

Temporary Administration and State Capitalisation of Ukrainian Banks:

Key Stages and Major Issues



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Since the financial crisis hit Ukraine in autumn 2008 and destabilised its banking sector, Ukrainian banks have struggled to survive and many have been placed in temporary administration by the National Bank of Ukraine (NBU). Simultaneously, in or-

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der to support the banking system and save it from collapse, the state worked out a rescue package one of whose elements includes state capitalisation of banks in need of urgent financial assistance. The state has to date recapitalised three Ukrainian banks¹, two of which (Rodovid Bank and Ukrgasbank) are among the top 25 largest Ukrainian banks in terms of overall assets (as of 1 July 2009²), while two more banks, Bank Nadra and Ukrprombank, also among the top 25 largest Ukrainian banks, are also under consideration for state capitalisation by the Cabinet of Ministers of Ukraine (CMU) and the Ministry of Finance of Ukraine (Min-Fin) having been recommended for this procedure by the NBU³. It is anticipated that the NBU may soon place several other banks in temporary administration prior to some of them, perhaps, being capitalised by the state. In this article, we shall outline some key aspects of the temporary administration and state capitalisation procedures and consider possible future developments.

Temporary administration

Temporary administration has been introduced in 16 banks to date⁴ (from a total of 198 as of 1 July 2009⁵), of which four

banks (Bank Nadra, Ukrgasbank, Ukrprombank and Rodovid Bank) are among the top 25 largest Ukrainian banks in terms of overall assets (as of 1 July 2009⁶).

In essence, temporary administration is a procedure that involves the NBU taking control over, and managing, a bank in order to, *inter alia*, preserve its capital and assets, bring its activities into compliance with Ukrainian law, restore its solvency and liquidity, and remove those factors which resulted in the worsening of its financial health. Despite the fact that there is an established procedure for temporary administration, the NBU has wide-ranging powers to intervene in it, and can at any stage initiate the liquidation procedure if it determines that the financial rehabilitation of a bank is impossible, or dismiss the temporary administrator if it considers that the administrator's actions do not comply with Ukrainian law.

Introduction of temporary administration

Temporary administration can be introduced by the NBU either at a bank's request, or at the NBU's own initiative on the basis of grounds stipulated by law⁷. In the latter case such grounds include: more than one violation by a bank of NBU requirements; a failure by a bank to fulfil at least 10% of its overdue obligations within five business days; the carrying out by a bank of operations which the NBU deems to hold a high level of risk and which have resulted or

¹ Resolutions of the Cabinet of Ministers of Ukraine of 10 June 2009, No. 580 (on the state capitalisation of Rodovid Bank), No. 567 (on the state capitalisation of Ukrgasbank), and No. 566 (on the state capitalisation of Bank Kyiv).

² http://bank.gov.ua/Bank_supervision/Finance_b/2009/01.07.2009/aktivi.pdf (as shown on 18 August 2009).

³ NBU's Resolutions of 16 April 2009, No. 231 (regarding state capitalisation of Bank Nadra) and No. 232 (regarding state capitalisation of Ukrprombank).

⁴ http://bank.gov.ua/Inf_mat/Pres_service/2009/banki_timch_adm.pdf (as shown on 18 August 2009).

⁵ http://bank.gov.ua/Bank_Supervision/dynamics.htm (as shown on 18 August 2009).

⁶ http://bank.gov.ua/Bank_supervision/Finance_b/2009/01.07.2009/aktivi.pdf (as shown on 18 August 2009).



may result in a loss of assets; a decrease of at least 30% in a bank's regulatory capital during the previous six months; the arrest or criminal conviction of any member of the bank's management.

The NBU publishes a notice of the introduction of temporary administration on its official website (www.bank.gov.ua) on the date it takes the relevant decision as well as in the official publications of the CMU (Uryadovi Kurier) or Verkhovna Rada (Golos Ukrayiny) within three days from the date of taking its decision.

Powers and actions of a temporary administrator

Upon appointment by the NBU, the temporary administrator assumes all the powers granted to the bank's

management bodies. Consequently, any agreements executed by the bank's management after the appointment of a temporary administrator are deemed invalid upon execution. Importantly, in addition to the powers usually typical for a bank's management, the temporary administrator is also vested with certain extraordinary rights – for instance, the right to apply to court to request the invalidation of any agreement if (a) within the transactions contemplated by such agreement the bank paid consideration which substantially exceeded the actual value of goods, services or other assets obtained by the bank, and (b) such transactions took place within three years before the appointment of the temporary administrator.

Upon his/her appointment the temporary administrator is obliged to perform a number of actions: examine the bank's financial state, take an inventory of its assets and liabilities, prepare a balance sheet, and provide the NBU with an action plan on how to cure the defects which were the reason for introducing temporary administration. The NBU can

either approve the action plan or appoint another temporary administrator. Measures envisaged by the action plan may include issuing new shares; reorganisation; restructuring of capital, assets and liabilities; liquidation or disposal of unprofitable affiliates; and suspending dividend payments. Usually, temporary administration may not last for more than one year; upon its termination the NBU can either resume the normal course of a bank's business and restore the powers granted to the bank's governing bodies, or liquidate the bank.

