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Banking: Part 2

Banking Crisis:
What Rock-Bottom Will Feel Like

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Editors' Note

Banking sector still not out of woods

This is the 12th edition of the Kyiv Post's Legal Quarterly, meaning this "new" product is coming to the end of its third year. It was born on March 28, 2014, only a month after President Viktor Yanukovich fled the EuroMaidan Revolution.

We are grateful that it has found a place in the market. We are still experimenting with the format, but have evolved to one in which each issue takes an in-depth look at a single topic and its legal ramifications, such as banking, customs, taxes, budget, courts, prosecutors and so on. We also are listening to those of you who want more profiles of people in Ukraine's legal community. We agree. Expect these changes and more in 2017.

This is the first edition in which we've repeated a topic: Banking. Our first banking issue came out on July 1. But so much keeps happening. The biggest bombshell is the nationalization of PrivatBank, which accounts for 20 percent of the sector's \$53 billion in assets. It has been a train wreck that will cost taxpayers at least \$5.6 billion (Hr 148 billion) to bail out. How much of the losses were due to fraud, insider lending or embezzlement? We'll probably never know, given how poorly Ukraine's politicized regulators and law enforcers work. But National Bank of Ukraine Governor Valeria Gontareva, at a Dec. 19 press conference announcing the nationalization, estimated related-party lending at a whopping 93 percent of PrivatBank's loan portfolio and said the bank had not kept required reserves for nearly a year. The only real questions are why authorities didn't act earlier and what penalty will former owner, billionaire oligarch Ihor Kolomoisky, suffer. The chances of Kolomoisky facing any criminal or civil penalties are non-existent, in our opinion. There's simply no history of prosecuting powerful people in this country, no matter what they do.

Meanwhile, taxpayer losses keep mounting in Ukraine's free-for-all banking sector. After PrivatBank, the costs are likely to top \$20 billion from the orgy of insider lending and unpaid loans. The banking sector may yet revive, but it's way too early to say it has recovered.

All of our contacts are available online at <http://www.kyivpost.com/contacts/>

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Money – what else is there when writing about banking? (Top left) Today's cover: The National Bank of Ukraine shows the new Hr 500 note. (Bottom left) Part 1 of our banking edition came out in July, but losses have grown considerably since then. (UNIAN)





Ukraine's banking sector resembles a piggy bank that was emptied out due to bank fraud, embezzlement and unpaid loans to insiders. The staggering costs since 2014 are expected to exceed \$20 billion before recovery. (Courtesy)

Credit expansion still weak after financial crisis

Usually commercial banking expands sharply after a major financial crisis. But that is not happening in Ukraine for many reasons, including the fact that borrowers have a bad habit of not repaying their loans.



By Anders Aslund

The more one delves into banking in Ukraine, the more difficulties emerge. As soon as one problem has been resolved, a new one appears. The problems are many but they can be resolved.

The first big headache is to get paid. Especially big Ukrainian businessmen have a habit of not paying anybody, which is a convenient way of enrichment for many in the elite.

To begin with the legal base needs to be improved. Creditors' rights need to be reinforced so that bankers can claim collateral of debtors and sell it off in case they do not pay. Half a dozen laws need to be promulgated.

The next problem is the judicial system, about which nothing positive can be said. The Prosecutor General's Office is famous for not going after important people, while it is



Anna Sisetska
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Brief review of Ukrainian banking system in 2016: is there any hope to restore?

The economy and the banking system of Ukraine in 2016 continue to be affected by the problems of 2014-2015. Hryvnia devaluation, aggression of the Russian Federation in Ukraine, insufficient corporate governance and the subsequent loss of confidence led to a deterioration of the banks' loan portfolio. All the above-mentioned have caused an outflow of deposits, freezing or substantial limitation of lending, and currency fluctuations, which has negatively affected the financial standing of many Ukrainian banks. Due to rising negative debts, banks had to create significant reserves for active operations, which inevitably had a negative impact on the level of capitalization of banks. In 2014-2016 the number of banks decreased significantly. In early December 2016 only 97 banks still had a banking license as compared to 180 banks in early 2014 according to the NBU.

Although the situation is not so hard as it was in 2014 and certain positive symptoms become apparent, it is still too soon to speak of abatement of the banking crisis. The Ukrainian banking system is currently in the middle of a reformation stage.

In December 2016, the NBU extended currency restrictions that have been effective for more than two years. Although they have a temporary nature, their validity period has not been defined this time. Definitely, such restrictions should neither replace the reform, nor be the reform itself. It is only swift actions of Ukrainian state authorities and regulators based on a comprehensive strategy that can bring the weakened banking sector of Ukraine back to health. Of course, the NBU and the government have succeeded in stabilizing the situation and even brought to life certain highly anticipated liberalizations. They include the liberalization in the market of importing services which implies the cancellation of price examination certificates by Derzhzovnishinform SE and the Ukrainian translation of the supporting primary documents, as well as removing barriers to export of services by the Law that became effective on December 3, 2016 making it legally possible to execute agreements by means of correspondence exchange and issue of invoices.

However, the NBU independently continues monitoring the currency transactions and may block any transaction the NBU believes to be risky, non-compliant with the law or posing a real or potential threat to legalization of proceeds from crime. As such, there is still much work to be done in order to put in place a modern and sound banking system which is adequately supervised. In particular, it is highly important to complete the internal reform of the NBU to change their functionality and establish within the mentioned process a bank and an export credit agency for supporting small businesses. Also, it is the matter of priority to take measures allowing to cancel currency restrictions that foreign investors name among the reasons keeping them from entering the Ukrainian market. All these restrictions refer, among other things, to the (a) established maximum allowable 120-day period for settlements under export and import transactions, (b) effective prohibition of early repayment of foreign currency loans to non-residents, although a debt-into-shareholder equity conversion is allowed, (c) mandatory sale of 65% of foreign currency earnings, (d) prohibition on dividends distribution for the period preceding 2014-2015 or in amounts exceeding USD 1 mln or 10% of the total amount of payable dividends during one calendar month, (e) prohibition on purchase and transfer of foreign currency for the purposes of returning abroad the funds received from sale of corporate rights in Ukrainian entities, corporate rights in Ukrainian entities, and funds received from Ukrainian entities' capital reduction or as a result of withdrawal from participation in the same, (f) prohibition on purchase of foreign currency at the instruction of a resident company that has foreign currency funds held in current and deposit accounts in an amount exceeding USD 25,000.00 or an equivalent thereof in any other currency, with a few exceptions.

The concept of a new currency control regulation for 2017 approved by the NBU provides for elimination of those restrictions in the context of EU integration aimed at increasing the export potential of our country. It remains to hope that the mentioned will be implemented in addition to making structural changes in the banking system of Ukraine. All of this is important not only for restoring confidence in the banking system and its attractiveness to foreign investors allowing to solicit accounts, but also to ensure quality improvement and risk mitigation for banking services, a high level of protection for consumers and financial intermediaries and to increase the role of the banking system in the sustainable economic growth of Ukraine.

seemingly quite successful at extortion. A new real office of prosecution needs to be built up with new staff.

The court system seems to get worse the higher up a matter gets. Therefore, serious cases are likely to lose. If contrary to expectation a sensible verdict is passed, the collection services of the Ministry of Justice have a rather poor reputation of not collecting. Private collection services have too restricted rights, which should be broadened.

In addition, Ukrainian banks have three big problems, their biggest customers, their managers and their owners. Many members of the Ukrainian elite enjoy parliamentary immunity, which they also apply toward banks. Senior members of important committees feel particularly immune, especially if their committee deals with economic matters, as most do. Quietly, a number of major Ukrainian banks not managed by their owners have seen a complete change of management. The rumor has it that a habit of kickbacks of 10 percent of unjustified loans developed under the years of President Viktor Yanukovich, who fled the EuroMaidan Revolution on Feb. 22, 2014.

The worst problem of Ukrainian banks, however, tends to be their owners. The owner of a bank has usually a capital of about 1/10 of the bank's assets, that is, its loans. Under Yanukovich, many bank owners developed a habit of giving 80 percent of the loans to themselves. As they wasted their funds, their banks went bankrupt and their poor depositors lost their money. This has been the main reason for the National Bank of Ukraine closing down almost half of the country's 180 banks in the last three years.

The NBU needs to do more. It needs to complete the closure of substandard banks. Statements are often made that the end goal is 50-60 banks. The NBU has sufficient capacity and routine to head for that target right now, so that people know that the bank cleansing is completed. The big remaining question is what will happen with PrivatBank, and it alone accounts for one-fifth of the banking assets in the country.

How can banking be pursued under these conditions?

Admittedly most have failed, but most hazards can be handled. To begin with, a bank needs to secure sufficient collateral and make sure that it can be seized and sold. As a rule, banks should avoid big clients enjoying legal or actual immunity, while a significant bank can make life sufficiently hard for a small or medium-sized debtor. Management needs to be checked with rigorous corporate governance and good audits.

Finally, bank credits need to be affordable. At present, the NBU policy rate has stabilized at 14 percent a year, and the consumer price index at 12 percent a year. Corporate loan rates have declined but stay high at 17 percent. Most borrowers have to pay far higher interest rates. Scarcely, the NBU estimates non-performing loans at the high level of 30 percent of all loans.

Usually, commercial banking expands sharply after a major financial crisis. Logically, it should start now, but so far credit expansion has barely begun.

Anders Åslund is a senior fellow of the Atlantic Council in Washington and a member of the supervisory board of Bank Credit Dnepr. ■



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A woman with a whistle tries to stop a police car carrying a detained protester during a rally of people who lost their money in the failed Bank Mikhailivsky on Khreshchatyk Street on Nov. 3. (Volodymyr Petrov)

Why many at the top don't want to talk about asset recovery



By **Brian Bonner**
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Many in Ukraine and in the world want to talk about how Ukraine will recover the \$40 billion in assets stolen since 2010, more than a quarter of it from the corrupt and dysfunctional banking sector.

But the ones who can do the most about solving the problem are also the least eager to talk about the mess: President Petro Poroshenko, Prosecutor General Yuriy Lutsenko, Deposit Guarantee Fund director Kostyantyn Voroshylyn and National Bank of Ukraine Governor Valeria Gontareva. Also on the list are many of the nameless, faceless, corrupt judges among a pool of 7,000 who are hiding behind their robes, their bribes in Ukraine and their 97 percent disapproval rating from the public.

To say this is a national disgrace doesn't begin to describe the sad situation.

To recap: Ukraine had no effective banking regulation before 2014 – the central bank didn't know who owned the

banks and granted big refinancing loans without personal guarantees or collateral.

Today's regulation remains suspect, despite the international accolades heaped in some quarters on Gontareva, who, despite her shortcomings, remains the best and most transparent person to lead the central bank.

This scandalous pre-revolution environment allowed for the most massive bank robbery in independent Ukraine's history: At least \$14.5 billion in losses through insider lending and bank fraud. In a lot of cases, "insider lending" was simply the polite term for "embezzlement."

More than 80 banks crashed this way – imploded in the multibillion-dollar orgy of bad lending by insiders who, of course, stuck suffering Ukrainian taxpayers with the bill that they keep on paying.

How many criminal cases have been forwarded by the central bank and Deposit Guarantee Fund for investigation? At least 3,500.



Andriy Olenyuk
Partner,
EVERLEGAL

Export credit agencies and opportunities for solar energy projects in Ukraine

How many bank owners are charged with fraud or convicted of fraud? 0.

How many civil lawsuits have been filed to recover assets from failed banks? Only 7, at least by the Deposit Guarantee Fund, according to its deputy managing director, Andrii Olenchuk, despite the fact that civil lawsuits offer the best opportunity to recover the money.

How much of the lost \$14.5 billion has been recovered, frozen, seized or repaid?

Estimates vary, since no person or agency coordinates this hunt, but the answer is far less than 10 percent of the total amount looted.

