

Guidelines

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Cross-border financing in Ukraine

Before lending to a Ukrainian borrower, or structuring any transaction involving Ukraine, it is crucial for a foreign lender to know the nuances of the Ukrainian legal environment. Proper awareness and understanding of the existing regulations will ensure secure execution of transactions in Ukraine and minimize the associated risks.

Below we identify a few of the most common and important local law issues relating to cross-border financing in Ukraine.

General provisions on lending

Ukrainian legislation permits Ukrainian borrowers (legal entities and individuals) to receive loans from foreign lenders.

The following are the key elements of the Ukrainian legal regime applicable to such foreign loans.

Parties to the loan agreement

The borrower may be a legal entity, an individual entrepreneur or any individual.

A non-bank borrower is required to appoint a Ukrainian servicing bank for the loan transaction. The servicing bank will monitor the compliance of all cross-border settlements under the loan with Ukrainian legal requirements and liaise with the National Bank of Ukraine (the "NBU") to perform all necessary registration activities.

The lender may be any foreign entity that possesses the capacity to grant such loans under the laws of its jurisdiction. Although the Commercial Code of Ukraine stipulates that a Ukrainian borrower may borrow from a "foreign financial institution," this provision is generally regarded in the market as declaratory rather than restrictive, as confirmed by the practice of the NBU, which registers loans from various categories of lenders (see the *Loan Registration* section of these guidelines).

Applicable law and jurisdiction

The loan agreement may be governed by a foreign law chosen by the parties in the loan agreement, and may provide for the resolution of disputes in or outside of Ukraine by court or arbitration (subject to certain limitations where the court of Ukraine would have exclusive jurisdiction).

The loan agreement must be signed by the parties in bilingual originals: in the Ukrainian language and in any foreign language chosen by the parties.

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The loan agreement must contain the signatures of the authorized representatives of the parties and seals (if available) of parties that are legal entities.

Loan disbursement and settlements requirements

The loan may be disbursed by wire transfer as: (i) payment into the borrower's account with its Ukrainian servicing bank; (ii) payment into the borrower's account with a foreign bank; or (iii) payment to a foreign exporter of goods, works or services to the borrower. Subject to certain exceptions, in case of (ii) above, the borrower is required to obtain an individual license of the NBU for the placement of currency values in a foreign bank account prior to applying for the registration of the loan agreement.

Settlements under such loan agreements may not be in physical cash.

Loan registration

General registration procedure

All cross-border loan agreements (except for commercial loan agreements and agreements on the provision of loans attracted by the state or secured by state guarantees), or receipt of a loan in foreign currency, between a Ukrainian borrower and a non-resident lender, should be registered with the NBU in the respective register. The registration of a loan lapses unless the loan (or any portion thereof) is utilized within 180 days.

The following details are included into the NBU's register: (i) the names of the lender and the borrower; (ii) the principal amount and maturity of the loan; (iii) the interest rate and any other amounts payable under the loan; and (iv) the applicable interest rate cap, as well as certain other information.

Prior to registration, a Ukrainian bank, acting as a servicing bank of the borrower, must sign off on the terms of the loan agreement. It is also required to ensure that all payments are made strictly in accordance with the terms of registration of the loan recorded in the NBU's register.

To be eligible for the NBU registration, the loan agreement must contain a mandatory stipulation that, throughout the term of the loan agreement, the borrower's loan utilization costs will not exceed the amount determined by reference to the maximum interest rate effective at the date of the NBU registration.

Another crucial aspect is to include a clause envisaging that the loan agreement becomes effective only upon (or not earlier than) its registration with the NBU. Otherwise, the agreement's registration will likely be rejected by the latter. This provision does not apply to loans: (i) granted by International Financial Institutions, namely the IFC and EBRD; (ii) guaranteed by the government of Ukraine; or (iii) received by a borrower-Ukrainian commercial bank, provided the loan's maturity does not exceed one year.