Moratorium

During the temporary administration the NBU may, and in practice often does, impose a full or partial moratorium on the satisfaction of creditors' claims. Except for those banks such as Bank Nadra, Ukrprombank and Bank Kyiv that had the benefit of a moratorium prior to and on the date of recent changes to Ukrainian legislation outlined below, such a moratorium may not last more than three months. The moratorium does not apply to those claims related to the servicing of a

⁷The principal legislative acts covering issues of temporary administration include the *On Banks and Banking Activities Act of Ukraine of 7 December 2000, No. 2121-III*, as amended, and the Regulation on Applying by the National Bank of Ukraine of Corrective Measures in Case of Violation of Banking Legislation approved by the Resolution of the NBU's Management Board of 28 August 2001, No.369, as amended.

bank's commercial activities (e.g., payment of salary and royalty, reimbursement of bank's employees for damage to their life or health).

State capitalisation

State capitalisation is one of the possible exit routes for a bank from temporary administration and involves the purchase by the state of a Ukrainian bank's newly-issued share capital⁸.

Conditions of, and procedure for, state capitalisation

Ukrainian law prescribes that state capitalisation is possible only if (i) the bank is an open (public) joint-stock company and meets the criteria for systemic banks established by the NBU, (ii) the bank is in temporary administration, and (iii) the state will take control over at least 75%+1 of the bank's shares (a shareholding sufficient to enable a shareholder to take decisions on any issues considered at the General Meeting of Shareholders of the bank). The decision on whether to undertake state capitalisation is taken by the CMU based upon NBU recommendations, and may contain certain conditions precedent to capitalisation that may include reducing the bank's charter capital, or entering into standstill and restructuring agreements with creditors on the restructuring of its indebtedness.

The management of state corporate rights in the bank is exercised by MinFin, though the actual decision on whether to sell the bank's shares owned by the state is taken by the CMU. Notably, Ukrainian legislation provides the possibility for certain shareholders of the bank to gain control over the bank by offering to purchase those bank shares owned by the state, with the state

required to give its decision on the proposed sale within 60 days of the offer.

After the bank's temporary administrator has arranged for the issuance of additional shares and their sale to the state, the NBU terminates the temporary administration, and the bank's management bodies take control of the bank.

Upside for investors

The procedure for state capitalisation also envisages the opportunity to involve a co-investor provided that the state, in unison with such co-investor, will own at least 75%+1 of the bank's shares, with at least 60%+1 of the shares being owned by the state. In such circumstances, MinFin (acting on behalf of the state) concludes an agreement with the co-investor for joint participation in the bank's capitalisation. The agreement, however, must include the following terms: (i) the bank's shares owned by the state and investor shall be sold as a single lot; and (ii) unless the prior approval of the MinFin has been obtained, the investor may not vote at the General Meeting of Shareholders of the bank to change the bank's charter capital and make amendments to the bank's charter.

No investor has yet been involved in the state capitalisation process. However, for those investors in a position to co-invest with the state, it may be possible to realise significant capital gains resulting from the sale of their shareholding upon privatisation, or perhaps to be in pole position to take a controlling interest when the state sells its equity stake.

Recent legislative developments

Following the requirements of the International Monetary Fund⁹, on 24 July 2009 the Ukrainian Parliament adopted the *On Amendments to Certain Legislative Acts of Ukraine Regarding Peculiarities of Taking Measures on Banks' Financial Rehabilitation Act of Ukraine, No. 1617-VI*, effective from 5 August 2009. The changes introduced by the act concern various issues of banks' financial rehabilitation and envisage, *inter alia*, facilitation

of procedures for a reduction in banks' charter capital, transfer of banks' assets and liabilities, and reorganisation of banks during temporary administration; establishing a "Bail-out Bank", the purpose of which is to protect the interests of banks' creditors by assuming assets and liabilities of insolvent banks; relaxing the taxation of certain transactions undertaken in the course of banks' financial rehabilitation; and increasing the NBU's powers with respect to the moratorium on the satisfaction of creditors' claims with simultaneous reduction of such moratorium's duration from six to three months. It is expected that new legislation will soon be introduced by the CMU and NBU to harmonise with this act and fill in some of the numerous legislative gaps relating to temporary administration and state capitalisation which are currently resolved by state authorities on a case-by-case basis.

Summary

Temporary administration and state capitalisation of Ukrainian banks are extraordinary procedures designed to rescue and then stabilise banks experiencing serious problems which cannot be resolved in the course of their normal business activities. Their implementation affects the interests of a bank's shareholders, customers and potential investors very significantly due to, firstly, the change of control over the bank – from the shareholders to the NBU (upon introduction of temporary administration), and from the NBU to the CMU and the MinFin (upon state capitalisation of the bank), - and secondly, due to the broad scope of powers granted to the state authorities exercising control over the affected bank.

Despite recent positive changes, current Ukrainian legislation remains ambiguous and incomplete, which leads to non-transparent procedures and, to a certain extent, unpredictable results. As the current recession becomes protracted in Ukraine and banks become increasingly fragile and in need of external capital injections and expertise, it is to be hoped that in the immediate future the procedures for temporary administration and state capitalisation will become more coherent and sophisticated to enable these needs to be met more quickly and effectively. ■

⁸ The principal legislative acts covering state capitalisation issues include the *Act of Ukraine On Urgent Financial Crisis Preventative Measures and Amendments to Certain Legislative Acts of 31 October 2008, No. 639-VI*, as amended; the *Procedure for State Participation in Banks Capitalisation* approved by the Resolution of the CMU of 4 November 2008, No. 960, as amended; and the *Special Procedure for Taking Measures on Financial Rehabilitation of Banks* approved by the Resolution of the NBU's Management Board of 1 December 2008, No. 405, as amended.

⁹ <http://www.kommersant.ua/doc.html?docId=1211162> (as shown on 18 August 2009).