Those officials who are brave enough to show up to conferences, like the Kyiv Post Tiger Conference on Nov. 29 and the International Asset Recovery Conference in Kyiv on Dec. 15-16, usually offer up excuses to explain the failure to bring justice to Ukrainians and money to the treasury.

The Deposit Guarantee Fund, which has paid out \$3 billion in losses to insured, and the National Bank of Ukraine, which is owed another \$3 billion, blame prosecutors for not filing criminal charges in obvious, clear-cut cases of fraud.

Prosecutors, in the rare moments where they will discuss the issue, say the central bank and Deposit Guarantee Fund submitted cases with weak evidence.

And the uninsured depositors, who are owed more than \$5 billion, are seething with anger at what they view as a rigged, corrupt, insider system now run by President Petro Poroshenko for his benefit and the benefit of his friends and cronies and other untouchable oligarchs or lawmakers.

Some of the powerful elite, who think they should be allowed to keep what they have stolen, are trying to run out the clock.

There is a five-year statute of limitations for liquidating insolvent banks. There's a three-year window for filing civil lawsuits.

All of the bank failures, reducing the size of the sector from 180 banks to only 100 today on the way to 50-60 banks, are turning out to be a mere warm-up to the big bombshell that is about to explode.

PrivatBank, which controls 20 percent of the nation's banking assets, is on the verge of collapse due to insider lending on a scale unrivaled by any other banks.

The bank's insured deposits are estimated at Hr 100 billion – a sum equal to the entire payouts to date by the Deposit Guarantee Fund. One could assume that the uninsured deposits are at least as much, another Hr 100 billion – for \$7.5 billion in taxpayer losses altogether.

Getting wind of what is ahead, people have been lining up to get their money out even as PrivatBank's owner, Ihor Kolomoisky, says there is no need to panic.

As I understand from insiders, the government was set to announce that it has taken control of the bank and its increasingly worthless assets, but the state in ownership of the three largest banks.

The big question is whether Kolomoisky will pay criminal or civil penalties for the bank's collapse. But it is not much of a mystery. No powerful person has ever been brought to justice in Ukraine – let alone one of the five most powerful people the nation.

So, congratulations and my sympathies, suffering Ukrainian taxpayers: You now own the three largest banks in Ukraine – UkrExImbank, the historical piggy bank of the president; Oschadbank, the historical piggy bank of the prime minister, and now the hollowed-out PrivatBank, which appears to have been the piggy bank of Kolomoisky.

Let's all hope that money starts growing on trees. ■

This year the development of "green energy" power plants, such as solar plants, has gained momentum. This is largely because of the attractive feed-in tariffs and the government guaranteed off-takes of all produced energy by the state-owned entity. Of course, there are also hurdles and uncertainties that prevent the sector from developing at a higher gear. Possible public pressures on the government to cut feed-in tariffs, predictability of securing feed-in tariff, land allocation and grid connection are among a few. Another important factor is the need to import large portions of equipment and materials needed for solar projects from abroad and pay significant amounts in hard currency. Given the lack of affordable financing for developing new projects in Ukraine, having necessary funds handy is not easy. Local banks do not offer favourable conditions for Ukrainian businesses under existing circumstances.

Considering the above, Ukrainian businesses are looking for financing abroad, including from export credit agencies ("ECAs") to secure so much needed funding. But what ECAs have on the table for such projects?

ECAs are usually public or quasi-public agencies that provide financing to exporters or importers to facilitate cross-border trade. The financing is provided by way of direct loans or guarantee and insurance covers. The official list of ECAs can be found on the OECD web-page (for example, EDC in Canada, Euler Hermes in Germany, Atradius in Netherlands, KEXIM in Korea). Overall, the financing provided by ECAs has certain advantages over regular corporate financing and is commercially attractive both for large companies and small and medium enterprises because of lower interest rates, mid- and long-term maturity periods and the exporters' ability to receive funds directly from ECAs and not from importers.

In the case of a direct loan, a Ukrainian developer can request an ECA to fund a purchase of equipment and materials from an exporter in the country of the ECA's origin. Requirements to such requests and to the relevant sale and purchase contracts depend on the ECA. Therefore, interested importers should get acquainted with such requirements in advance before making any arrangements with exporters. Often in such case, an importer signs a financing agreement with the ECA, which, in turn, pays for the equipment under a sale and purchase agreement directly to the exporter. The importer then must repay the loan to the ECA on the terms of the financing agreement between such importer and the ECA.

Another product provided by ECAs is the guarantee and insurance covers. Such covers are usually provided by ECAs to financial institutions (such as banks) that finance the purchase of goods from foreign sellers. That way, the ECAs act as guarantors and the financial institutions act as financiers extending financing.

Regardless of the stringent capital flow controls introduced in Ukraine, the National Bank of Ukraine expressly allows for a possibility of ECA financing for Ukrainian borrowers without funds hitting bank accounts in Ukraine. Under the applicable regulations, Ukrainian borrowers or banks can obtain and repay loans in hard currency to finance imports, provided that such loans are provided with the participation of a foreign ECA, which country of registration has an official ranking of not less than "A" as confirmed by one of the world's leading rating agencies (Fitch Ratings, Standard & Poor's, Moody's). Regulation contemplates that credit funds may be transferred by the financier directly to the exporter under the terms of the sale and purchase agreement without such funds being first transferred to the importer/borrower in Ukraine as is customarily required for cross-border loans. The regulations also specifically provide that a Ukrainian borrower is entitled to repay such funds but subject to certain conditions (documentary confirmation that the funds have been paid to the exporter in the first place). Moreover, the regulations permit to repay various fees associated with the ECA's participation above the interest cap imposed by the same regulations.

Thus, Ukrainian businesses that wish to develop solar power plants but lack funds to purchase equipment abroad have a good range of products by ECAs that they can use. Overall, before turning to ECAs for loans or covers, any business must carefully analyse the ECA's requirements and determine which product is the best fit for the project at hand.



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People line up at an ATM of a PrivatBank branch on Saksahansko Street on Dec. 19. (Kostyantyn Chernichkin)

State buys PrivatBank; taxpayer losses will be at least \$5.6 billion

By **Josh Kovensky**
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Ukraine's government is nationalizing the country's largest commercial bank, PrivatBank, after it failed to fill an Hr 89 billion hole (\$3.4 billion) in its books.

National Bank of Ukraine Governor Valeria Gontareva and Finance Minister Oleksandr Danylyuk announced the decision on Dec. 19, pledging to protect depositors' money, saying that the bank's credit portfolio is infected with insider loans -- many of them unpaid -- amounting to 97 percent of the loan portfolio.

Gontareva's statement revealed what had been known to the NBU for at least a year. It

also lent credence to what critics have alleged for even longer: that PrivatBank operated more like an embezzlement scheme for owner-oligarchs Ihor Kolomoisky and Gennadiy Bogolyubov than a properly functioning bank. The question now is whether they will repay these bad loans and face any legal consequences, or simply stick Ukrainian taxpayers with a bill that could exceed \$5.6 billion (Hr 148 billion).

Gontareva hinted at the nationalization of PrivatBank a week earlier while announcing the institution's financial stability report on Dec. 13. "The key risk to financial stability

Do you or your bank own the money on your current account?



Maxim Oleksiyuk
Partner, Attorney at Law

Over the last several years, more than 80 banks in Ukraine have been declared insolvent. Business entities and private citizens have lost billions of hryvnias that was on their current accounts. We've got used to the news of another bank turning into an empty can, from which all funds have been washed out, leaving zero chances for restitution. It looks like there can be no happy end for stories like these. Here I'd like to shift your attention to a little detail which the banks avoid disputing, and which changes the whole scene dramatically: it is whether your bank owns the funds in your current account?

Let's take a look from different angles:

the comparative and common sense approach: Today, hryvnia is issued by the National Bank of Ukraine and are declared to be the only legal payment instrument in the country. But the law limits the ability of legal entities and natural persons to make settlements in cash, thus forcing us to use cashless payment systems. The NBU empowers its agents — the banks — to register and account all transactions with these financial instruments — cash — on bank accounts. Being just a registrar and a

bookkeeper, banks are not allowed to operate with your money until you decide to enter into a deposit or trust account agreement with the bank. A current account shouldn't be confused with a deposit account — where one concludes another agreement on a bank deposit, under which funds are borrowed by the bank and title to the funds is transferred to the bank's ownership. In fact, accounting your money on your account itself does not provide your bank with any rights to your money. Let's compare a current account with accounts in securities (shares, bonds, etc.) — the latter is also opened by banks serving as depositaries of securities. If the insolvency of a bank were to lead to the loss of title to shares by shareholders of a joint-stock company, who would keep shares in such an account opened with a bank? Another example: could you imagine that the hypothetical insolvency of the state registrar service or the state land cadaster would lead to losing your title to your house or land plot?

"If you want to steal some money, don't rob a bank — open one."

Bertolt Brecht

formal/legal approach: there is no provision either in the law or in the usual agreements on servicing current bank account stipulating the alienation of your funds in favor of the bank by means of accounting

them on a current account opened with a bank. One cannot find any title transfer wording, or even transfer in trust provisions or orders while communicating with the bank regarding servicing your current bank account — unless you explicitly order the transfer of your money from your account to an account belonging to the bank. Even the wording 'transfer from account to account' is not logically correct, because the title is transferred from person to person, with due reflection in the accounts. Changes in accounts are just the registration of a transaction for the transfer of a virtual financial instrument.

There is no formal or common sense reason to stick to archaic image of the bank as the custodian of your money. This paradigm has sunk into oblivion, together with real money made of gold and silver — for better or worse. Today's currency is a virtual thing — even that of paper. There's no doubt that this ambiguous and non-transparent situation — is artificially supported by the banks in order to get profit from operating with your money, while not entitled to do so. The insolvency of a bank should not have any adverse effect on current accounts — which are simply a register kept by a bank, acting as the NBU's agent. Such a register is subject to transfer to another agent as it is. But such approach could hardly be supported by the NBU, which cares for the banks and their business first.

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PrivatBank owner Ihor Kolomoisky in December 2010. Kolomoisky surrendered control of the bank to the state on Dec. 18. (Ukrainian photo)

in the short run is possible non-compliance by a few large banks with recapitalization programs, which were based on diagnostic studies,” said Gontareva.

These reports prompted withdrawals from PrivatBank. On Dec. 16, there were reports that PrivatBank had limited daily withdrawals from ATM machines.

But now, PrivatBank has effectively become a second Oschadbank - a mammoth business run by the state.

The amount that could have been siphoned out of the bank through insider loans may be as high as Hr 163 billion (\$6.3 billion), according to NBU data. That is more than Ukraine’s defense budget and at least 5 percent of the nation’s economic output this year.

Even after nationalization, Kolomoisky will retain control of the bank’s payment systems, which appear to be owned via separate legal structures, giving him continued leverage.

Political analyst Vitaly Bala said that the threat to destroy the bank has been a main source of power for Kolomoisky. “He’s a very creative businessman,” said Bala, laughing. “But the problem has become too big for the government to ignore.”

The International Monetary Fund has made resolving the PrivatBank problem one of the conditions for Ukraine to receive the next loan installment. With upwards of \$3.5

billion in payments to foreign creditors due next year, NBU officials may need IMF lending to make it through 2017. IMF lending has stalled at \$7.7 billion out of a possible \$17.5 billion because of Ukraine’s failures on the reform front, including in the banking sector.

Privat party

Ukraine’s banking sector is characterized by poor regulation, insider lending, and fraud. Some thought that PrivatBank’s size alone would protect it, but since its 1992 founding, it appears that its owners also fleeced deposits off its customers through insider loans.

PrivatBank has 20.5 million depositors holding \$11 billion in assets, out of 45 million Ukrainians with a banking system worth \$52.8 billion. That accounts for 21 percent of the sector’s assets.