As mentioned above, the registration of a loan agreement or amendment thereto (the "**Registration**") is carried out by the borrower's Ukrainian servicing bank via electronic communications with the NBU through the following steps:

- **Initiation of Registration.** The Registration is initiated by the servicing bank at the request of the borrower. The borrower submits to the servicing bank an application accompanied by an original of the loan agreement (amendment agreements and related documents). The lender is entitled to request only registration of assignment of claims under the respective loan as follows: (i) in case the claims are assigned by one non-resident to another or from a Ukrainian bank (which ceases to be servicing bank under the loan) to a non-resident - under joint application of assignor and assignee; or (ii) if the claims are assigned by a Ukrainian bank (which continues to be servicing bank under the loan) to a non-resident - the Ukrainian bank applies to the NBU on its behalf. If the Registration is initiated by the lender, the servicing bank requests additional documents and performs additional checks of the respective transaction and parties thereto.
- **Review of submitted documents by the servicing bank.** The borrower's servicing bank has up to seven business days to review the documents. If the documents comply with the requirements of Ukrainian legislation, then the servicing bank submits by electronic means the documents supplied by the applicant (borrower or lender) together with electronic copies of the notification of the loan agreement (amendments to the loan agreement) filled in by the bank and certain other documents (as may be required in particular cases), to the NBU.
- **Audit of documents by the NBU.** The NBU has seven business days to review the application and either to refuse Registration or to register the loan agreement (amendments thereto). The NBU may request additional documents from the servicing bank. The documents requested by the NBU should be provided within the term established in the NBU's request. The seven-day term for the Registration of the loan agreement starts running from the date of submission of the last document to the NBU. Importantly, the NBU may initiate an additional audit of the submitted documents in case it finds that the loan falls under the criteria of risky financial operations. In this case, the seven-day term starts running after such audit is completed.
- **Notification on registration of a loan.** The NBU registers the loan agreement, enters respective information into the electronic register of notifications about loan agreements and provides to the servicing bank access to the respective records of the register. Accordingly, the servicing bank informs the borrower and the applicant (in case the application on registration was submitted by the lender) about the Registration by sending a written notice not later than on the next day after the Registration.



The loan agreement (except for overnight loans, loans with a maturity not exceeding one year) must be registered before the first disbursement under such agreement occurs. The NBU may inform the tax authorities of a loan disbursed before and/or without its registration. Accordingly, the Ukrainian tax authorities are unlikely to treat cross-border loans favorably if the loans have not undergone registration with the NBU. Thus, receipt of funds without the registration of a loan will incur a fine, alongside further mandatory registration of the respective loan agreement.

Maximum interest rates

To be eligible for the NBU registration, the loan agreement (together with any related fee letters and other documentation) may not provide for costs of utilizing the loan by the borrower (i.e., the aggregate of interest and other payments, except the repayment of principal and payments contingent upon the occurrence of force majeure events) that exceed the statutory ceiling established by the NBU and effective at the date of registration. Such ceiling is determined by reference to the "Maximum Interest Rate," set out by the NBU for the relevant category of loans.

Hence, the NBU sets the Maximum Interest Rate for cross-border loans, which includes interest, default interest, fees, costs and expenses established in the loan.

The Maximum Interest Rate applicable to loans in freely convertible currencies (so-called "foreign currencies of the 1st category") is as follows:

- (a) for fixed interest rate loans:
 - with maturity of up to 1 year - 9.8% per annum;
 - with maturity from 1 to 3 years - 10% per annum;
 - with maturity over 3 years - 11% per annum; and
- (b) for floating rate loans - LIBOR for three-month USD deposits plus 750 basic points.

The maximum interest rate limitation does not apply to loans of investors under the production sharing agreement with respect to such agreement.

Importantly, the NBU may refuse the registration of a loan agreement with an interest rate exceeding the mentioned interest caps. The established rates do not apply to cross-border loans granted by International Financial Institutions.



Also, should the loan agreement be governed either by Ukrainian or by foreign law, a mandatory requirement to specify the maximum floating interest rate increase may apply. Latest developments in this issue predict the elimination - or at least mitigation - of such requirement. However, if the loan agreement lacks such provision, the NBU may refuse registration of such cross-border loan agreement.

Licensing requirements and approvals

Use of foreign currency

As per the general rule, any use of foreign currency on the territory of Ukraine, either as a means of payment or as collateral, may legally be carried out only pursuant to a permit of the NBU issued on a case-by-case basis (the so-called "individual license"). The foregoing rule does not apply to foreign currency transfers performed within Ukraine by a Ukrainian commercial bank or financial institution pursuant to its general license for the carrying out of currency transactions issued by the NBU.

