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## **CLEANSING OF THE UKRAINIAN BANKING SYSTEM IN THE LIGHT OF SUSTAINABLE DEVELOPMENT GOALS**

**Abstract.** The cleansing of the Ukrainian banking system, performed in 2014—2016, showed the purpose of the National Bank to break the old models of banking and ensure sustainable development of the banking system and Ukraine as a whole. At the same time, the cleansing of the banking system was revolutionary, affecting not only the owners but also the broad sectors of society and the business entities, who suffered losses. Due to high relevance and social impact, discussions about the root causes, methods, and consequences arose. This article aims to establish the compliance of cleansing the banking system of Ukraine with the goals of sustainable development.

In this study, we considered the provisions of economic theory and the theory of banking systems, taking into account the spirit, ideals and principles of sustainable development. This study has the structure as follows. Firstly, we performed a theoretical analysis of the evolutionary and revolutionary types of banking reforms. Then we conducted a historical-economic analysis of the events that preceded the beginning of the cleansing of the banking system. In the central part, we analyzed the generalized causes and specific problems that led to the withdrawal of banks from the market in the primary wave of cleansing. Finally, we singled out three groups of NBU's comments on the liquidation of specific banks. We established their close connection with the implementation of task 8.3 of the eighth Sustainable Development Goal.

We pointed out some discrepancies between the reasons for the liquidation of individual banks and the comments of the NBU. Therefore, we have suggested combining comments into groups which more clearly reflect liquidation reason. Such groups include non-compliance with stakeholders, lack of bank recovery strategy and resources, and misbehaviour by shareholders, insiders, and related parties. Finally, we reaffirmed the revolutionary nature of the reform. We proved that, despite the losses, its absence, in the longrun, could have made it impossible to meet Task 8.3 of the Eighth Sustainable Development Goal.

Promising are as of further research are comparing the procedure and results of cleansing the banking system in Ukraine and foreign countries.

**Keywords:** banking system, cleansing, liquidation, banking reform, sustainable development.

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## **ОЧИЩЕННЯ БАНКІВСЬКОЇ СИСТЕМИ УКРАЇНИ У СВІТЛІ ЦІЛЕЙ СТАЛОГО РОЗВИТКУ**

**Анотація.** Очищення банківської системи України у 2014—2016 рр. показало рішучість Національного банку у зламі старих моделей банківництва і прагнення забезпечити сталий розвиток банківської системи та України в цілому. Разом з тим очищення банківської системи мало революційний характер, зачепило інтереси не лише власників банків, а й широких верств суспільства і підприємниці, котрі зазнали втрат. Це породило дискусії щодо першопричин, методів і наслідків очищення. Метою цієї статті є встановити відповідність процесу очищення банківської системи України цілям сталого розвитку.

Це дослідження виконано на основі положень економічної теорії, теорії банківських систем у дусі ідей і принципів сталого розвитку. Спершу ми здійснили теоретичний аналіз еволюційного та революційного типів реформ у банківському секторі. Тоді провели історико-економічний аналіз подій, що передували початку очищення банківської системи. В основній частині проаналізували узагальнені причини і конкретні проблеми, які призвели до виведення банків з ринку в основній хвилі очищення банківської системи. Виокремили три групи коментарів НБУ щодо ліквідації конкретних банків і встановили їхній тісний зв'язок із виконанням завдання 8.3 восьмої Цілі сталого розвитку.

За результатами проведеного дослідження вказали на деякі розбіжності між причинами ліквідації окремих банків і коментарями НБУ, у яких описано індивідуальні

проблеми в банку на момент ліквідації. Запропонували об'єднання коментарів у чіткі групи, що відображують нову або модифіковану причину ліквідації. До таких груп належать невиконання зобов'язань перед стейкхолдерами, відсутність стратегії та ресурсів оздоровлення банку і поведінка акціонерів, інсайдерів і пов'язаних осіб. Ми підтвердили революційний характер запровадженої реформи і довели, що, попри понесені втрати, її відсутність у довготривалій перспективі могла унеможливити виконання завдання 8.3 восьмої Цілі сталого розвитку.

