

## RETAIL RUN-OFF IN UKRAINIAN BANKING SECTOR. CASE STUDY



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In 2011 and 2012 a number of foreign banks with a presence in Ukraine decided to pursue the strategy of retail business run-off. The hopes of foreign bankers in relation to organic growth of their Ukrainian subsidiaries were not justified. Moreover, many Ukrainian banks faced serious difficulties with repayment of retail debts.

In view of the above, four foreign players declared their plans to quit Ukrainian retail banking business and to completely shift their focus to servicing corporate clients.

As a result, most of those players simply sold off their retail portfolios to Ukrainian players interested in retail business development, including through acquisition of distressed debts, and afterwards closed down their branches and outlets.

In the described environment of the Ukrainian retail banking market one of the exit strategies, recently implemented in Ukraine by a major international banking group deserves special attention.

### Structural Considerations

After a thorough investigation of available options to quit retail business in Ukraine and to remain focused on corporate business development, the following two-stage strategy was chosen by a foreign banking group (the Group): (i) acquisition of a non-operational newly established Ukrainian bank holding a valid banking license — to transfer thereto corporate banking clients (the Target) followed by (ii) sale of a Ukrainian subsidiary (the Subsidiary) to an investor through the auction process, subject to a full parent funding repayment by such investor.

No wonder that in times of recession the most attractive bid was submitted by a Ukrainian investor (the Investor) with an impressive

track record and a solid reputation in the Ukrainian retail banking sector. Hence, to effectuate sale of the Subsidiary, retaining retail loans, as well as the corporate business spin-off into the Ukrainian-owned Target, the Group commenced negotiations with two Ukrainian counterparties.

Given the (i) lack of established practice in Ukraine for the deals of this type (the transaction in question is the first-ever case in Ukraine of selling a foreign-owned bank to a Ukrainian investor so far), and (ii) mixed structure of the Group's exit transaction, containing elements of both equity and debt deal due to substantial amount of outstanding parent funding, as well as (iii) the requirement to make the Target ready for commencement of banking operations and acceptance of the former corporate portfolio of the Subsidiary as a result of the corporate business spin-off, a list of issues faced by the Group and their advisers was especially extensive and therefore required full attention to the project.

As a result of efficient negotiations between all parties involved the overall transaction structure looked as follows:

(1) Simultaneous signing of two share purchase agreements (the SPAs) by the Group — (i) on acquisition of the Target from its shareholders, being Ukrainian individuals. Considering the status of the Target's sellers, as well as the Group's KYC and risk management requirements, ancillary collateral documentation was signed by the parties to secure due performance by the sellers of their obligations under the SPA (the Transaction 1), and (ii) on sale of the Subsidiary, containing the caveat with regard to corporate clients to be spun-off into the Target prior to closing of the SPA (the Transaction 2);

(2) Fulfillment of conditions precedent prescribed for Transaction 1, including obtaining regulatory approvals (i.e. concentra-

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tion permits from the Antimonopoly Committee of Ukraine (the AMCU) and approvals from the National Bank of Ukraine (the NBU) for substantial participation in the Target) by the Group;

(3) Closing of Transaction 1, as well as appointment of new Supervisory Board and Management Board members;

(4) Preparatory actions for making the Target operational, including but not limited to extension of the NBU license for performance of banking transactions, obtaining the licenses for performance of custody and securities trading activities from the National Securities Commission, installation of the necessary software systems, obtaining membership of Visa and Master card payment systems, correspondent accounts opening, hiring new personnel combined with the transfer of certain former employees of the Subsidiary in charge of the corporate business to the Target, obtaining membership of Reuters;

(5) Effectuation of corporate business spin-off from the Subsidiary into the Target;

(6) Fulfillment of conditions precedent prescribed for Transaction 2, including obtaining regulatory approvals by the Investor (i.e. the AMCU concentration permit and the NBU approval for substantial participation with the Subsidiary);

(7) Repayment by the Investor of the Group's funding earlier extended to the Subsidiary through the mixture of the Subsidiary's additional liquidity and the funds additionally attracted by the Investor and placed with the Subsidiary after execution of the SPA;

(8) Closing of Transaction 2, including appointment of the Investor's representatives to the Subsidiary's governing bodies.