The bank, however, minimized the problem and through last week said it was meeting central bank refinancing requirements and operating normally. It also said that only 17.7 percent of its credit portfolio is related-party loans -- a far cry from 93 percent that the NBU calculated. Before nationalization, Dragon Capital placed the amount at between 40 and 80 percent.

According to the NBU figure, the insider lending would amount to \$6.3 billion (Hr 163 billion) out of a total loan

portfolio of \$6.8 billion (Hr 180 billion.)

Besides a source of cash, PrivatBank was a lever of influence for Kolomoisky. It was feared that he could destroy the bank in retaliation for legal moves that interfere with his vast business interests in airlines, oil and media.

Another path to destruction involves PrivatBank's online banking service Privat24. The division provides internet banking, a payment system that processes 40 percent of transactions in Ukraine, according to Samopomich Party lawmaker and member of the Parliamentary Committee on Banking Oleh Lavryk.

"The bank is used as a machine for receiving money," said Oleksandr Savchenko, director of the Kyiv International Institute of Business and a former NBU official, of Kolomoisky's intentions. "It's a good mechanism, it can perform good operations, or it can kill."

Flunking the test

PrivatBank's related parties - Kolomoisky and Bogolyubov - have largely failed to repay their loans to the bank, resulting in a non-performing loan rate of up to 70 percent, the central bank said.

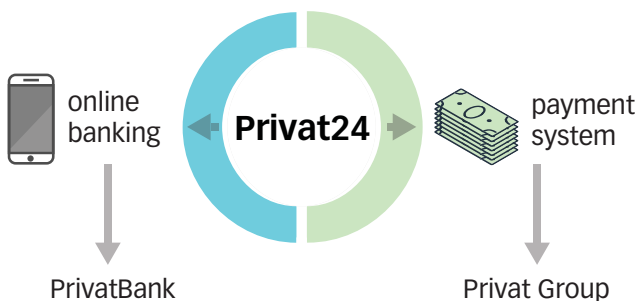
The NBU has known this since at least November 2015, according to Oleksandr Zavadetsky, a former head of the NBU's related party loans monitoring department, one of the first government officials to analyze the bank's loan portfolio for insider lending.

"The insider loans diagnostic on PrivatBank showed results that nobody expected to see," Zavadetsky, who left the central bank in October, told the Kyiv Post. "It caused real anxiety among everyone."

In June, the NBU struck a deal with Kolomoisky that would see him attempt to recapitalize the bank while reducing related party lending. If Kolomoisky met the requirements, he would be allowed to retain control of his bank.

Coordinated with the IMF, the plan gave PrivatBank's owners

NATIONALIZING PRIVATBANK WON'T MEAN NATIONALIZING PRIVAT24



In addition to being Ukraine's largest physical bank by assets, PrivatBank runs the country's most popular online banking service, Privat24.

The payment system is not owned through PrivatBank, giving the owners control of the system even in the event of nationalization of the bank.

40% The percentage of transactions that the Privat24 payment system processes in Ukraine.

*according to Oleh Lavryk, lawmaker and member of the Parliamentary Committee on Banking

Privat24, one of the most advanced payment systems in Ukraine, still belongs to billionaire oligarch Ihor Kolomoisky, despite the Dec. 19 privatization of PrivatBank.



Artem Stoyanov
Senior partner,
LCF Law Group

Owners of business, while making decision on raising credit funds for its development, depend on stability of the economic and financial system, but not always they can predict all risks that can influence the possibility of refund in the future, for example world crisis in 2008.

Moreover, it is impossible for business to predict extraordinary occasions, such as military actions in the Eastern Ukraine or annexation of Crimea by Russian Federation.

It must be admitted that in case of problems with loan servicing, borrowers often try to avoid fulfillment of their loan liabilities, save their assets and to continue running their business. Usually, this is accomplished by commencement of the insolvency procedure.

In such case, only the one, who actually controls the insolvency procedure, has a chance to achieve positive result from it.

Control of the insolvency procedure is a possibility to influence the decision of creditors' meeting on formation of the creditors' committee, and, further, the decision of creditors' committee on appointment of insolvency officer – asset manager or liquidator, and on proceeding to the next stage of the insolvency (financial rehabilitation, liquidation) and determination of property disposal procedure.

With such purpose, owners of business can form certain amount of accounts payable in legal entities that are allied or affiliated with borrower, which may give them a possibility of indirect influence on commencement of such procedures.

In such cases, lack of active performance from the lending bank, intended to protection of its interests, is a guarantee that insolvency initiators or more active creditors would gain control over the insolvency procedure, including the property disposal procedure.

Lending bank can ensure control of the insolvency procedure by forming of liabilities pool, the volume of which would be more extensive than its opponents have.

At the same time, by filing the creditor's claims, bank should understand that current legislation divides creditors on scheduled creditors and secured creditors (whose claims are secured by the borrower's pledge of property).

Only scheduled creditors have the right to participate in creditors' meeting with a right to vote and influence the insolvency procedure by election of a creditors' committee. Claims of secured creditors are registered in the list of creditors separately and are not taken into account in the process of determination of the creditors' votes.

Consequently, it is clear that Bank can ensure determining influence on the decision of the creditors' committee by solving two problems. Firstly, to file maximum amount of its scheduled claims, and secondly, to take measures for decrease of scheduled claims of the other creditors.

With this purpose, Bank, before filing, should analyze the amount of its claims and debtor's assets that secure such claims, particularly, value and relevance of such assets.

For example, to secure performance of obligations under the credit agreement, Banks can take in pledge goods for sale, namely, property that is used by the borrower in operating activities or borrower's right to claim against its counterparties on supply agreements, services agreements, etc.

In the majority of cases, as of the date of borrower's insolvency commencement, such subjects of a pledge may not be actually available. So, Bank would not have a possibility to uphold its claims at the cost of such pledge. This demonstrates that including of such subjects of pledge to the list of secured claims would be not recommended.

Current Law on insolvency provides creditors with the right to abandon such pledge, so that bank's claims would be included to scheduled and would provide bank with more chances to refund through control of borrower's insolvency procedure.

Additionally, bank should analyze claims of other creditors, and special attention should be given to claims, which would allow such creditors to influence decision of creditors' meeting on formation of the creditors' committee, and on decisions of the creditors' committee.

In case of the slightest doubt and sufficiency of such claims, it would be reasonable to object against them and prove their groundlessness.

Law on insolvency also provides scheduled creditor with the right to seize the court with claim on invalidity or denial of debtor's legal transactions or property actions that were made during one year, preceding the initiation of an insolvency case.

With the help of such instrument bank has a possibility to appeal against formation of liabilities in legal entities, affiliated with borrower, and increase of its influence on the decisions, which would be made within the insolvency procedure.

Careful attention to the candidature of asset manager is also important. In the case of any reasonable suspicions of interest of the abovementioned person to debtor or one of the creditors, bank should apply the procedures to discharge the appointed asset manager and complain against his actions to the regulatory.

Following conclusion from the practice of insolvency case proceedings can be made: only active performance and high qualification of bank's legal advisers would allow protecting interests and rights of a lending bank in case of insolvency of the borrower with maximum efficiency and positive result.

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Ukrainian Finance Minister Oleksandr Danylyuk and National Bank of Ukraine Governor Valeria Gontareva announce the nationalization of PrivatBank on Dec. 19. Losses to taxpayers could exceed \$5.6 billion. State officials promised to protect depositors. (Julia Berezovska/ Press office NBU)

three years to gradually fill the hole. But all banks had to attain a capital adequacy ratio of 5 percent by the end of September, meaning that Kolomoisky had to inject money into PrivatBank worth 5 percent of its credit portfolio.

“The IMF is funding the country, so they see that there is potentially a hole in the financial system that can be created in an aggravated situation by PrivatBank,” said Ihor Olekhov, head of law firm Baker & McKenzie’s financial institutions practice in Kyiv.

PrivatBank’s press service only admitted to a capitalization requirement of Hr 10 billion (\$379 million).

A December report from the NBU says that the country’s top 20 banks had an average non-performing loan rate of 53 percent; even at that level, Kolomoisky would have to supply at least Hr 89 billion (\$3.4 billion) of his own money to make the bank safe.

The IMF-approved repayment plan had already run into problems by the September deadline. It turned out that collateral for many of the bank’s loans came nowhere near matching the value of the loans themselves - out of a credit portfolio of Hr 180.4 billion (\$6.8 billion), PrivatBank was able to verify collateral for Hr 31 billion (\$1.1 billion), leaving an Hr 148 billion (\$5.6 billion) gap.

Some fear that PrivatBank owner Ihor Kolomoisky has siphoned money out of the bank, leaving Ukraine's taxpayers on the hook for up to \$6 billion in losses under state ownership; PrivatBank says all is well.

Danylyuk cited that Hr 148 billion figure during the post-nationalization press conference of the maximum amount of money that Ukrainian taxpayer would have to pay.

The IMF duly noted this failure in its September memorandum, referring to “a decision for state participation in

the recapitalization of a problem systemic bank.” Moreover, the fund allotted Hr 166 billion (\$6.3 billion) in bond issuances for “bank recapitalization.” Subtracting the Hr 14.3 billion (\$542 million) set for state-owned Oshchadbank and Ukreximbank, that comes to Hr 135.7 billion (\$5.1 billion) to cover issues relating to “systemic banks.”

At the time the report was released, the NBU ran a stress test on the top 20 banks.

PrivatBank flunked.

On the offensive

The NBU determined that PrivatBank’s shareholders either could not, or did not want to, repay the loans to recapitalize the bank. Bank CEO Oleksandr Dubilet flew to Washington, D.C., in early October to lobby against the bank’s nationalization. At the same time, lawmaker and metallurgy mogul Serhiy Taruta was at an IMF meeting in Washington distributing a pamphlet alleging corruption in the NBU.

In Kyiv, protests started to appear with more frequency around the NBU. One protest in November, over the collapsed Bank Mikhailivsky, saw thousands of pensioners close down the street on which the NBU is located.

Volodymyr Fesenko, director of the Penta political studies center, said that while PrivatBank was likely behind some of the Kyiv disturbances, “the interests of many different factions came together. Batkivshchyna, (businessman Serhiy) Taruta - a political crisis and snap elections would all be to their benefit,” Fesenko said.

What does nationalization really mean?

Gontareva said on Dec. 8 that she intended to resolve the issue of PrivatBank by the end of 2016.

In its second-ever financial stability report on Dec. 13, the NBU published figures showing that PrivatBank was Hr 89 billion (\$3.4 billion) short of filling its capital needs. “Resolving this risk demands quick, tough, and coordinated actions by the NBU and the government,” reads the report.

In the week leading up to nationalization, the Ukrainian press was full of rumors. PrivatBank’s press service released a statement the day after the NBU report on Dec. 14, calling nationalization reports part of a “coordinated information attack.”

But by Dec. 18, a joint NBU and Deposit Guarantee Fund team was in Dnipro to begin the takeover.

That evening, the Cabinet of Ministers issued a decision under Article 41.1 of the law on guaranteeing deposits, saying that they had agreed to a request from the NBU to nationalize the bank. PrivatBank simultaneously entered into temporary administration as the government bought 100 percent of the shares from Kolomoisky for Hr 1.

The bank now belongs to the Ministry of Finance, allowing the government to inject up to 150 billion in capital to stabilize the institution.

To fund the capital injection, the government will issue Ukrainian treasury bonds to fund the bailout.



Oleksander Plotnikov
Partner, Arzinger

Positive developments in debt restructuring

Recent years may be characterized as the era of big debt restructuring projects in Ukraine. Unlike in countries with developed economies, legislation in Ukraine is not advanced enough to facilitate efficient and swift debt restructuring. Some legal and financial instruments that are customary for such matters in developed countries are still not available in Ukraine.