Перспективними напрямками подальших досліджень є порівняння процедури і результатів очищення банківської системи в Україні та іноземних державах.

**Ключові слова:** банківська система, очищення, ліквідація, банківська реформа, сталий розвиток

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**Introduction.** Since gaining independence, Ukraine has suffered from parasites that spread chaos in the political and socio-economic systems. For a long time, the country was under the decisive influence of a symbiosis of odious politicians, former criminal authorities and traitors. As a result of implementing criminal community models in public administration, corruption, financial and economic violations, and banal budget thefts have become unacceptable. Boldly, during Yanukovich's rule, the country turned stern to Europe and moved in the direction of Eurasian integration.

Fortunately, the Revolution of Dignity thwarted the imperialist plans of the eastern neighbour. However, the revolutionary way of development always leaves behind many unresolved issues. One of such issues for Ukraine was the banking system's functioning, which has undergone significant mutations due to the former government's actions. After the Revolution of Dignity, the renewed political and ideological system required immediate reforms in the banking sector, which began in early 2014. The reforms were wanted and met the requirements of Ukraine's Western partners, but the way they were carried out was criticized. In the minds of ordinary citizens, the process of cleansing the banking system is still associated with the loss of bank deposits and the devaluation of the national currency.

**Analysis of researches and problem statement.** Unfortunately, according to analysis of Publons and Science Direct databases, the cleansing of the banking system in Ukraine has not attracted the attention of foreign researchers. Barisitz S. & Lahnsteiner M. analyzed mainly the nationalization of Privatbank and addressed the issue of cleansing the banking sector and the subsequent challenges facing the National Bank of Ukraine and the government [1]. Repko M. analyzed the Ukrainian crisis of the banking system and its purification through the prism of the concept of the rule of law and proved the close connection between the weak judicial system and the degradation of banks [2]. International expert groups also carried out the analysis of the 2014—2016 events in Ukrainian banking system. For example, the expert group «The German Economic Team» conducted a comprehensive assessment of past reforms in the banking sector of Ukraine [3].

We also observe a limited number of studies in Ukraine. Ramskyi A. et al. studied the process of stabilization of the banking system in light of Ukraine's European integration prospects [4]. Mihus, I. et al. assessed the quality of anti-crisis reforms in banking [5]. Rodionova, T. et al. analyzed data on the processes in the banking system of Ukraine in the period 2014—2018 in order to identify the main trends of stabilization and problems that arose during the reforms [6]. Koriahina T. V., Simon A. P., Teliatnyk V. M. analyzed the leading causes and consequences of cleaning the country's banking system. The authors, however, did not consider the impact of reform on achieving goals of sustainable development in Ukraine [7].

Thus, the 2014—2016 reforms in the Ukrainian banking system have not been studied considering their consequences on the opportunities for sustainable development, particularly the implementation of the Global Sustainable Development Goals.

The concept of sustainable development often becomes a methodological basis for research on banking systems and reforms. Despite using the «sustainability» concept in banking research to

denote the state and model of development of banks themselves, rather than the environment [8; 9], many researchers pay attention to the role of banks in the overall process of sustainable development. For example, Moufty S., Clark E., & Al-Najjar B. [10] found a significant positive relationship between the internal social dimensions of sustainability and the bank's performance. Shuang W., Ji-heng W., Bing L., & Xiao-wen Y. [11] emphasized the social role of banks in the sustainable development of local areas. Ziolo M., Bąk I., Cheba K., & Spoz A. [12] emphasized the potential of the banking system to influence companies with a transparent business model operating in the ESG-sensitive sectors. Some researchers criticized banks environmental impact in the framework of the sustainable development theory. The main reason for criticism is the financing of industrial projects related to environmental pollution [13].

In our study, we also relied on the results of studies by Vicen V. et al. on the functioning, social responsibility and transparency of large enterprises for sustainable development in Ukraine after the Revolution of Dignity [14]. Furthermore, we took into account the results of research by Yevstakhevych A., & Von-Nahy I. K. on the content, structure, and prerequisites for implementing the concept of transparent social responsibility of enterprises, which provides for effective and open interaction with stakeholders [15].