Transfer of foreign currency from Ukraine

Under the general rule, any transfer abroad of foreign currency from Ukraine requires an individual license of the NBU. Among the operations carried out with the license are the following:

- repatriating and transferring funds in Hryvnias into Ukraine, if in excess of the amounts in Hryvnias transferred abroad on legal grounds;
- depositing funds in foreign currency and other "currency valuables" (e.g., securities, banking metals, etc.) in an account or on deposit outside Ukraine (except, inter alia, the opening by a duly licensed Ukrainian commercial bank of a correspondent account with a foreign bank, and the opening by a Ukrainian resident individual of a bank account with a foreign bank for the duration of such individual's stay abroad); and
- investing abroad, including transferring foreign currency abroad in connection with acquiring assets and securities.

Importantly, a foreign investor may repatriate accrued interest without an individual license of the NBU. This rule may also apply to the principal amount of the initial investment.

Yet if the repatriation of the investment is carried out by a foreign investor who did not make an initial investment in Ukraine but who acquired respective rights in the chain of transfers, such investor may face difficulty in purchasing foreign currency for such purpose.



Exemptions to consider are, in particular, as follows:

- transfer of foreign currency abroad by a resident or non-resident individual within the limit of the amount previously imported into Ukraine on a legal basis;
- transfer of foreign currency abroad by a resident in discharge of a contractual obligation in such foreign currency to a non-resident;
- repatriation from Ukraine abroad of the foreign investment in foreign currency previously made in Ukraine upon the termination of the relevant investment activity; and
- transfer of foreign currency abroad by a foreign investor (or its representative office in Ukraine) to other investors based on a production sharing agreement.

Payment restrictions and exchange controls

180-day rule

Settlements under the export or import contracts between a Ukrainian resident and a non-resident may be carried out in foreign currency as well as in Hryvnias. If in foreign currency, such proceeds must be collected on a resident's own bank account within 180 days from the date of the customs clearance of the exported/imported goods. This rule does not extend to the receipt of proceeds for export of services (other than transport services) and intellectual property rights.

This 180-day period may be prolonged only pursuant to a special permit issued by the Ministry for Economic Development and Trade of Ukraine.

Failure to comply with this requirement may result in the imposition of a fine. Such fine is equal to 0.3% of the amount due under the contract for each day of delay in receiving the foreign currency proceeds or the imported goods. The total amount of the accrued fine is limited to the amount of the non-received proceeds or the value of the non-delivered goods.

Temporary FX restrictions

In 2014, the NBU introduced numerous "extraordinary" currency control restrictions in order to settle the situation on the foreign exchange market of Ukraine. Among the current FX restrictions are the following:

- the mandatory sale by Ukrainian banks of 50% of foreign currency proceeds received by Ukrainian businesses from abroad;
- limits on the amount of dividends that foreign investors can repatriate from Ukraine;
- prohibition of early repayment of cross-border loans, subject to certain exceptions;



- restrictions on set-offs under export agreements, subject to certain exceptions;
- prohibition for banks to grant/extend hryvnia loans secured by pledges of funds in foreign currency;
- prohibition on purchasing foreign currency for corporate clients of Ukrainian banks that have foreign currency funds in their bank accounts, subject to certain exceptions;
- limits on monthly amounts of funds to be transferred abroad under individual licenses of the NBU; and
- limits on purchasing foreign currency and transferring it to foreign investors in connection with the sale of shares/corporate rights in Ukrainian companies as well as on repaying capital abroad upon liquidation of a Ukrainian company or decrease of its share capital, subject to certain exceptions.

The restrictions will remain in effect until the Ukrainian financial sector shows strong signs of financial soundness, allowing the NBU to liberalize the existing FX restrictions.

Remittance rule

Additionally, payments for services, works and goods provided by non-residents, the aggregated amount of which exceeds USD 5,000,000, may be performed only upon obtaining a bank's letter of credit which complies with appropriate requirements established by the NBU.

Financial monitoring

If the amount of payment: (i) equals or exceeds UAH 150,000 (currently equivalent to approximately USD 5,700 or EUR 5,100); and (ii) meets one of the additional criteria particularly listed below, it may be subject to financial monitoring carried out by the Ukrainian banking or financial institution.