At the same time we have to admit that situation is changing and we see significant positive developments in borrowers' and creditors' approach to restructuring. Some issues which several years ago could be deal breakers, may be easily resolved now and do not prevent parties from a dialog. I would say that ability to put yourself in shoes of the other party and readiness for compromises are essential for successful restructuring. And being engaged in a number of restructuring projects which involve both local and foreign creditors we see that very often parties are ready now to go against their short-term interests in order to close the deal and obtain benefits in the future.

In addition to general evolving of creditors' and debtors' approach to the debt restructuring, I can also mention some positive improvements of local legislation which make voluntary debt restructuring more attractive for all involved parties.

I mean the Law of Ukraine "On Financial Restructuring" (the "Restructuring Law") which became effective on 19 October 2016 and changes implemented to the Tax Code of Ukraine in connection with this law.

Thought not perfect, the Restructuring Law creates legislative base for voluntary debt restructuring in Ukraine. It is fair to say that without this law there were successful restructurings in Ukraine and most of the market could live without this law. However, one of the main positive novelties introduced by this law is implementation of some unified rules for all participants of a restructuring project which further may be improved as the practice develops. Moreover, the Restructuring Law is welcomed by the state-owned banks which were limited in their ability to participate in restructuring projects due to their status and risks connected with it.

Now, it is clearly stated that state-owned banks and banks with state-owned share in the capital may participate in restructuring projects on agreed conditions, which may include i.a., suspension of accrual of interest and partial debt writing off. Due to this we expect that state-owned banks will be the most active creditors in practical utilization of the new law.

In addition to technical issues which aimed at making the restructuring process more organized and straightforward, tax preferences given to participants of debt restructuring under the new law are attractive enough to stimulate both debtors and creditors to arrange debt restructuring projects under the Restructuring Law. The most important preferences are connected with VAT-exemption of some operations with assets as well as exemption from corporate profit tax of the profit obtained by a borrower as a result of debt writing off.

Though the Restructuring Law has become effective several months ago, implementation of its rules is still subject to creation of special bodies (secretariat and arbitration court) which are required by the law. It is expected that all bodies will be created by February 2017 and then first restructuring projects under the new law will be commenced.

So far debtors and creditors have some additional time to agree on the terms of restructuring so that in the process of restructuring they will be able to fix their arrangements in the restructuring plan without unnecessary long-lasting negotiations and will swiftly pass to the stage of implementation.

\$6 billion bailout?

But won't filling the hole in PrivatBank's spreadsheet will mean that the Ukrainian government is paying for Kolomoisky's insider lending?

"Unfortunately, yes," said Savchenko, the business school director and former NBU official.

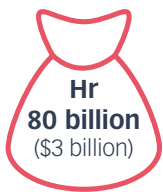
Kolomoisky has likely used the past few months to "siphon the tastiest bits out of the bank," said Fesenko, the political analyst, meaning that Ukraine will likely inherit an empty bank.

Given that the NBU says PrivatBank has a total loan portfolio of Hr 180.4 billion (\$6.8 billion), the bank's nationalization could mean Ukraine will pay up to 20 percent of its annual national budget over time to cover the losses.

The risks inherent to nationalizing PrivatBank led to dithering from the Presidential Administration on what decision to take, said Bala, the political analyst.

Zavadetsky, the former NBU related party lending monitor, said that the NBU should have nationalized PrivatBank in December 2015 after it realized the depth of the related-party lending problem.

"What should have happened, didn't happen," Zavadetsky said.



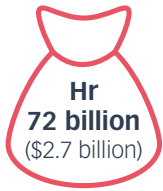
Insured losses

This is the amount the taxpayer-financed Deposit Guarantee Fund has paid out to individuals who lost their money in liquidated banks since 2014. The maximum individual payout is Hr 200,000 or \$8,000.



Uninsured losses

The number from the Deposit Guarantee Fund comes from an accepted creditors claim registry, filed by uninsured depositors (over Hr 200,000 in losses), corporate entities, etc. These non-insured deposits will be paid out from proceeds received from the sales of assets of failed banks. Payouts are made according to priorities set out by law. As of Dec. 1, there is an approved registry for 79 liquidated banks.



Unrepaid refinancing loans

This is the amount of money that bankers or former bankers owe the National Bank of Ukraine for refinancing loans from the central bank, dating back at least to 2008, when Viktor Yushchenko was president.



Total losses

The losses are likely to grow as more banks are liquidated and more claims for financial losses are filed. The bank losses amount to 15 percent of Ukraine's expected gross domestic product in 2016. The actual dollar value of the losses is higher, since some of the unpaid loans were taken out when the exchange rate was Hr 5/\$1. Now the rate is Hr 26/\$1.

By Ira Movchan | Kyiv Post
Sources: National Bank of Ukraine, Deposit Guarantee Fund of Ukraine

Ukraine's banking sector losses have grown to at least \$14.5 billion, not counting another \$6 billion in probable losses from the newly nationalized PrivatBank. The losses are broken into three categories: state payments to insured depositors, uninsured deposits lost by consumers and unpaid refinancing loans owed to the National Bank of Ukraine.



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People walk away from a PrivatBank branch on Oct. 24 in Kyiv. (Kostyantyn Chernichkin)

Poroshenko's 'moment of truth'

NBU officials insist that they will attempt to force Kolomoisky to repay the loans. If not, they say, they will attempt to seize as much of his collateral as they can.

But political analysts doubt that the Dnipro billionaire will repay his debts.

"Kolomoisky has been more inclined to negotiate in recent months," said Fesenko. "This situation with PrivatBank was critical, and forced him and the government into a deal. But it's unlikely that he will pay back everything immediately."

Fesenko added that the 1+1 TV channel, which loses money but provides political influence, could have figured into the deal to nationalize PrivatBank. As long as Kolomoisky retains 1+1, he will be able to spread his own version of the story.

Some outgoing PrivatBank officials are doing so. Both Dmytro Dubilet, the bank's information technology director, and Oleg Gorokhovskiy, a bank executive, claimed that the bank was forced into nationalization by an information attack. Aleksandr Dubinsky, a journalist on 1+1, suggested that the government does not know how to operate

PrivatBank's technological systems, setting up a narrative in which Kolomoisky pulling the plug on Privat24 looks to be the result of government incompetence.

Kolomoisky will also be able to fight nationalization through the courts/ Ukrainian law has no specific concept for bank "nationalization," complicating the government's position.

"The issue is not clearly addressed in current law," said Oleksandr Kurdydyk, an attorney at DLA Piper's Kyiv office.

One scenario that worries is that Kolomoisky could win a court case after the government has pumped billions of dollars to financially stabilize the bank.

Whether Kolomoisky is held to account for the bank's failure, and how much of the burden average Ukrainians must shoulder, is now in the government's hands.

"It's a moment of truth" for the president, Savchenko said. ■




















NEWS ITEM: Some fear that PrivatBank's owner Ihor Kolomoisky has siphoned the bank's money abroad prior to the Dec. 18 nationalization and handed over an empty bank.

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Phone number	Top executives	HQ	Est.	Main Specialization, services	Major clients	Languages
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This file photo shows about 50 people who came to the Deposit Guarantee Fund office in Kyiv on the morning of June 21 to demand the return of the money they had deposited with Mykhailivsky Bank, which went bankrupt and closed on May 23. (Anastasia Vlasova)

Deposit Guarantee Fund admits poor results in recovering failed banks' assets

By **Natalie Vikhrov**
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The government has paid out more than Hr 80 billion (\$3 billion) to Ukrainian customers with insured deposits in the nation's 80 collapsed banks since 2014.

But little of that money, and as well another \$5 billion in losses from uninsured deposits, has come from bank owners, managers and shareholders, who pocketed billions of dollars of Ukrainian deposits through insider loans and other embezzlement schemes.

The Deposit Guarantee Fund has filed

more than 3,000 criminal reports to law enforcement agencies- 376 of them linked to owners and top managers of insolvent banks. However, this approach has yielded poor results. To date, there have been merely two convictions of bank owners or top management.

In comparison to the thousands of criminal reports, the fund has filed a total of seven civil lawsuits throughout 2014 and 2015 against the bank owners and shareholders of Tavryka, ERDE, Forum, and Mercury banks, amounting



A woman with Delta Bank cards hanging on her neck attends a rally of depositors of collapsed banks in front of parliament on Nov. 15. (Volodymyr Petrov)

to claims of Hr 13.4 billion (\$510 million).

Despite losing all seven lawsuits, the fund has come under fire for failing to further pursue the civil route against bank leadership, which has proven effective in many other countries, including Russia.

Andriy Olenchuk, the Deposit Guarantee Fund deputy managing director, admitted that the organization struggled in its pursuit of civil claims.

Both banking sector experts and anti-corruption authorities have criticized the organisation for repeatedly forwarding criminal cases to the Prosecutor General's office, where the investigations typically stall.

Even in the cases of Mikhailovsky and Delta banks, where top officials called for the arrest of the their owners, neither Viktor Polishchuk nor Mykola Lagun have been arrested to this day.

According DLA Piper partner Oleksandr Kurdydyk, on average civil claims took 30 to 40 percent less time to reach a resolution compared to criminal.

Furthermore, Igor Budnik, head of the risk management department of the National Bank of Ukraine, at Kyiv Post's 5th Tiger Conference on Nov. 29, said the evidence bar for civil lawsuits is lower -- requiring only to prove guilt in civil cases by a preponderance of evidence rather than beyond a reasonable doubt, the criminal standard.

Olenchuk said the fund was currently renewing its efforts to pursue civil lawsuits with the help of international agencies, but legislative amendments in this area were also key if the fund was to have any chance of success.

He said in one case against Forum Bank, co-owned by former Party of Regions members of parliament Vadim Novinsky, the court decided that the real sum of the losses could not be determined until all the assets were sold.

"(We would have to) finish the liquidation, and then after a few years we'd be able to understand the difference between creditor's demands and assets...this is all without long-term prospects."

"Other lawsuits were based on lack of evidence and often the emphasis was on the fact that guilt wasn't proven."

Olenchuk said by the time a bank is declared insolvent and the



Artem Taranowski
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An Ultimate Obstacle for the Execution of the European Court's Judgments Against Ukraine

Golovan and Partners Law Firm provides legal support to the applicant in the group of cases pending before the Grand Chamber of the European Court of Human Rights mentioned as an indication of failure in solving the problem of non-enforcement or delayed enforcement of Ukrainian courts' judicial decisions.

It is obvious that the court ruling in ones favour worth nothing without it's being enforced. For instance, during 2006-2011 only near 30 % of court decisions in Ukraine were enforced.

In 2007 one of Ukrainian commercial courts found in favour of our client and ordered to recover assets from the state-owned enterprise. After numerous legal actions, made in order to enforce this court decision, we initiated an insolvency proceedings against the state-owned enterprise based on the demands under the court order.

From 2007 till present time the court decision in favour of our client remains un-enforced. And it seems that all legal actions made by our client and by us as its legal advisors in a past 9 years, all brand new and reformist legislature in bankruptcy sphere, all efforts to implement European Court's practise in Ukrainian law system — looks like desperate and chaotic moves in an ocean of irresponsibility.

For now we can say for sure, that there is no difference for Ukrainian officials on how to enforce law: by direct, common sense and good faith-applying of positive law and generally acknowledged law principles, or by long and exhausting struggle in a court rooms and even longer efforts to execute judgment.

In a vast number of cases there are no any negative legal consequences for officials, responsible for violations of human rights, even if the courts directly points at such violations and at responsible officials.

Unfortunately, despite the binding position of the European Court that not just Ukraine's legislation but administrative practice too should be reformed, we would take the liberty of arguing that there is no reform of administrative practice taking place here.

Under the law and supporting regulations the Ministry of Justice of Ukraine is to bring to light those liable for the violations of the Convention, and initiate legal actions against them; the Ministry of Justice of Ukraine also must consolidate information on measures taken to recover the state budget losses from violations of the Convention. According to information provided by the Ministry of Justice of Ukraine upon our request several years ago, during 2006-2012 there were UAH 64,884,885.28 of losses awarded.