## Key Legal Considerations

### Regulatory Approvals

In late 2011 new NBU regulations came into force, which significantly amended the procedure of obtaining NBU approval for cross-border acquisitions in the Ukrainian banking sector, making them longer and more complicated. Such procedure remained untested within the course of obtaining NBU

approval for the Target acquisition by the Group. Moreover, according to recent legislative novelties a bilateral agreement between the NBU and a banking regulator of the applicant's jurisdiction (the Group's Holding Company in the given case) is required for obtaining NBU acquisition approval<sup>1</sup>. Given the lack of bilateral agreements between the NBU and most European jurisdictions, as well as the NBU interpretation letter<sup>2</sup> stating that lack of the respective bilateral agreement leads to the NBU rejection from granting the acquisition approval to the applicant, substantial efforts were put on establishing connections between the NBU and the foreign regulator, as well as on facilitation of executing a bilateral agreement. Well-arranged and coordinated actions of the Group and its advisors aimed at preparing the NBU application for the acquisition and the underlying documents, as well as established cooperation on the regulators' side enabled the Group to obtain NBU acquisition approval — being the very first in Ukraine issued to a legal entity in accordance with the new procedure.

### Minority Shareholders Rights

Proper planning and structuring of the project required observance of minority shareholders rights. Firstly, according to the laws of Ukraine, minorities are entitled to require a buy-out of their shares at a fair market value in case of voting against entry into any material transaction by the issuing bank (effectuation of the corporate business spin-off by the Subsidiary in the given case). Secondly, the acquirer of the controlling share stake in a Ukrainian legal entity (the Investor in the given case) is obliged to send a mandatory offer to minorities to buyout their shares at their fair market value. Fortunately, from the Ukrainian law perspective obstruction by minorities against either corporate business spin-off

<sup>1</sup> As of the date of writing this article bilateral agreements are in place with banking regulators of the following jurisdictions: Armenia, Belarus, China, Cyprus, Hungary, Kyrgyzstan, Latvia, Lithuania, Luxembourg, Poland, Russian Federation, Sweden, Turkey.

<sup>2</sup> NBU letter No 18-313/6192-12246 provided in response to ACC inquiry.

by the Subsidiary or acquiring the controlling share stake in the Subsidiary by the Investor can hardly be treated as an obstacle to closing of the transaction as long as their shares are bought out at the fair market value.

## Implications of Corporate Business Spin-Off

The following issues had to be properly handled within the course of corporate business spin-off:

(1) obtaining consents from the clients (where required by the loan agreement) for the transfer of the corporate loan portfolio by the Subsidiary to the Target (through assignment of loan claims and the underlying security at the net book value), as well as for banking secrecy disclosure;

(2) obtaining consents of beneficiaries under guarantees issued by the Subsidiary for replacement of the guarantor to the Target;

(3) replacement of FX control agent under FX export import contracts serviced by the Subsidiary to the Target;

(4) obtaining clarifications from the NBU allowing to consider the credit history of corporate clients in the Subsidiary for the Target's lending purposes — not to decrease the borrowers classification and, therefore, to avoid additional provisioning.

## FX Implications

To ensure due repayment of outstanding parent funding of the Subsidiary prior to closing of Transaction 2, utilizing the mixture of the excess of the Subsidiary's liquidity and the funds additionally attracted by the Investor, the following actions were required:

(1) adoption of a deposit retention program for the Subsidiary, envisaging the range of interest rates that could be offered to depositors in order to retain existing liquidity of the bank within the pre-closing period;

(2) entry into USD/UAH SWAP transactions with Ukrainian commercial banks and the NBU — to ensure repayment of USD-denominated outstanding Group funding at the expense of funds attracted by the Ukrainian investor, mostly in UAH.

well as public private partnership concessions and infrastructure law.

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