

Oligarchs making gains: the costly nationalisation of Ukraine's PrivatBank

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On 18 December, the government in Ukraine decided to nationalise the country's largest bank, PrivatBank. It has been owned by the oligarchs Ihor Kolomoyskyi and Henadiy Boholyubov (over 90% of the shares). Formally, the decision was taken following a motion from the National Bank of Ukraine (NBU) and the Financial Stability Council after the major shareholders put forward a proposal to the government to take over the bank for the benefit of its clients. On 19 December, in an attempt to calm the situation on the market, Ukraine's most senior officials, including the president, the prime minister and the head of the NBU, guaranteed the safety of deposits to clients of PrivatBank. In the pessimistic scenario, the state will have to pay 148 billion hryvnias (around US\$5.5 billion) for the nationalisation of this bank.

The decision to nationalise PrivatBank did not come as a surprise, and no major obstacles have yet been seen in the acquisition process. The bank has had serious liquidity problems for several years. The International Monetary Fund has insisted the bank be reorganised as part of the programme for clearing the Ukrainian banking system, and have made the availability of the fourth instalment of the loan (around US\$1 billion) dependent on this. The consent to nationalise the bank also has a political aspect and is a consequence of an informal deal between President Petro Poroshenko's camp and the previous shareholders. The party which has benefited most of all from this deal is Ihor Kolomoyskyi, who has got rid of the enormously indebted bank at the expense of the state and has most likely strengthened his position in other sectors of the country's economy.

PrivatBank – a giant with feet of clay

PrivatBank is Ukraine's largest and technologically most advanced bank – its assets in November this year were assessed at 271 billion hryvnias (around US\$10 billion, 25% of the assets of the Ukrainian banking system as a whole) and it provides services to around 50% of Ukraine's retail clients. The bank also has the largest network of ATMs and payment terminals in the country. Considering the scale of the assets and the value of the loans granted, PrivatBank has been recognised by the central bank as one of the three banks of key significance for the stability of Ukraine's banking system.

At the same time, PrivatBank has long had serious problems with financial liquidity, mainly due to its loan policy. Kolomoyskyi and Boholyubov offered high interest on savings. Then they used the deposits to provide loans to the companies they were linked to without

properly securing them. As a result, the share of so-called “bad loans” in the bank’s portfolio in December this year was assessed at 97% by the regulator and at 80% by market participants. In the opinion of the NBU’s head, Valeriya Hontareva, PrivatBank needs 148 billion hryvnias (US\$5.5 billion) to pay for its liabilities, that its debt to the NBU as part of stabilisation loans is 14 billion hryvnias (US\$550 million), and that total debt is 19 billion hryvnias (US\$700 million). Furthermore, the bank failed to carry out the plan for increasing capitalisation which had been agreed with the NBU and continued siphoning off funds. The bank’s dramatic situation which could potentially destabilise Ukraine’s banking system as a whole and has led to action to recover PrivatBank becoming one of the main conditions set by the IMF as part of implementation of the three-year programme of financial support to Ukraine worth US\$17.5 billion.

Operation ‘nationalisation’

A smooth takeover of PrivatBank by the state will be the largest and technically most difficult operation in the history of Ukraine’s banking system. 100% of shares in PrivatBank were taken over on 19 December by the Ministry of Finance of Ukraine for the symbolic price of 1 hryvnia. To avoid massive withdrawal of deposits, the Verkhovna Rada passed a law on 20 December to additionally protect the bank’s clients’ rights (guaranteeing 100% of the deposits’ value, regardless of their size), also on 20 December the NBU recapitalised the bank with 15 billion hryvnias (US\$550 million). The Minister of Finance, Oleksandr Danylyuk, announced that at the initial stage the ministry will issue internal bonds worth 43 billion hryvnias (US\$1.5 billion), which will be cashed (bought by the NBU) only if there is panic on the market. In the worst-case scenario, the ministry will repeat this operation four more times, increasing PrivatBank’s capitalisation by 148 billion hryvnias (US\$5.5 billion). The government has also appointed a new president of the bank in co-operation with the IMF. The new president is Oleksandr Shlapak, an experienced politician and manager in the banking sector, who has served as minister of finance (February – October 2014), deputy head of the NBU (2003–2005), and head of PrivatBank’s Lviv branch from 1993–1998.

A Poroshenko–Kolomoyskyi pact?

Given PrivatBank’s ownership structure, there is a political tone to its nationalisation. The government’s decision to take over the bank was preceded by informal negotiations between President Poroshenko and Ihor Kolomoyskyi which ended in a compromise. The tactical alliance between these two politicians lasted between March 2014 and March 2015. After Poroshenko was elected president in May 2014, he decided that Kolomoyskyi would maintain his position as the governor of Dnipropetrovsk Oblast and that his business partner, Ihor Palytsia, would stay on as the governor of Odessa Oblast. However, Kolomoyskyi’s attempts to strengthen his position in the oil sector and increase the popularity of Ukrop (the political party linked to him and critical of President Poroshenko) have led to an open conflict with the president.

The person who will benefit most from the nationalisation of PrivatBank is Kolomoyskyi, who is handing the enormously indebted bank to the state. He siphoned off billions of dollars from this bank in the past (around US\$2 billion as part of sham import contracts over

the past two years alone). As part of the compromise with the government he will most likely additionally receive a guarantee of political immunity and of maintaining influence in other sectors of Ukraine's economy, above all the oil sector. He holds a 43% in the largest company in this sector, Ukrnafta (50% plus one share is owned by the state). Proof of this may include the amendments to the tax code adopted on 20 December reducing oil field operation charges by almost a half. Even though, according to the Ukrainian minister of finance, the deal with Kolomoyskyi and Boholyubov envisages that the previous shareholders will compensate for the state's expenses on recapitalising PrivatBank, seems unlikely that this will be the case in practice.

The compromise on the takeover of PrivatBank proves that the conflict between Poroshenko and Kolomoyskyi has ended and may be an element of a more comprehensive deal between them. It cannot be ruled out that the price of the state's takeover of the insolvent bank – given Poroshenko's falling popularity and the upcoming election – will be support from Kolomoyskyi's media (the 1+1 Media Group) and common political front against Yulia Tymoshenko's Batkivshchyna and Opposition Bloc, which have been gaining strength.

The consequences of PrivatBank's nationalisation

The state's decision to take over the bank has been positively received by the IMF, G7 and the European Union. The nationalisation is an important step towards the stabilisation of Ukraine's banking system. The government's intention is to strengthen and restructure PrivatBank, and then, at least in part, to sell it to a foreign investor. No withdrawals were seen on 19 and 20 December on a scale that might pose a threat to the bank's stability, although it may be expected that some of the clients will no longer use PrivatBank's services due to the reduction of the interest rates on deposits and the distrust of state institutions. Even though it is difficult at the present stage to assess how PrivatBank's nationalisation will affect Ukraine's macroeconomic situation, it may be expected that it will increase inflationary pressure and reduce the exchange rate of the Ukrainian currency in the short term.