Alongside with that, according to information provided by the Ministry of Justice of Ukraine, the whole amount of money recovered was UAH 30,404.93 in 2008, and UAH 76,564.07 in 2009.










One way or another, the existing administrative practice seems to contribute nothing to resolving the problem of violations of the Convention on the whole and the problem of non-enforcement or delayed enforcement of domestic judicial decisions in particular, if not worsen the problems at all.

It seems that Ukrainian state bodies just do nothing to punish it's own officials responsible for violations of Ukrainian law. It's mush easier for state to pay just satisfaction under decision of the European Court from time to time, than eliminate the true root of this problem — personal irresponsibility of bureaucrats.

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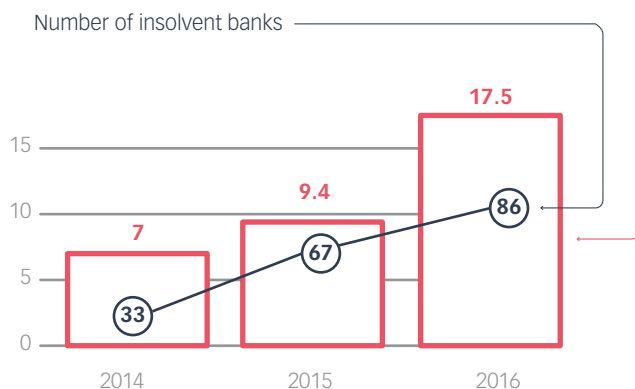
Financial entanglements of 11 members of the Ukrainian Parliament's banking committee

Name	Financial interests	Name	Financial interests
 <p>Serhiy Rybalka (Radical Party)</p>	<p>The central bank demanded Serhiy Ribalka's removal as banking committee chair, saying he was incapable of doing his job - an accusation Ribalka called "worthless." Ribalka owns the snack-producing SI Group, which had a conflict with supermarket chain ATB over an alleged Hr 110 million (\$4.1 million) debt.</p>	 <p>Pavlo Rizanenko (Petro Poroshenko's Bloc)</p>	<p>Pavlo Riznanenko marked \$725,000 in his official declaration. He also appears in U.S. government documents as working with Washington lobbyists for oligarch Victor Pinchuk.</p>
 <p>Maksym Polyakov (Narodniy Front)</p>	<p>The central bank has accused Maksym Polyakov, former head of national financial services commission, of being in the Ukrainian insurance industry's pocket. Polyakov, who declared \$250,000 in an unnamed bank account as well as Tiffany jewelry, denies the allegation.</p>	 <p>Viktor Romanyuk (Narodniy Front)</p>	<p>The former Ukrsotsbank and Prominvest-bank employee declared \$750,000 and 18,700 euros in Ukrsotsbank. Viktor Romanyuk also owes around Hr 1 million (\$38,000) to his brother, Eduard.</p>
 <p>Ruslan Demchak (Petro Poroshenko's Bloc)</p>	<p>In August 2015, Ruslan Demchak bought the insolvent Omega Bank to create RVC bank, taking Omega's Hr 229.1 million in assets to make the bank. The transaction cost Demchak Hr 32 million.</p>	 <p>Oleksandr Zholobetsky (Petro Poroshenko's Bloc)</p>	<p>Oleksandr Zholobetsky seems more bank-shy than his fellow deputies - in his declaration, he noted \$180,000 in cash, a Cartier watch and his wife's Lexus. No other deposits were noted.</p>
 <p>Mykhaylo Dovbenko (Petro Poroshenko's Bloc)</p>	<p>Mykhaylo Dovbenko was receiving dividends from the collapsed Bank Khreshchatyk, which closed in April. Novoye Vremya reported that Dovbenko was able to take much of his money out of Khreshchatyk before the bank collapsed.</p>	 <p>Leonid Klimov (Vidrodzhennya)</p>	<p>Leonid Klimov is the former owner of Imeksbank, which was taken over by the government in January 2015. The central bank gave Imeksbank Hr 310 million (\$11.8 million) in refinancing in November 2014, a sum Klimov has refused to repay. The Depositi Guarantee Fund is paying Hr 4.3 billion (\$163 million) to insured depositors. Klimov refuses comment.</p>
 <p>Denys Dzenzersky (Batkyvshchyna)</p>	<p>Denys Dzenzersky owes millions of dollars to VTB Bank over the failure of his Westa car battery plant in Dnipro.</p>	 <p>Oleh Lavryk (Samopomich)</p>	<p>Oleh Lavryk keeps his Hr 482,000 (\$18,300) deposits in the Lviv-based VS Bank. He also received an Hr 62.3 million (\$2.3 million) loan from the bank in 2007 using the company Prombudprylad as collateral, in which Lavryk has a stake. Prombudprylad also owns Samopomich's headquarters in Lviv, and has another company as a shareholder controlled for eight years by party chief Andriy Sadovyi.</p>
 <p>Ivan Fursyn (Volya Narodu)</p>	<p>Deputy Ivan Fursyn himself owns two small banks - Misto, and Clearing House. Fursyn, head of the banking subcommittee, co-owns Clearing House with Viktor Yanukovich-era kingmaker Serhiy Lyovochkin through his wife, Yulia.</p>		<p>By Ira Movchan Kyiv Post Source: National Agency for the Prevention of Corruption</p>

Source: National Agency for the Prevention of Corruption

Ukrainian banking crisis by the numbers

Estimated assets of insolvent banks, \$ billion



The number of insolvent banks has risen to 86 in the last three years, leaving Ukraine with less than 100 banks. (Sources: National Bank of Ukraine, Deposit Guarantee Fund)

fund steps in as a temporary administrator, the evidence is typically gone.

Following pressure from the International Monetary Fund, changes to legislation in 2015 gave the fund more freedom to file civil lawsuits.

However, Olenchuk said that the amendments were minor and did not address key problems, such as alleviating the fund's responsibility to prove the bank shareholders' guilt.

Furthermore, from September 2015, new fees were introduced that would see the fund charged up to 1.5 percent of the claimed amount for every civil lawsuit it filed.

A fund spokesperson told the Kyiv Post the money for the court charges would be taken from the liquidated bank assets, which is used to satisfy claims of creditors of the banks.

Olenchuk said the fund tried to address the issue with the Ministry of Finance but it fell on deaf ears.

He said the fund was however open to assistance and advice on filing civil lawsuits.

Furthermore, he said the fund was going to be working with international companies to assist them with insolvent bank projects.

Daria Kaleniuk, executive director at the Anti-Corruption Action Centre, said civil claims were the only feasible solution for Ukraine considering there is no will to pursue criminal cases.

"I think civil cases, especially targeting beneficial owners internationally and their assets internationally, this is the way moving forward. Even if we hire private firms and they can work for a possible percentage of recovery... if we identify 100 percent but recover 40 or 60, it's already more than zero," she said.

She said it was also important to address the issues in the law, which were hindering the Deposit Guarantee Fund from pursuing further civil claims.

"There should be no fees in the percentage of the possible claim...for the Deposit Guarantee Fund to start the civil claim," she said.

"The law also says that first you have to calculate the amount of debt and amount of remaining assets to be sold, but first we have to wait for the assets to be sold, which could be years. It postpones the moment when the action could be started significantly." ■

BUSINESS ADVISER



Natalya Ulyanova
Managing partner,
ICF Legal Service

Special Control Area

The fight against capital outflows is an inevitable process with more and more countries, whose governments are going along the road of de-offshorisation of their domestic economies, getting involved.

The so called Base Erosion and Profit Shifting Action Plan (BEPS) initiated by the Organisation for Economic Co-operation and Development (OECD) and aimed at suppressing taxation base erosion and profit shifting is one of such tools.

Currently, there are already over 20 countries, with the overwhelming majority of them being members of the European Union, which have amended their national legislation to adopt the BEPS Action Plan. Besides, about 30 countries have signed multilateral treaties to exchange tax and financial information.

Ukraine will begin implementing the provisions of the BEPS Action Plan in 2017 as well. What is meant here is the fight against abusive taxation practices, which involves application of special tax regulations and tax conventions, the disclosure of schemes which businesses use to ease the tax burden, as well as the efficient application of double tax treaties. Though these are only the basic requirements, the fact of joining the BEPS Action Plan suggests by itself that the world tax trends are entering Ukrainian legislation.

Will it affect Ukrainian businesses? Of course, it will. And along with the review of the approaches to structuring their operations and choosing partners, companies will have to rebuild their interactions with banks. But the reason is not only that the reliability of the Ukrainian banking system has been in the risk zone for several recent years and one should apply special care to choose financial institutions.

In their turn, banks are strengthening monitoring of customers' activities. It is not least because since July 1, 2014, banks have had to meet the requirements of the Foreign Account Tax Compliance Act (FATCA), which was adopted in the USA. The act obliges all financial institutions to automatically disclose information about accounts of American taxpayers and companies incorporated outside the USA. And the fines for non-compliance with the FATCA requirements are applied against banks regardless of their jurisdiction.

Moreover, it is since 2013 that the Common Reporting Standard (CRS) developed as the OECD initiative has been implemented, which suggests annual automatic exchange of information between governments. Banks reporting both individuals' and companies' accounts are also covered by this exchange.

As a result, Ukrainian companies face problems with their cross-border transactions, as banks see them as having signs of "suspicious transactions", block them pending clarification, and demand extended documentary justifications. It is especially related to payments in dollars.

Another alarming trend is tightening conditions of foreign currency payments in European banks which, until quite recently, authorised transactions without any misgivings, sometimes even not requesting a full package of transactional documents.

Currently, correspondent banks refuse to sort out numerous suspicious transactions of their customers and become subjects of the regulator's fines. Therefore, all payments, both incoming and outgoing, are checked by banks' internal monitoring functions. It can often result in freezing or even closing an account.

Moreover, when working with banks, not everything may depend on a customer only. For example, there are certain nuances when we speak of a transaction between a Ukrainian and a foreign bank. The National Bank of Ukraine issued the list of foreign banks (including European ones), "whose operations may be associated with conducting risky operations". But after receiving this list, a lot of Ukrainian banks perceived it as a guide to action and started blocking transactions, without even labelling their points.

Therefore, businesses have to take their own control over the situation. First, they should think over the proper cash flow scheme. In order to do this, you should be aware of peculiarities of transactions with your current bank and the bank where your partner's account is opened. Second, you should prepare all documents before the transaction; otherwise it will take a lot of time to collect documents to confirm the transaction, and the account will be blocked during all this time. Third, it is very important to establish communication with the bank. Fourth, you should probably consider risk hedge. As a matter of fact, it is always optimal for a customer to go to the bank with the support of a qualified partner who will not only help to choose a financial institution, but will also conduct successful negotiations with the bank at all stages, prepare all the documents and provide minimisation of risks during the transactional process. After all, banks would rather abandon a customer and their profit, as transparency plays a great role there. Therefore, the knowledge of hidden agendas and the ability to evade them are the guarantees that your business will be successful.



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Ex-Bank Mikhailivsky clients protest in Kyiv on Nov. 3. (Volodymyr Petrov)

Chaotic sales of collapsed bank loan portfolios opens many opportunities for fraud

By **Natalie Vikhrov** and **Josh Kovensky**
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Ukrainians have lost billions of hryvnias in uninsured bank deposits over the past two years as the government has taken over and liquidated dozens of banks whose main business model was embezzlement and fraud.

But for some, the resulting chaos is a lucrative opportunity.

Ukraine's Deposit Guarantee Fund is tasked with selling the assets of liquidated banks back into the market. The juiciest assets are the bank's loan portfolios, which can include collateral for businesses around the world.

