatically increase need for debt counselling in order to facilitate FX mortgages restructuring and other NPLs resolution

C.3 Consumer and data protection



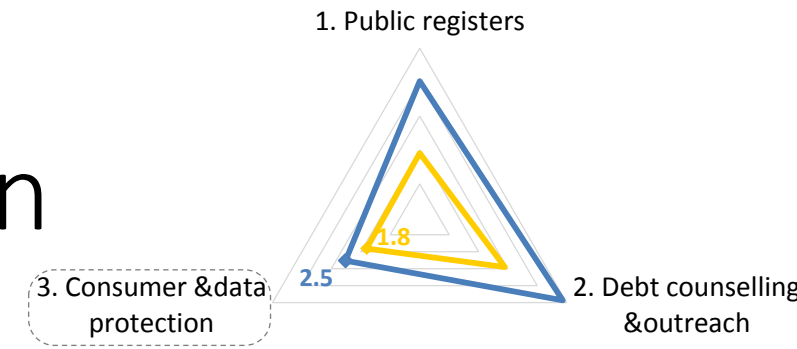
Assessment for Ukraine: 2.5 (March 2017)

- There is appropriate legislative requirements for consumer and data protection
- Banks do not consider consumer and data protection as impediments to NPL sales or other resolution strategies
- Mandatory borrower notification is required

EU best practices: Ireland, Italy, Portugal

- There are restrictions on recording and sharing personal information established in data protection legislation
- But the restrictions are proportional and do not pose obstacle to private debt resolution
- Data protection restrictions do not apply for central credit registry and prudential reporting

C.3 Consumer and data protection



Assessment for Ukraine: 2.5 (March 2017)

- There is appropriate legislative requirements for consumer and data protection
- Banks do not consider consumer and data protection as impediments to NPL sales or other resolution strategies
- Mandatory borrower notification is required




Progress and tentative actions (April 2018)

- There were legislative initiatives to establish possibility for immediate freezing bank accounts of debtors by court decisions
- Proposed solutions were technically difficult and had risks to banking secrecy of client information
- So far the only feasible option for account freezing is possible with participation of the NBU
 - The NBU directs request to the banking system on identification of all accounts registered for a client and orders freezing the amounts based on court decisions

C.3. Accounts freezing is a good mechanism for increasing debt recovery but its implementation should not bear risks to banking secrecy and data protection

C. Registers & information framework: initial assessment and progress

Country evaluation results for NPL framework

	CY	DE	GR	IE	IT	PT	SI	ES	EU8 average	UA 2017	Progress
1. Public registers	1.3	0.6	4.9	2.5	1.0	2.6	1.7	0.6	1.9	4.0	
2. Debt counselling & outreach	5.0	1.3	5.0	3.0	2.9	0.0	5.0	1.2	2.9	4.9	
3. Consumer & data protection	3.6	2.8	2.8	0.0	0.0	0.0	3.3	1.6	1.8	2.5	

Score 5 stands for the worst NPL framework, whereas 0 score stands the best practice NPL framework

Source: ECB Stocktake of national supervisory practices and legal frameworks related to NPLs (November 2016)

Action plan proposal

Priority NPL framework areas	Proposed actions	Counter-party	Donors	Tentative timeline	Scores March'17	
A.4.	NPL write-offs	(1) Developing draft regulation and recommendations on write-offs	NBU	WB	(1) Oct.'18	4,2
A.5.	Collateral valuation	(1) Drafting legislative amendments on unification of assets valuation before and during court process, increasing supervisory role of the SPF, improving appraisal industry self-regulation; (2) Developing supplementary tools for the NBU to safeguard quality of appraisal in the financial sector	NBU, SPF, MOJ	WB	(1) June'19 (2) Dec.'19	4,5
A.6.	NPL governance /workout	(1) Providing training to the NBU and banks about NPL management Guidelines, (2) Other support to the NBU in Guidelines implementation	NBU, NABU	WB	(1) May'18 (2) Oct.'18	3,9
B.1.	Sale of portfolios	(1) Developing amendments and supporting the draft law on ARCs, (2) Assessment of NPL sales platform and templates implementation	NBU, MOE	EBRD	(1) Dec.'18 (2) Nov.'18	4,4
B.2.	Debt enforcement /foreclosure	(1) Assisting in drafting a new law to strengthen creditors' rights; (2) Assisting in updating existing MOJ regulations that affect judicial proceedings	MOJ	WB, IMF	(1) Aug.'18 (2) Feb.'19	3,9
B.3.	Corporate insolvency	(1) Developing amendments and supporting the draft law 8060; (2) Deliver a 'good practices' workshop on Insolvency and NPL reduction (3) Drafting an improved inter-creditor agreement	MOJ, NBU	IMF, WB	(1) June'18 (2) Sep.'18 (3) Oct.'18	3,8
B.4.	Household's insolvency	(1) Developing amendments and supporting the draft law 8060 (2) Deliver an initial 'good practices' workshop on personal insolvency	MOJ	WB, IMF	(1) June'18 (2) Dec.'18	4,8
B.5.	Judicial system	(1) Establishing cooperation with the NSJ on best practice training for judges of Commercial, Commercial appellate and Supreme courts; (2) Assess court and court related processes for commercial and insolvency cases	MOJ	WB	(1) Dec.'18 (2) Feb.'19	4,4
B.6.	Tax regime	(1) Continuing dialog with the MOF on issuance of tax interpretations	MOJ	WB, IMF	(1) Sept'18	3,9
C.1.	Public registers	(1) Developing amendments and timeline for implementation on smoothing credit assessment among creditors based on the central credit registry	NBU	IMF, WB	(1) Nov.'18	4,0
C.2.	Debt counselling & outreach	(1) Design and execution of debt counseling support to individuals and SME (related to draft law 8060 on insolvency)	MOJ	WB, IMF	(1) Dec.'18	4,9