In this article, we intended to analyze the main wave (2014—2016) of banking system clean up in the light of a sustainable development approach. In other words, we want to end the debate on the appropriateness and method of carrying out these reforms, taking into account the ideas and principles of sustainable development. Thus, the purpose of the article is to establish the compliance of 2014—2016 reforms in Ukrainian banking system and the goals of sustainable development.

**Methodology and research methods.** This study is based on the provisions of economic theory and the theory of banking systems, ideas and principles of sustainable development. Firstly we conducted the theoretical analysis of the types of banking sector reforms. Then we provided a retrospective analysis of the circumstances that preceded the beginning of the cleansing. In the main part, we analyzed the generalized causes and specific issues that led to the withdrawal of banks from the market in the main wave of cleansing. Finally, we grouped the NBU's comments on the liquidation of specific banks and established the connection with Sustainable Development Goals.

We obtained the results using the following methods: retrospective analysis (to generalize the timeline from the financial and economic crisis to the main wave of banking system cleansing), induction (to postulate the prerequisites for cleansing the banking system), content analysis (to process the NBU's data on withdrawn banks), abstraction (to establish the boundaries of the study), synthesis (to group the NBU's comments on liquidated banks), interdisciplinary analysis (to establish the compliance of the banking system cleansing procedure with the Sustainable Development Goals).

The information base of the study was the scientific works of Ukrainian and foreign authors, expert comments, data from the National Bank of Ukraine, Internet resources.

**Research results.** Continuous development is the fundamental basis of human civilization and the key to its prosperity. Development is accompanied by changes — in culture, worldview, behaviour of individuals and organizations. Individuals can respond to changes quite dynamically. Retail consumers, small businesses, and microfinance institutions rapidly adapt to change and find their place in the new economic and social conditions. However, in the banking field, changes are based on a legislative basis, and legislative activity has a lengthy procedure, depending on the political will and the situation.

Timely small-scale reforms in the banking sector strengthen banks' ability to meet the demands of the times and participate in sustainable development processes [16]. Such reforms are evolutionary, and they harmonize with the previous history of the country's banking sector. Furthermore, the implementation of these reforms is not carried out under the pressure of insurmountable circumstances but is aimed primarily at further improving the banking system, policies and procedures.

Revolutionary reforms are the opposite of evolutionary ones. Economic history has many examples of successful (and not very) revolutionary reforms. Most often, however, reforms of this

type do not modify the banking sector but focus mainly on institutional transformations, simplification of business conditions, development of individual territories, etc. [17]. These reforms often contradict previous governments' policies and are carried out under pressure (from society or foreign partners). They can lead to a short-term decline in economic and social indicators, but they can yield incredible results via precise implementation without sabotage. The well-known examples of revolutionary economic reforms relate to successful market transformations in Eastern European post-socialist countries which already join the European Union.

For the banking sector, revolutionary reforms are uncharacteristic because of a simple but always relevant rule attributed to J. Rockefeller: «Big money likes silence» [18]. Discussion of evolutionary reforms appears mainly in specialized publications and is of interest to banking professionals. Revolutionary transformations are usually gaining publicity and concern various segments of the population. In the latter case, human cognition and memory property is also manifested when negative news is remembered better than positive news. Therefore, any failures, omissions or natural negative consequences of revolutionary transformations in the banking sector have long caused publicity and negative perceptions of government and national bank policies.

Until 2009, when the echo of the global financial and economic crisis swept through Ukraine, there was no demand for a revolutionary transformation of the banking system, neither in society nor in politics. However, according to history, due to the spirit of the old Ukrainian political system, domestic banks sought salvation in informal relations rather than in sustainable transformations.

The financial and economic crisis of 2009 revealed the inability of banks to perform economic, financial and social functions fully. Pre-crisis economic policy was based on increasing consumer lending at the expense of foreign resources. However, the real sector of the economy did not receive enough attention from the government [19, p. 2].