Not only is the DGF overwhelmed with its caseload of hundreds of millions of dollars worth of assets to sell, but it lacks control over the exchanges it uses to sell them. This opens up an opportunity for fraud in the buying of the

assets. Some of the best assets are sold at cut-rate prices to the former owners of the banks, managers of the exchanges, and assistants of members of parliament.

One investigation by Radio Liberty's Schemes program demonstrated how former Delta Bank owner Mykola Lagun was able to buy back chunks of Delta's loan portfolio at a fraction of their value.

Practitioners in Ukrainian banking law agree that these assets are often sold back to the same bankers whose insider lending destroyed the financial institution in the first place.

Ihor Olekhov, head of Baker McKenzie's Kyiv banking practice, said that this will likely continue to happen as long as law enforcement does not bring cases against the owners of collapsed banks.

“Effectively you cannot limit who is going to buy the loan portfolio, because if you start imposing those limits, you effectively restrict the market,” Olekhov said.

Conflicts of interest

The Deposit Guarantee Fund started to disclose the details of the sales - including selling price and buyer - on its website in June, revealing transactions in which the fund has sold off loan portfolios to companies with unknown beneficial ownership for less than 7 percent of their value.

According to the Anti-Corruption Centre, many of the purchasing companies were only registered in 2015 and have no clear ownership structure.

The exchanges that sell the loans themselves may also be caught up in the problem.

“There are so-called pocket exchanges - exchanges which were apparently created only for certain low aims,” said Antonina Volkotrub, financial manager at the Anti-Corruption Action Center. “They have nominal directors, and don’t always meet all the requirements.”

All of this lack of transparency allows for striking conflicts of interest to occur. For example, a firm called Morgan Capital won a number of auctions to cheaply buy up portfolios in July and August.

One sale in July saw Morgan Capital buy a loan originally valued at Hr 7 million (\$270,000) for Hr 550,000 (\$20,800).

The sale occurred on an exchange called “Electronic Trades of Ukraine.”

But both Morgan Capital and the exchange appear to be controlled by the same person: a man named Ruslan Kharchenko.

Looking further through the roster of purchasers reveals a number of politically exposed people. In one case, a loan valued initially at Hr 106 million (\$4 million) was bought for Hr 6.5 million (\$246,000) by a company apparently controlled by a nominee director linked to allegedly rigged tenders run by one-time Odesa Governor Vladimir Nemirovsky.

Other transactions, of which there are hundreds, appear to be linked to former Party of Regions deputies.

What is your value?

Industry experts agree that a lack of a unified approach to asset valuation only adds difficulty to effectively auctioning off assets such as loan portfolios.

With a lack of valuation guidelines set out by the industry regulator - the State Property Fund - the Deposit Guarantee Fund, with assistance from the U.S. Treasury, established and approved its own valuation method in 2015, specifically to assist with pricing non-performing loans.

“It is very easy to value a piece of banking equipment, a banking outlet, a piece of real estate, because there are plenty of market benchmarks,” Yuliya Bereshchenko, head of the Deposit Guarantee Fund’s asset management and sales department, said.

“But to value a loan, there needs to be a more detailed valuation methodology, which takes into account the quality of the collateral, whether the borrower is solvent or insolvent, the guarantors, the stage of the litigation process.”

Using an independent appraisal valuation as a benchmark, the fund engages third party licensed firms to perform independent appraisals. It also has an independent appraisal unit, separate from the asset sales office, which performs its own calculations using the same data.



Head of the Deposit Guarantee Fund’s asset management and sales department Yuliya Bereshchenko talks to the Kyiv Post in Kyiv on Dec. 15. (Anastasia Vlasova)

Bereshchenko said the fund typically starts with the highest price, which is reduced by 10 percent every two weeks until the asset is sold.

Alexander Paraschiy, Concorde Capital’s head of research, said that because there is no unified valuation approach, the price of loan portfolio may vary, which means “there is big room for pricing and for corruption.”

“It’s complicated. That’s why we’re bringing in BDO.”

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Top 25 banks by assets. Ukrainian banks ranked by assets (as of Dec. 1)

Total assets of Ukraine's banking sector are estimated by the National Bank of Ukraine at \$52.8 billion. The top 20 banks account for 88 percent of the sector's assets.

	Bank	Overall assets (billions, \$)	Ultimate beneficiaries		Bank	Overall assets (billions, \$)	Ultimate beneficiaries
	1 PrivatBank	10.3	Ihor Koloymoisky and Gennadiy Bogolyubov		13 OTP Bank (1998). Until 2006, known as Raiffeisen Bank Ukraine.	0.9	OTP Bank Plc, Hungary
	2 Oschadbank (1991)	7.2	State (Cabinet of Ministers)		14 VTB Bank (1992). Previously Bank Mriya until 2007.	0.8	Bank VTB Russia (Russian Federal Property Agency)
	3 Ukreximbank (1992)	5.8	State (Cabinet of Ministers)		15 Bank Pivdennyi (1993, Odesa)	0.7	Yuriy Rodin and Mark Bekker
	4 Ukgazbank (1993) Previously Khadzhbeybank (1993-1995) and Intergazbank (1995-1996)	2.2	State (Ministry of Finance)		16 Citibank (1998)	0.7	Citigroup Inc., USA
	5 Raiffeisen Bank Aval (1992). Until 2006, it was Posh-tovo-pensiynyi bank Aval.	1.9	Raiffeisen Bank International AG (Austria)		17 ING Bank Ukraine (1997)	0.6	ING Bank N.V., Netherlands
	6 UkrSotsbank (1991)	1.9	Unicredit Bank Austria AG, Austria and Alfa Group		18 ProCredit Bank (2000). Previously Microfinansoviy Bank (2000-2003)	0.4	ProCredit Holding, Germany
	7 Sberbank (2001). Previously Bank NRB-Ukraine (2001-2005) and NRB (2005-2008)	1.8	Sberbank Russia (Central Bank of the Russian Federation)		19 Kredobank (Lviv, 1992). Previously Zakhidno-Ukrain-skiy Komertsyinyi Bank (until 2001) and Credit Bank (2001-2006)	0.4	PKO Bank Polski SA, Poland
	8 UkrSibbank (1991)	1.6	BNP Paribas S.A. France		20 Megabank (1991, Kharkiv)	0.3	Viktor Subotin
	9 PUMB	1.5	Rinat Akhmetov		21 Bank Credit Dnipro	0.3	Viktor Pinchuk
	10 Alfa Bank (1993), earlier Bank Vito (until 1997) and Kyivinvestbank (1997-2001)	1.5	Alfa Group consortium, Mikhail Fridman		22 Platinum Bank (2005). Previously International Mortgage Bank (2005-2009)	0.2	Grygoriy Gurtoviy
	11 Prominvestbank (1992)	1.3	Vneshkom-bank Russia (Russian government)		23 Diamantbank (1993)	0.2	Igor Kerez, David Zhvaniya
	12 Credit Agricole (1993). Previously Index-bank until 2011.	1.1	Credit Agricole S.A., France		24 Bank Vostok (Dnirpropetrovsk, 2002). Previously Agrobank (2002-2007), Khoum Credit Bank (2007-2011)	0.2	Volodymyr Kostelman, Volodymyr Morokhovskiy
					25 Tascombank (2008)	0.2	Serhiy Tihpko

Source: National Bank of Ukraine

Bereshchenko said the fund does not have the power to restructure loans, which includes deep haircuts, but borrowers have pursued other routes to buy back their loans on the cheap - including dragging it through the courts.

Moreover, according to allegations received by the fund, auctions hosted by independent online platforms can be manipulated to act in the interests of one particular buyer, or prevent other bidders from participating in or winning the auction.

The fund recently started to move its auctions to ProZorro, the public e-procurement system, a move that Bereshchenko believes will eliminate such allegations.

Asset sales through ProZorro have generated Hr 30 million (\$1.2 million) for the fund, with around 1,000 individual assets listed on the system.

Bereshchenko said the fund was preparing for the decision to move all asset sales to ProZoro, which is managed by Transparency International.

But she admitted that even a shift to ProZorro will not give the fund control over whose hands the assets fall into in the end.

Furthermore, there is currently no legal obligation to prevent the asset from being sold back to the original borrower.

“I know that buyers may not be the ultimate buyers but, in the Ukrainian environment, by law we are not allowed to

restrict the circle of buyers,” Bereshchenko said.

“By law we are obliged to sell at the maximum price in the shortest period of time, which means to anyone. The only restriction is embedded into our regulation number two - that a loan may be sold only to a (certified) financial institution.”

‘By law we are obliged to sell at the maximum price in the shortest period of time, which means to anyone!’

– Yulia Bereshchenko, head of the Deposit Guarantee Fund's asset management and sales department.

Bereshchenko says that given Ukraine's macroeconomic status, handing the loan back its original borrower who defaulted on the loan may not be altogether negative.

“If strategically, the government decides that selling loans back to bad borrowers... is the wrong thing to do, then they should impose pre-qualification criteria. But the competition will probably be lower, and we do not know whether the prices will be lower, because the borrowers are not allowed to participate in the auction.”

“If we are selling to the highest bidder, no one should care if that bidder is (actually) the borrower.” ■



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Ukraine slowly warms to cashless economy

By **Denys Krasnikov**
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Many Ukrainians think it is much safer to keep their money under the mattress than in the bank.

This point is proven by Ukraine's richest: The country's top officials and lawmakers, many of them millionaires, tend to keep their vast savings in cash, according to their recently filed electronic declarations of assets.

But even with distrust in the banking sector lingering, the number of cashless operations is slowly increasing in Ukraine.

Slow growth

In the first nine months of 2016 Ukrainians have

made in total 1,272 million cashless payments worth Hr 398 billion – more than for the whole year of 2015, according to the National Bank.

Today, 35.8 percent of all the payments in Ukraine are cashless, up from just 8 percent in 2011.

Based on the data for July – September 2016, the most popular way to pay cashless is through a shop's point of sale terminal – that's how 35.9 percent of the cashless payments were conducted, while 33.1 percent were card-to-card payments, and 27.8 percent were internet transactions. The remaining 3.2 percent were made through self-service devices.



A man makes a cashless payment to enter the Kyiv metro network at Ploshcha Lva Tolstoho station in the city center. (Volodymyr Petrov)

The top five banks behind the most internet transactions in 2015 were PrivatBank, Raiffeisen Bank Aval, Alfa Bank Ukraine, Oschadbank and First Ukrainian International Bank (PUMB).

But while the number of cashless payments is slowly increasing, this slow growth shouldn't mislead one into thinking that Ukraine is moving to cashless economy at any great pace.

The numbers are still very small compared to developed European countries and the United States, where citizens have almost forgotten about the times when they had to pay cash in public transport or in a store. Compared to them, Ukrainians are only beginning their move towards a cashless economy.

According to the Swedish National Bank, Riksbank, in 2014, Ukraine was among those countries in the world with the greatest fondness for cash: The amount of cash circulating in the economy equaled 18.1 percent of the country's gross domestic product. In comparison, in Poland the same indicator was 7.5 percent, in Canada – 3.8 percent, and in Sweden – 2.2 percent.

"It's been a long time since I last used cash in Sweden – cards work everywhere," says Gustav Henman, a Swede, and the cofounder of Beetroot, an IT company that operates in Ukraine.

"In Ukraine, using cash is obviously inevitable in some cases."

Henman even says he enjoys using cash for a change – as long as it's not coins.

"Feels a bit nostalgic and exotic in some way," Henman told the Kyiv Post. "But surely it's convenient not to handle cash. You more or less forget about the whole concept of (paper money) after a couple of years of only card payments."

How to go cashless, and why?

The country's high cash circulation is fueling the nation's corruption problem, says VISA country manager for Ukraine, Georgia and Armenia Dmytro Krepak.

"Cashless means transparency. Cash, on the other hand, is a key element of the shadow economy and corruption in any society," Krepak told the Kyiv Post.

