

## Privatbank nationalization: top questions

Flash note / Fixed Income / Banks

### How will the nationalization occur and what is the recovery value for Eurobond holders?

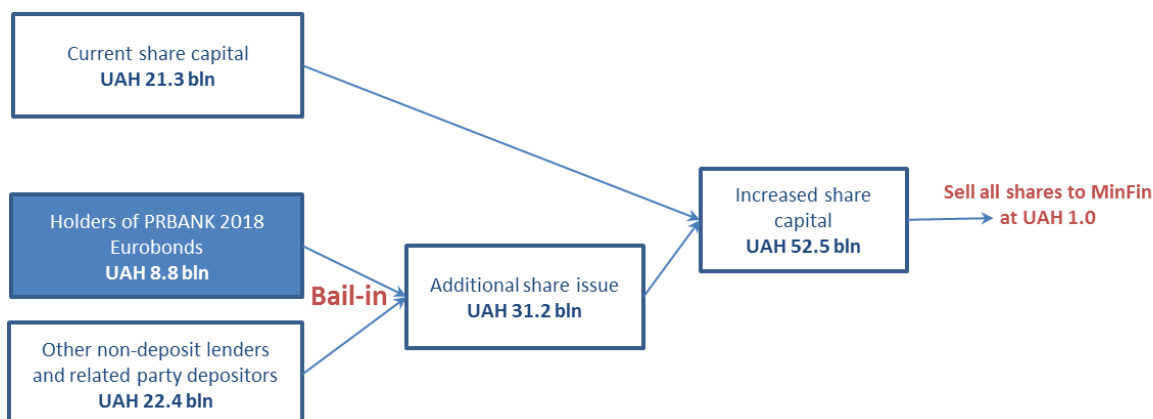
**The recovery value is ZERO.**

**The procedure is as follows:**

- 1) The bank is recognized insolvent and is transferred into the Deposit Guarantee Fund (today).
- 2) The Deposit Guarantee Fund will (in one-three days):
  - Provision the bank's loans based on central bank (NBU) estimates. The NBU sees that all the related party loans should be fully provisioned. This will create a capital gap of about UAH 148 bln, according to the NBU.
  - The Fund also have a right (not obligation, but according to the NBU it will use this right) to convert into equity (**bail-in**) all the unsecured non-deposit liabilities and liabilities to related parties via additional issue of the bank's shares:
    - o The total value of such liabilities is UAH 31.2 bln
    - o **This includes all the bank's Eurobonds**, including PRBANK 01'18 bonds for USD 160 mln and PRBANK 02'18 bonds for USD 175 mln (total estimated par value of UAH 8.8 bln).
- 3) If the capital of Privatbank after the bail-in and provisioning is negative (which will be the case), the Fund will sell the bank to the Finance Ministry for UAH 1.0 (in one-three days).

**All in all, the holders of 2018 Eurobonds will become the holders of 17% in Privatbank equity for a while. 100% of the bank's equity will be sold to MinFin at UAH 1.**

### How Privatbank's nationalization will look like (timing – three days)



The above procedure is stipulated by the law on the State Deposit Guarantee System, which was amended in mid-2015, most likely, following IMF negotiations.

## How the capital gap emerged and who bears responsibility?

The gap is the result of full provisioning of loans to related parties (gross amount of about UAH 168 bln), which is fully non-performing, according to the NBU. The central bank believes this entire related loan portfolio should be fully provisioned (the current rate of provisioning is about 10%). The 100% provisioning is required as all the loans have no hard collateral, and all the related borrowers are empty shells.

Responsibility for the capital gap is with:

- The bank's shareholders, which in fact created a "vacuum cleaner" as it's locally called, or a financial entity that took deposits from households (for about UAH 153 bln, plus UAH 5.5 bln taken on behalf of the bank by its P2P program), and lent mostly their own related businesses.
- The NBU for inefficient supervision in the past (the problem of de facto, non-performing loans to related parties is not new).
- The NBU for delaying the bank's nationalization (according to the NBU, the one-year delay in the bank's resolution resulted in a UAH 16 bln increase in the capital gap).
- The bank's auditing firm – PWC – which failed to disclose a risk of absence of hard collateral under most of the bank's loans, and reported the bank's low exposure to related parties (about 22% of corporate loans, not 98%, as claimed by the NBU).