Financial monitoring applies to the following operations:

- money transferred to an anonymous (numbered) account abroad which has also been opened with a financial institution in a country included by the government of Ukraine into the offshore zone list;
- money transferred abroad without a corresponding foreign trade contract; and
- payment under a foreign trade contract that does not provide actual supply of commodities, work and services to the customs territory of Ukraine.



Collateral

Collateral options under Ukrainian law include mortgages over immovable property, pledges over movable property, assignment of rights, surety agreements and guarantees.

All mortgage agreements in respect of immoveable property and land are subject to mandatory notarization. All other types of security do not require notarization unless the parties agree otherwise. In any event, the benefit of notarizing finance documents is that it enables enforcement on the basis of a notarial writ of execution without the need to obtain a court order.

A mortgage over immovable property and a pledge over movable property should be registered with the Unified State Registry of Property Rights over Immovable Property and the State Registry of Encumbrances over Movable Property. Failure to carry out such registration does not make the security invalid, it will affect the secured party's priority. A mortgage over immovable property should also be registered at the Registry of Prohibitions of Alienation, which will protect the lender from any unauthorized transfer of the collateral.

Immovable property

The ownership of immovable property is one of the most reliable forms of security in financing. A mortgage over the land automatically extends to any immovable property located on the land. Ukrainian law expressly allows objects that are in the process of being constructed to be mortgaged. The mortgagor may construct an immovable object on the land with the right to possess and own the object upon its completion. Prior consent of the land owner, however, is needed to obtain such a mortgage.

Movable property

The registration of any pledge over movable property is only valid for five years. To extend the validity of the registration for another five years, a lender must file a request to extend the registration with such registry before the expiration of the five-year term. Otherwise, there is a risk that lender may not satisfy his/her claims in the event of default of the pledger as the priority right against any other registered pledgee or a liquidator will be deemed terminated.

Corporate rights

Critical for investors is preventing any unauthorized transfer of shares. To do so, once the security is registered with the State Registry of Encumbrances over Movable Property, one has to make sure that it also has been registered with the company's securities registrar and/or the custodian who maintains the securities account of the pledger. Additionally, in order to facilitate enforcement, entering into a conditional sale/assignment agreement is highly recommended.



Bank accounts

A pledge agreement securing money in a bank account is a pledge of property rights. The pledgor may not be restricted from using the money. However, the bank may withdraw money on behalf of the pledgee.

The recent legislative amendments have improved the mechanism for establishing, maintaining and enforcing bank account pledges and provide, in particular, for the following: (i) debit of the pledged account by the pledgee without the need to execute direct debit agreement; (ii) the enforcement of pledged funds through either assignment of the pledged rights to funds in the bank account in favor of the pledgee or sale of such rights to a third-party buyer; and (iii) permission to a bank to refuse to perform any transaction with the pledged funds on the instructions of the account holder if such transaction would decrease the balance of that account below an agreed threshold.

The above amendments also introduced the long awaited concept of escrow accounts.

The amendments are anticipated to become effective soon.

Guarantees (Suretyships)

A surety is a secondary obligation to fulfill the obligations of the principal debtor if they fail to do so. A guarantee, which may only be issued by a financial institution, is an obligation to pay to the creditor a specified sum if the principal debtor fails to fulfill its obligations. Unlike a guarantee, a surety only remains effective while the principal obligation is still in place. Hence, a guarantee will be effective even after the obligation under it is terminated and is therefore preferable, though it may take extra time to agree with a financial institution to act as a guarantor.

Tax registration, interest withholdings and other payments

Foreign legal entities are taxed in Ukraine on the "net" basis with respect to income derived from their commercial activities undertaken in Ukraine through a permanent establishment.

Income derived from sources within the territory of Ukraine by foreign entities, other than through permanent establishments in Ukraine, is taxed in Ukraine on a "gross" basis, being subject to withholding tax ("**WHT**") at the time of the remittance of such income to such foreign entities. Such tax is withheld from the sums remitted, except for income in the form of consideration for goods (works, services), which is generally not subject to WHT.