Currently, there are over 31.1 million active payment cards in Ukraine, but that's owing to the fact that an average Ukrainian has more than two cards. And the country's potential is huge, for Krepak says only one-fifth of Ukrainians trust banks and online transactions, and hence there's still a lot of customers waiting to discover cashless services.

The National Bank of Ukraine plans to bring the amount of circulating cash from 18.1 to just 9.5 percent of GDP by 2020, as part of their Cashless Economy project.

Reducing the amount of paper money will increase the database of taxpayers, reduce expenditures on supporting monetary circulation and printing bills, and allow cashless money to be used for economic purposes.

Iryna Kholod, the CEO of consultancy firm E-Commerce Expert says the development of a so-called cashless society in Ukraine will indicate the stability of the country's development and will send a positive signal to the European Union, which Ukraine longs to join.

She thinks that currently not all of Ukraine's transactions are clear, agreeing with VISA's Krepak that cashless payments will help the market become "well-organized and transparent."

"Cashless payments will get most of the transactions out of the shadows, and will show their real volume," Kholod said.

Terminals needed

Although more than 50 percent of Ukrainians' salaries are paid in a cashless form, 80 percent of all spending are done with cash.

Another reason for people to withdraw money they receive on their bank card is the scarcity of point-of-sale terminals in the country. There are 200,000 retail terminals in Ukraine, while VISA's Krepak thinks that the country needs 1 million at least.

After retail, the focus is on making payments for public transport and utilities cashless – these are the two most frequent cash transactions in Ukraine.

"Cashless is convenient," says Yaroslava Boyko, a coordinator at Kyiv Smart City, a group of volunteers that are implementing technology and cashless solutions in Kyiv's public transport and other municipal systems. "Everything can be done with three clicks, which saves up to 30 minutes of one's time."

The NBU also promises to push for utility companies to issue electronic bills. There already are intermediary services that collect utility bills in an electronic form for a customer to pay online.

"Migration to cashless is a global trend, and Ukraine is not an exception here," says Krepak of VISA. "Consumers get more digital, they expect a 'fast-lane' consumer experience and this is what electronic payments offer – they make overall consumer experience better." ■



A woman buys an electronic ticket for a Ukrainian train. Payments for public transport and utilities are still the two most frequent cash transactions in Ukraine. (Volodymyr Petrov)



Despite a massive wave of bank failures, the sector could right itself in 2017, resuming commercial lending that is vital to the national economy. (PHL)

NBU puts small banks under pressure, yet experts stay positive

By **Maria Romanenko**
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Just three years ago there were 178 banks in Ukraine, with assets ranging from Hr 203 billion (\$8.12 billion) to Hr 120 million (\$4.8 million).

Then came revolution, war, economic crisis... and banking collapse.

Today, only 103 banks remain, a 42 percent reduction, with six of those under temporary administration or receivership. As the article was being prepared, another small bank, Investbank, was placed under temporary administration by the National Bank of Ukraine.

After such bloodletting, which the central bank refers to as “cleansing” of the market, the problem of low liquidity in the bank sector is less urgent than it was even six months ago, according to financial expert Vasyl Nevmerzhtskiy.

The issues for today are, instead,

capitalization and the quality of loan portfolios at the remaining banks, he said.

The NBU currently sets the minimum share capital for a bank at Hr 120 million (\$4.8 million), but from July it will increase this to Hr 200 million (\$8 million). As the regulator gradually raised its share capital requirements, banks have been closing, or have merged with, or been bought out by the stronger banks.

“Strategically, by the end of 2017, we may only have around 50-60 banks left,” Nevmerzhtskiy told the Kyiv Post.

And with a new resolution from the central bank (No. 351, setting stricter requirements on reserves to cover loan portfolios) coming into force on Jan. 1, Ukrainian banks, especially the smaller ones, will have to find additional capitalization, making conditions for their survival even tougher.

Small banks “need to create a strategy of

survival, to decide how they will compete with systemic banks,” Nevmerzhitskiy said.

However, the new rules are not designed to sweep all small banks from the market, said Ihor Olekhov, the head of Baker & McKenzie’s regulatory and financial institutions groups in Kyiv. Small but strong banks should be able to keep going.

“Ukraine is in the process of an asset quality review, and there is an intention to set up clear rules in general, under which only banks with sufficient capitalization and high level of reliability can operate,” Olekhov said.

“If banks can satisfy these requirements, nobody will stand in their way,” he added.

But with the Ukrainian banking system undergoing possibly the greatest changes in the history of the country, what is the outlook for the sector? And more specifically, is there a future for the 60 smallest banks, which make up less than 5 percent of the whole banking system in terms of assets?

Changing conditions

According to Olekhov, the banking regulatory system has become a lot stricter over the last five years.

“If a bank’s capital isn’t sufficient, then the NBU implements a three-year plan, according to which a bank is given the choice to either increase its capital, or decrease the amount of risky assets it has,” Olekhov said.

There is also the question of the legitimacy of the bank’s assets.

“Tax declarations, sources of money, transactions carried out, money pay-ins and pay-outs (all need to be approved) in commercial banks,” Nevmerzhitskiy says.

Nevmerzhitskiy also emphasized that the tougher regulatory environment doesn’t necessarily spell the end for the banks at the bottom of the market.

“It’s likely that we will see changes in the amount of banks in total. (We previously had) Alfa-Bank buying Ukrsofsbank, Unicredit closing down, Serhiy Tihipko (the Ukrainian politician and finance specialist) buying Universal Bank. So we’re (also) talking about absorption and gradation,” Nevmerzhitskiy said.

At the same time, new financial companies are being launched, which is changing the whole Ukrainian banking system. According to the registry of the National Financial Services Committee, the country has over 1,700 financial companies. More than 210 new licenses for providing financial services were issued in 2015, and about 190 were issued in the first three quarters of 2016.

“You can now see a lot of currency exchange offices on the streets that belong to financial companies rather than banks,” Nevmerzhitskiy said.

Comparing the conditions for setting up a bank against those for a financial company, it’s easy to see why.

“To set up a new bank today you need Hr 500 million (\$20 million), while financial companies can open with a budget of only Hr 7 million (\$280,000) and provide services

like loan giving, loan buying, factoring and guarantee provision,” Nevmerzhitskiy said.

According to him, many of the new financial companies could be offshoots from banks that have closed, with former bank workers setting up shop to provide niche financial services by themselves.

“If (former) managers of systemic banks carried out factoring in their banks, they might think ‘We’ve already written the procedures, we know the methodology and understand the risks. We can take our old clients, find some money, and set up a financial company to carry out factoring operations.’”

Ukraine may have only 60 banks by the end of 2017, two-thirds fewer than in 2014. But there may still be room in the market for the smaller ones despite the consolidation.

Ways to survive

Olekhov thinks the smaller banks can survive, but to do so they need to take advantage of their strong points.

“They can make decisions quickly and effectively, unlike big banks, where non-standard decisions may take 3-6 months, and sometimes even up to a year,” he said.

“Thanks to their quickness and agility, small banks can offer new and non-standard services.”

And there is a lot of potential in the Ukrainian market for such banks, and if they go about this task creatively, they will do well in Ukrainian environment, Olekhov believes.

A high quality of customer services is another selling point of small banks.

“In a small bank nobody will tell you that the cash register is closing, or that it’s lunch time, or that a computer has broken down. It’s this level of (customer service) that’s very much treasured by clients,” Nevmerzhitskiy said.

“A manager and a client almost become friends: you help him, he helps you. You just don’t get this in the systemic banks,” he added.

So it is vital for bank managers in the small banks to understand the value of their relationships with clients, that these clients are important to them, if they hope to survive, Nevmerzhitskiy said.

Expanding a branch network is not as good a way for the smaller banks to develop as it once was, Nevmerzhitskiy said.

Those that do decide to expand their branch networks can do so by picking up the best staff from smaller banks that have foundered, he said.

“Those banks that are able to (survive) will form a strong team of top managers from people who are working, or have already quit their jobs at other banks, in order to build the most effective sales team, and create innovative services to develop their business.” ■



UkrLandFarming's equipment is seen in Poltava Oblast. The agricultural company is restructuring its large debt among financial problems of its owner Oleg Bakhmatiuk, who also owned two failed banks and who owes the National Bank of Ukraine 11 billion (\$340 million) in unpaid refinancing loans alone. (Ukrafoto)

Risks remain high for lenders in Ukraine's agricultural sector

By **Bermet Talant**
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The failures of Mriya, Creative and UkrLandFarming agroholdings to pay their debts have made some lenders wary of the sector.

Ukraine's agricultural sector is one of the big engines driving the economy, but creditors contended with all sorts of calamities in the last three years – revolution, war, economic recession, high inflation and currency devaluation.

These factors, along with parliament's refusal to lift the moratorium on sales of agricultural land, have clouded financing prospects. Without land as collateral, the 10 largest Ukrainian agroholdings, which control 2.1 million hectares of land, have had to turn to other sources of financing.

Mriya default

Mriya, the Ternopil-based agroholding that controls 180,000 hectares of land in western Ukraine, highlights the troubles. The company went public on the Frankfurt Stock Exchange in 2008. In August 2014, it defaulted to creditors. The previous owners, the Huta family, are suspected of siphoning the money abroad through a network of offshore firms – the alleged scheme came to light in the Panama Papers scandal in April. The Hutus fled Ukraine, leaving Mriya with \$1.3 billion in debt.

Since then, the new management appointed by Mriya's creditors and bondholders has been trying to preserve the agroholding, repay the debt and return the assets illegally seized by

the Huta family. In September, they approved the conditions for restructuring its debt of \$1.1 billion to \$330 million.

On Dec. 16, the Ternopil Economic Court satisfied a claim by BNY Mellon Corporate Trustee Services Ltd., which represents the interests of eurobond holders. They sought the recovery of \$573 million worth overdue obligations from 68 Mriya group subsidiary companies registered in Cyprus that operate in Ukraine and acted as sureties for the bonds issued in 2011 and 2013 by Mriya Agroholding Plc.

Simon Cherniavsky, CEO of Mriya, told the Kyiv Post that this lawsuit was crucial for Ukraine since it was the first time eurobond holders had claimed their rights in Ukraine rather than the country where the bonds were issued. “The Ukrainian judiciary demonstrated its ability to protect the rights of foreign investors,” Cherniavsky said.

According to Volodymyr Igonin, lawyer at Kyiv-based Vasil Kisel and Partners law firm, the Mriya case was a de facto precedent and its experience overcoming massive debt would be employed by other creditors in the future.

Despite this small victory, Alexander Paraschii, research director at Concorde Capital, said Mriya’s experience was unlikely to have any positive outcome for its creditors. He noted that Ivan Huta, the previous owner, recently established a new agricultural company in Ternopil Oblast called Agrarnaya Horodnitsa.

“Most agroholdings are comprised of small collective farms, and by virtue of Ukrainian laws, they can only hold lease rights on farmland. With his power in Ternopil, Huta is able to pull those rights from Mriya in favor of his new agro-company, and Mriya will lose its land bank,” Paraschii said.

Creative bankruptcy

Amid the Mriya crisis, another shock followed up in 2015. One of the leading agricultural processing holdings in Ukraine, Kirovohrad-based Creative Group, was involved in a well-documented forgery. In July 2015, Creative Group was acquired by several investors. An audit revealed falsifications in accounting and collateral documents used for borrowing from banks. As one of the owners Rysbek Toktomushev said, this “massive historic fraud” prevented them from restructuring the debt. In June, they filed for bankruptcy.

“Because of the accounting fraud the actual debt is totally disproportionate to the real income and real asset base of the company: the numbers just don’t stack up.” Toktomushev told the Kyiv Post. “The previous owners pictured income and assets for collateral coverage that had never existed or been far less.”



