## Is there any chance for the bank's bondholders to recover their value?

The prospectuses of PRBANK notes envision the possibility of accelerating the notes in case the bank is declared insolvent. At this stage, we have little understanding on how this could be enforced. As we highlighted above, Ukrainian legislation allows government agencies to bail-in the unsecured bondholders.

We believe there is some chance to claim the recovery of the noted in international courts:

- The Deposit Guarantee Fund is not obliged by law to bail in Eurobond holders.
- According to Privatbank, it was the National Bank of Ukraine who forced Privatbank to restructure its Eurobonds maturing now in January 2018 (the initial maturity was in September 2015). At the date of restructuring, the NBU was aware of all systemic problems of the bank (including huge capital gap and high probability of its nationalization) – so, in our view, the regulator was not sincere with the bond holders last year.

Our understanding is that using the right to bail in Eurobond holders wasn't sole initiative of the NBU or the Deposit Guarantee Fund – this was insisted by the IMF.

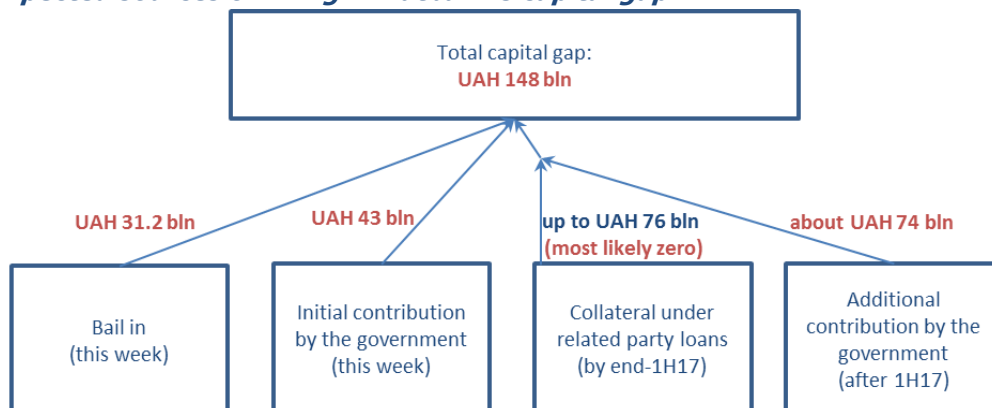
## What will be the government’s next steps?

The Finance Ministry will recapitalize the bank after due diligence. Based on preliminary NBU estimates, Privatbank’s total capital gap is UAH 148.0 bln.

This gap will be filled in the following way:

- UAH 31.2 bln - via bail-in (this week).
- UAH 43.0 bln - will be contributed to bank equity by MinFin via local government bonds (this week).
- About UAH 73.8 bln (the exact number will be available after due diligence) is expected to be contributed by Privatbank’s existing shareholders in the form of hard collateral under loans that they took from the bank. The expected effect of collateral on the bank’s capital is up to UAH 76 bln, based on NBU estimates. The deadline is end-1H17. It’s clear now that the bank’s existing shareholders won’t contribute anything. So, most likely, it will be MinFin that will have to contribute the rest of the gap.

### *Expected sources of filling Privatbank’s capital gap*



## Will the bank’s existing shareholders be punished for the losses?

The NBU is still expecting to recover up to UAH 76 bln from the bank’s related party borrowers, in the form of contribution of hard collateral. As we understood it, this was the written obligation of the shareholders, with no way to enforce it. The only way to force the shareholders to repay the related loans is a threat of criminal persecution. However, in our view, this is a poor stimulus. That said, we do not expect the bank’s shareholders will contribute anything more to the bank’s bailout, nor do we expect any punishment for them.

That said, the bank’s nationalization will cost the full loss of the Eurobond holders’ contribution to the bank, as well as about UAH 117 bln to the state budget.

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