Withholding tax

Under a general rule, WHT applies at the rate of 15% to Ukrainian-sourced income (including interest, dividends) at the time of remittance to a non-resident, unless otherwise provided by an applicable double taxation treaty. Depending on the period when a loan was provided to a resident, a full exemption or a reduced



5% rate under domestic law may apply to interest paid to a foreign lender under a loan financed by issuing of bonds traded on foreign stock exchanges.

Beneficial ownership

One of the requirements for qualifying for a full exemption or a reduced tax rate available under a double tax treaty is that a non-resident recipient of Ukrainian-sourced income (including interest) meets the beneficial owner test. By law, a beneficial owner of income is a person who "has the right to receive such income." In connection with this, a non-resident acting as an agent, nominee holder or intermediary in respect of such income would not be treated as a beneficial owner.

In determining the beneficial owner status, Ukrainian fiscal authorities would analyze, among other things, the following: (i) functions performed and risks borne by a non-resident; (ii) non-resident's powers with respect to income; and (iii) whether a non-resident (who has very narrow powers with respect to income) transfers all or most of the income to the other non-resident who would not be eligible for reduced tax rates had the income been paid directly to such non-resident.

Whether a foreign lender meets a beneficial owner test should be carefully analyzed on a case-by-case basis.

Gross-up clause

Ukrainian tax law expressly prohibits the insertion of a gross-up clause in agreements for all cross-border transactions, including cross-border loans. Any gross-up clause that is nonetheless included in a cross-border agreement would be invalid. Accordingly, should parties to the agreement apply for registration with the NBU, receipt of rejection of the latter is highly probable.

While additional fees or increased interest are sometimes used in practice to receive the equivalent of the full interest, the said risks would not be completely eliminated. Therefore, to manage such risks, foreign lenders should seek qualified advice on this matter prior to providing loans to Ukrainian borrowers.

Enforcement of Foreign Arbitration Awards and Recognition of Foreign Court Judgments

If a non-resident enters into a dispute with a Ukrainian party, it should be known that foreign court decisions are recognized and enforced in Ukraine based on international (bilateral) agreements or under the reciprocity principle. The latter's existence is presumed unless proved otherwise.

Importantly, a foreign judgment may not be enforced in Ukraine if:

- such a foreign judgment did not come into force;
- Ukrainian authorities possess exclusive jurisdiction over such disputes;



- a Ukrainian court has rendered a judgment or is considering a dispute in the same matter between the same parties; or
- the term for applying for enforcement of a foreign judgment has expired.

Ukraine is a party to the 1958 New York Convention on Recognition and Enforcement of Foreign Arbitral Awards. Foreign arbitration awards are generally easier to enforce than foreign court decisions. A foreign arbitral award is usually recognized as binding and is enforced, provided the appropriate motion is filed with the competent Ukrainian court. The exceptions would be the following:

- the agreement to arbitrate is invalid under the chosen law;
- one of the parties was legally incapable of entering into the arbitration agreement; or
- the losing party was not duly notified of the appointment of the arbitrator or the commencement of the arbitration proceedings.

Notably, the arbitration award may also be unenforceable in Ukraine if the Ukrainian court determines that either the object of the dispute cannot be subject to arbitration under Ukrainian legislation or that the recognition and enforcement of such arbitral award contradicts public policy.

Parallel Debt

Ukrainian law does not recognize common-law security trust. Instead, parallel debt structures can be used to achieve similar commercial effect. Under the latter, parties to the English law-governed syndicated facilities agree that the security agent should be the joint and several creditor of each and every obligation of the borrower towards each finance party.

Although, as with many other civil-law jurisdictions, this security structure has never been tested in the higher Ukrainian courts, it should be recognized in Ukraine.

FATCA

This regulation primarily affects US investors who may want to hold bank accounts in either Ukrainian or foreign banks operating in Ukraine. As per the general rule, a 30% withholding tax applies to all foreign financial institutions and non-financial foreign entities, as defined by FATCA, who refuse to comply with the disclosure requirements.

The Agreement on implementing FATCA was signed between the Ukrainian and US governments on 7 February 2017. It is expected to be implemented in the applicable Ukrainian laws in 2017.



Additional notes

These Guidelines are issued to inform Baker McKenzie clients and other interested parties of legal developments that may affect or otherwise be of interest to them. The comments above do not constitute legal or other advice and should not be regarded as a substitute for specific advice in individual cases.

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