The government has to take decisive action and review economic policies to overcome the effects of the crisis. However, the anti-crisis policy was ineffective. Shkura I. and Peitsch B. stressed that the government had to solve numerous economic problems to restore the financial and banking system after the crisis. In addition to the shortage of currency derivatives and lack of long-term resources, the government had to remove the political uncertainty and instability of the financial system, streamline the rules of trading in bank shares, improve communication with the public about the banking system and the threat of devaluation [20, p. 40].

Thus, in the post-crisis years, a vicious circle was established. The government's inability to finally overcome the consequences of the global financial crisis has strictly complicated the dynamic development of the banking system. On the other hand, banks starving from lack of capacity could not fully participate in the national economy's financial stabilization and sustainable development. The economic aspect of this problem is quite fully described by M. Szczepański and M. Khmelyarchuk [21]. However, after the Revolution of Dignity, another aspect of banks failure became clear — corruption [4].

In its analytical paper on the «major banking cleanup», the National Bank of Ukraine avoids direct allegations of Yanukovich's government's involvement in weakening the banking system. Instead, experts argue about the institutional insolvency of banks, which arose and was maintained due to the «oligarch» status of their owners, who were eligible to solve issues in illegal or semi-legal ways [21]. At the same time, «de-oligarchization» of the banking system during cleansing provoked a disturbance in the information space due to speculations about the possible political persecution of oligarchs who supported the previous government. Explaining the de-oligarchization aspect of cleansing the banking system, the former head of the NBU V. Gontareva pointed out a struggle against «oligarchic banking», which consisted of implementing a scheme to finance the oligarch's business based on borrowed funds. If no such scheme was implemented, the bank continued to normal functioning even being in ownership of oligarch (like in the case of the V. Pinchuk and R. Akhmetov banks) [23].

Let us take a closer look at the reasons for the liquidation of banks. The National Bank of Ukraine presented a brief overview and complete data on the list, chronology, and reasons for the

withdrawal of banks from the market [24]. These data cover the period from 16.01.2014 to 11.08.2021.

The NBU identified five main reasons (R) that could trigger the bank's withdrawal from the market: R.1 — loss of capital or liquidity; R.2 — problems identified during financial monitoring plus cash and fraudulent violations; R.3 — functioning on the territory of the Autonomous Republic of Crimea or the ATO zone; R.4 — decision of the owner; R.5 — the lousy business reputation of owners or management. In addition, the withdrawal comments include other issues that sometimes extend the meaning of R.1 to R.5.

First, we note that most liquidations in 2014—2016 (the main wave of cleanup) was due to violations of R.1, in exceptional cases — R.2. Much less often, the NBU recorded R.3 — R.5, and seldom they were the cause of liquidation in themselves.

Secondly, the NBU's comments are sometimes debatable, but they explain the reason for the bank's liquidation much better than R.1 — R.5. A detailed analysis of the comments may be the subject of a separate study. So instead, we will focus on just a few critical comments that illustrate the NBU's response to threats to sustainable development.

The first large group of comments includes the loss of liquidity and default to stakeholders. The comment on the loss of liquidity practically does not change its form. Instead, «default» reason in some cases took the following forms:

- non-repayment of the NBU loan;
- inability to fulfil its obligations;
- non-fulfilment of the obligations for bank capitalization undertaken by the shareholder;
- the presence of unfulfilled obligations to customers;
- hidden non-fulfilment of obligations to clients;
- hidden non-fulfilment of obligations (for ex. non-payment of the salary to moners of State Enterprise «Coal of Ukraine»);
- NBU inspection revealed non-fulfilment of obligations to customers;
- inability to meet its obligations to depositors and other creditors;
- the bank ceased to fulfil its obligations to depositors, other creditors and the National Bank of Ukraine, to which it also owed refinancing loans;
- non-fulfilment of guarantees provided to clients by Union Standard Bank.

The second group includes comments related to the lack of strategy and resources for the recovery of the bank:

- non-compliance with the requirements of the NBU regarding the provision of a financial recovery plan;
- lack of an acceptable plan for the financial recovery of the bank;
- there is no real plan for financial recovery;
- lack of real sources of funds to improve the financial situation and restore solvency.