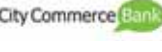

Since the fall of 2015, Creative managed to decrease its debt from more than \$700 million to \$545 million. The major lenders are state-owned Oschadbank (\$313 million), UkrEximBank (\$109 million), private VTB Bank (\$18 million) and Greek-based Piraeus Bank (\$15 million each).

According to Toktomushev, \$74 million debt to the syndicate of European banks, led by UniCredit Bank, was bought out by an investment group whose identity he didn’t disclose. Kernel Group, another giant agrobusiness in Ukraine, acquired an oil-extracting plant Ellada, and thus bought out Creative’s \$95.8 million debt to UkrGazBank.

“Our intention now is to claim damages from the previous shareholders. Also, as the banks foreclose the production assets, our intention is to buy sound production assets back at auctions,” said Toktomushev.

Paraschii of Concorde Capital said that many Ukrainian

Top 10 payouts from Deposit Guarantee Fund

	Amount (million, \$)	Owner of bank	Date of temporary administration
 Delta Bank	606	Mykola Lagun 	March 3, 2015
 Finance and Credit Bank	394	Kostyantyn Zhevago 	Sept. 17, 2015
 VAB Bank	268	Oleh Bakhmatyuk 	Nov. 21, 2014
 IMEXBANK	165	Leonid Klimov 	Jan. 27, 2015
 Nadra Bank	146	Dmytro Firtash 	Feb. 6, 2015
 Forum Bank	110	Vadim Novinsky 	March 26, 2014
 Khreshchatyk Bank	105	Andriy Ivanov 	April 5, 2016
 Brokbusinessbank	102	Serhiy Kurchenko 	Feb. 28, 2014
 Kyivska Rus	83	Viktor Bratko 	March 19, 2015
 City Commerce Bank	75	Nurulislam Arkallayev 	March 26, 2015
Total of top 10 banks			\$2.05 billion
Total payouts to all insured depositors who lost money in failed banks since 2014 (up to Hr 200,000 or \$8,000 limit.)			\$3.03 billion

Source: Deposit Guarantee Fund of Ukraine, National Bank of Ukraine.

agrocompanies tended to abuse international accounting standards. They either overreport expected crop yield and market prices and show high operational revenues from unharvested crops.

Or they conceal from their financial statements some of their assets with large debts, like it was in Mriya; or, as it happened with Creative, they document overestimated or even non-existent assets as collateral for bank loans.

UkrLandFarming's uncertain future

Lately all eyes have been on UkrLandFarming, the largest agricultural holding, which controls 670,000 hectares of land. Not so long ago it was expected to go public, but cancellation of tax relief and economic recession hurt business. In addition, two banks – VAB and Financial Initiative – that belonged to its owner Oleg Bakhmatiuk went bankrupt in 2015.

The NBU filed five lawsuits against Bakhmatiuk, who acted as the guarantor for his banks' loans, to recover debt worth Hr 10.9 billion (\$419 million) and had his property frozen by the court approval. He also owes Hr 5.3 billion to the state banks.

"The NBU will take all measures within Ukrainian law to recover the debt on refinancing loans from the insolvent banks at the stage of liquidation, as well as from their sureties," the NBU press service said. The central bank claimed that Bakhmatiuk was using "semi-legal methods to evade its liabilities, such as foot-dragging on legal processes." Bakhmatiuk, in turn, accused the NBU and its governor, Valeria Gontareva, of attempting to destroy UkrLandFarming.

In October, Bakhmatiuk told Interfax-Ukraine that he was ready to sell the company over the conflict with the NBU. Earlier in April, UkrLandFarming reported successful talks with Deutsche Bank, Russian Sberbank and eurobond holders on restructuring more than a half of its

\$1.7 billion debt.

Bakhmatiuk is under criminal investigation now. He could not be reached for comment.

Alexander Paraschii doubted that Mriya's scenario would work for UkrLandFarming.

"First, Mriya Plc. was officially registered in Cyprus, while most of the assets of UkrLandFarming are registered in Ukraine. This means foreign creditors will have to litigate in Ukraine. Second, we can witness how difficult it is to litigate with Bakhmatiuk – the NBU has won some lawsuits against him, but the court decisions aren't being executed for some reasons," he said.

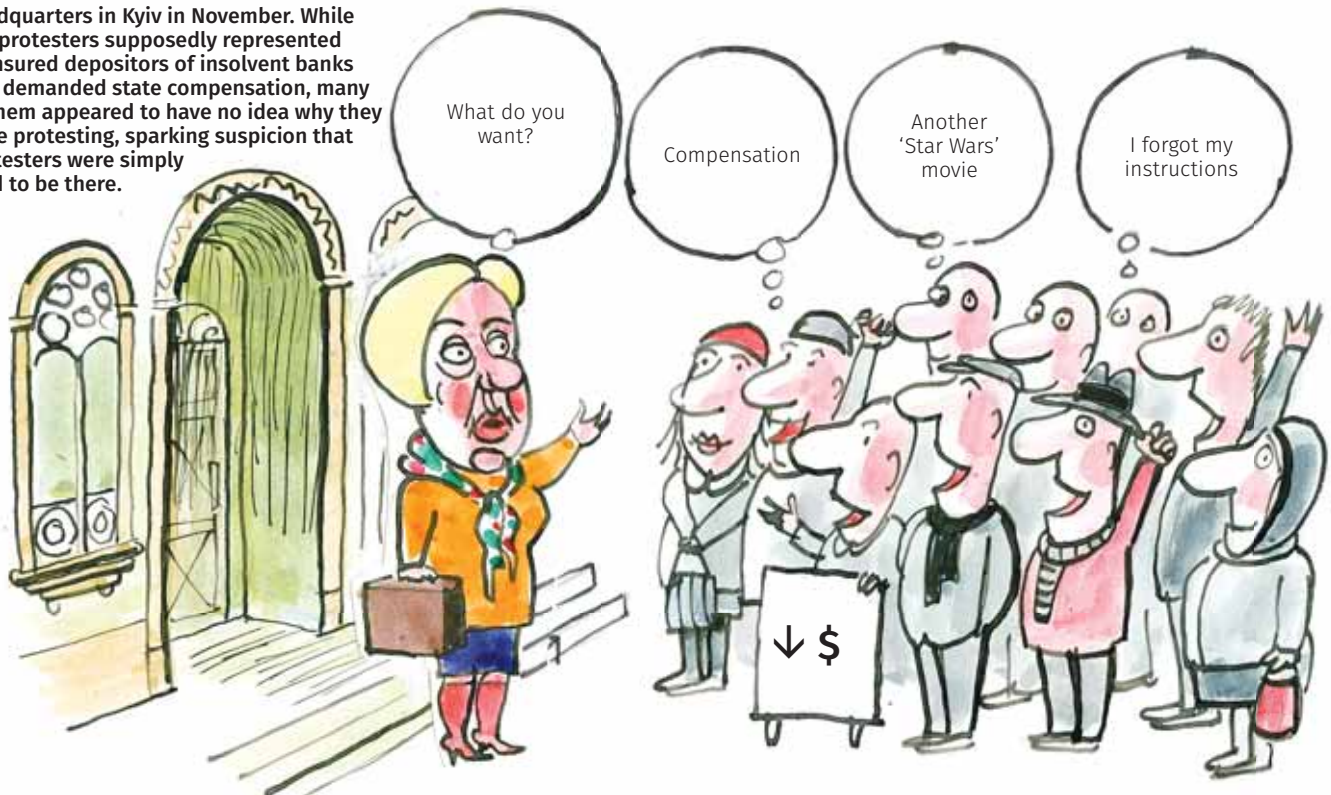
The resolution of these disputes to a large extent depends on debtor companies' ability to negotiate with their creditors as well as relies on compliance with legislation and execution of the judicial orders.

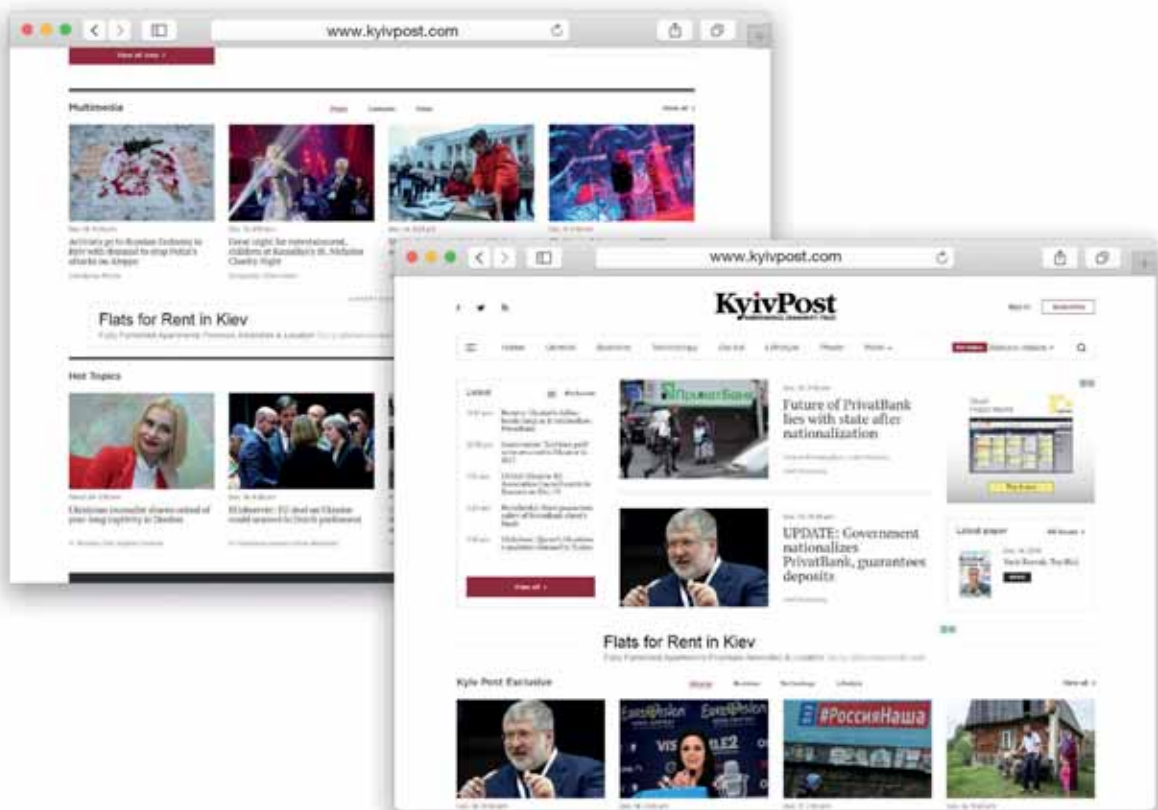
Volodymyr Igonin of Vasil Kisl & Partners said that Ukrainian legislation on debt restructuring is inadequate. Still, the Ukrainian legal framework is being changed to comply with a common business practice of the developed markets.

Comprehensive legal due diligence provides a prospective lender with an understanding of the company's assets and liabilities, as well as available collateral for loan repayment. The high level of implemented corporate governance can be another institutional safeguard from wrongdoings of the management and particular owners.

"Our practice shows that strategic creditors may recommend or even insist on implementation of the best practice of corporate governance (e.g. a powerful supervisory board with independent directors, risk-management procedures, transparent reporting etc.) in a borrowing company as a condition to granting it a substantial loan," said Igonin. ■

NEWS ITEM: Hundreds of people protested near the National Bank of Ukraine headquarters in Kyiv in November. While the protesters supposedly represented uninsured depositors of insolvent banks and demanded state compensation, many of them appeared to have no idea why they were protesting, sparking suspicion that protesters were simply paid to be there.





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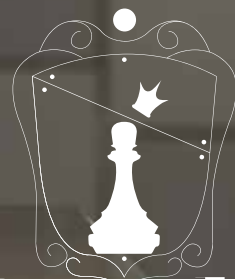
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