The third group includes comments related to the behaviour of shareholders, insiders and related parties:

- lack of shareholder support;
- non-fulfilment by shareholders of the bank's capitalization obligations;
- management and owners of significant participation of the bank took measures to meet the requirements for recapitalization... but this was not enough to meet the requirements of the NBU to recapitalize the bank;
- the shareholder undertook written commitments to maintain the bank's liquidity at the expense of proceeds from the sale of its non-core assets... did not do so within the prescribed period;
- lack of real support of shareholders, the Chairman of the Supervisory Board took his interest in sub-debt placed in the bank;
- detection of conflict of interest in the bank;
- the catastrophic volume of lending to shareholder-related companies;

- attempts of owners to withdraw funds from the bank;
- withdrawal of funds by insiders (during the period in a problematic state).

The development of the banking system is one of the tasks within the framework of sustainable development goals. Task 8.3, which refers to 8 SDGs, was formulated as follows: «Strengthen the capacity of domestic financial institutions to encourage and expand access to banking, insurance and financial services for all» [25]. The identified problems that led to the launch of the procedure for cleaning up the banking system in Ukraine are direct evidence that the withdrawn banks did not function as sustainable development partners with goal eight and task 8.3. These banks abandoned the principles of social responsibility and often caused direct damage to the state, businesses, and individual depositors. Moreover, the actions of these banks were aimed at illegally enriching certain groups of people or solving the problems of personal business of their owners.

The possible social explosion and significant threats to sustainable development in the social sphere were offset by clear and effective actions of the Individual Deposit Guarantee Fund. In most cases, more than 90% of individuals received full compensation from the DGF. Moreover, funds of legal entities and debt on refinancing did not exceed the amount of total assets on the date of the decision on insolvency.

Of course, there were losses, both financial and reputational. These were the inevitable waste that arose in the case of any revolutionary transformations. However, following the recommendations of international partners to stabilize the situation in the banking sector, the NBU has made a significant contribution to the country's sustainable development for decades to come.

In 2021, S&P experts inspected the Ukrainian banking sector. They stressed that «Ukrainian banks are well equipped to fight the economic shock of 2020—2021 thanks to the National Bank of Ukraine's (NBU) system clean-up, increased capital and liquidity cushions, and strengthened banking regulation and supervision» [26]. M. Ormotsadze noted that to some extent, confidence in banks had been restored [22]. A. Melnychenko stressed the existence of several unresolved issues in the legal field, but in general, noted that «the banking system has recovered from the long-term bankruptcy in Ukraine» [27]. In September 2021, the Chairman of the NBU K. Shevchenko announced on his Facebook page that the banking sector's net profit increased by 40% compared to the previous period and is the highest in ten years. Lending to businesses and individuals is growing, and the stress test has identified only four banks that need to take additional measures to reduce the risks of their activities [28].

In the end, we conclude that the reform of the banking sector was a painful but inevitable task in the framework of Ukraine's European integration aspirations and in light of the implementation of the Sustainable Development Goals. The future seems bright. Maintaining high-quality banking regulation will keep the banking sector at the level necessary for European integration and support financial initiatives to ensure the implementation of other sustainable development goals.

**Conclusions.** In this study, we reviewed the historical background and specific reasons for the banking system cleansing with the focus on the main wave of cleansing (2014—2016). We pointed out some differences between the synthetic reasons for the banks liquidation of and NBU's concrete comments describing individual problems in the bank at the time of liquidation. We grouped individual comments into groups which more clearly reflect liquidation reason: non-compliance with stakeholders; lack of strategy and resources for the bank's rehabilitation; misbehaviour of shareholders, insiders and related parties. We have established the revolutionary nature of the reform implemented and proved that in the long run its absence, despite the losses incurred, may have made it impossible to meet Task 8.3 of the Eighth Sustainable Development Goal.

Promising areas of further research are comparing the procedure and results of cleaning the banking system in Ukraine and foreign countries.

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