

client alert

BANKING AND FINANCE | UKRAINE

10 AUGUST 2015

NEW LAW: REVIEW OF THE BANKING SECTOR REFORM

Draft Law no. 2045a On Amendment of Certain Laws of Ukraine Related to Improvement of the System for Individual Deposit Guarantee and Removal of Insolvent Banks from the Market has been approved by Verkhovna Rada in July. If signed into law, it will bring a revision of many substantial rules on how insolvent banks are dealt with.

Below are selected changes that will directly affect creditors of sub-standard banks.

RANKING OF THE CREDITORS

The Parliament has amended the ranking of the creditors: now, individual entrepreneurs are at par with ranks 4 and 6 (individual depositors not covered by the DGF payments and claims of the individuals under the checking account agreement, respectively). Two new rankings 7 and 9 were created, respectively: (7) claims of other unaffiliated depositors and of unaffiliated legal entities - customers of the bank; (9) claims of affiliated creditors of the bank. It must be stressed that claimants of the subordinated debt are the only creditors behind the affiliated creditors of the bank and can only improve their position by taking a pledge (mortgage) over the bank's assets.

REVISED RULES FOR THE STATE TO BAIL OUT BANKS

The state of Ukraine must pay for removal from the market of a systemically important bank in one of the following forms or combination thereof:

- (i) acquisition by the Ministry of Finance or by a state-owned bank of (a) the insolvent bank or (b) its assets and liabilities; and/or
- (ii) transformation of the insolvent bank into a 'transition bank' with the state acting as investor.

We note that potential targets of such mandatory bail out are: four privately owned banks: Delta Bank, Privat Bank, Raiffeisen Bank Aval and Ukrsotsbank; two banks controlled by the Russian Government - Prominvestbank and Sberbank Rossii.

INVALID *AB INITIO*. RESET

The Draft law further expands the grounds to invalidate contracts if the bank - counterparty has become insolvent: when the bank is sub-standard (in the NBU classification), it cannot form new, extend or transform pre-existing contracts if that would result in the increased costs for the removal of such bank from the market. We believe the clause seeks to address, primarily, the issue of attracting (preserving) deposits at higher interest rates or split of large deposit into several small ones to increase exposure of the Deposit Guarantee Scheme. However, this 'catch all' language makes it harder to transact with the sub-standard bank in any type of a contract.

The legislature had mixed progress in clarification of the criteria for 'creating privileges to one creditor over another' - the law explains, that the DGF must suspend operation under the transaction that seeks to: (i) secure performance by the bank under the obligation that has arisen prior to the temporary administration of the bank; (ii) change ranking of the creditor; or (iii) perform obligations early.

RING FENCING THE ASSETS OF INSOLVENT BANKS

The Draft law restated key provisions on the rights of third parties to the assets of insolvent banks. First, while the bank is under temporary administration, no foreclosure on its assets can take place, including attachment; existing attachments and public liens on the assets of the bank must be lifted. No creditors of the bank can benefit from the offset (in any way under the Civil Code of Ukraine) during this period.

Second, during the liquidation, the bank can accrue certain interests and penalties, at discretion of the liquidator. Further, the liquidator can allow offsets with unaffiliated creditors, provided they did not acquire their claims to the bank; i.e., such creditors can, if needed, assume the debt to the bank, for example, from the borrowers. The law effectively prohibits consolidation of debt / investment in the claims to the bank. The cross-currency exchange rate applicable to the offset (when such is allowed), is the official rate on the date when the DGF starts removing the bank from the market.

Third, although some MPs proposed to save banks through conversion of deposits into hares, however the sponsors of the law shelved the idea.

PROCEDURAL REMEDIES

Activities of the DGF with respect to the insolvent bank cannot be restrained by a court injunction or attachment of assets. Moreover, any attachment of the bank's assets instituted prior to the bank becoming insolvent will not prevent a transfer of such assets, e.g. to the transition bank.

Furthermore, neither the insolvent bank, nor its beneficiaries can contest acquisition of the former's shares or assets and liabilities, claim any direct or collateral damage on the grounds of invalidity or illegality of the transfer; such prohibition comprises non-fallibility of the decisions and actions by the DGF and its counterparties in the above transfers.

LIQUIDATION OF BANKS FROM THE OCCUPIED TERRITORIES

The law resolves situation with the banks registered in the Crimea and East Donbas through liquidation - the National Bank of Ukraine must decide on revocation of the licenses and liquidation of the banks that neither participate in the centralized system of electronic payments nor conduct other banking activities. In practical terms, the DGF will be able to seize and sell the assets of such banks held in 'mainland' Ukraine which are within the reach of the executive and judicial authorities. The constitutionality of this approach, however, can be seriously questioned.

DAILY MONITORING

Each bank will be obliged to keep a database of depositors, their deposits and interest liabilities that can be accessed by the Deposit Guarantee Fund (DGF) on a daily basis. In its turn, DGF must publicise certain information with respect to the insolvent bank, in particular:

- financial reports;
- main sections of the assets evaluation report;
- results of the inventory check (actual assets v. assets on the balance);
- ways and means applicable to the disposal of the bank's assets;
- schedule of expenses incurred by the DGF in administration of such bank.

A bank may not be placed into temporary administration for longer than two months (used to be 3-6 months), including permitted extensions.

Note to the reader: There are currently about 60 of insolvent banks (UAH 300 billion balance sheet value) under the management of the Fund and its agents. The figure can double or triple under the strategy announced by the National Bank of Ukraine.

**BANKING & FINANCE
CONTACT LAWYERS**

IGOR KRASOVSKIY
igor.krasovskiy@gide.com

OLEH ZAHNITKO
oleh.zahnitko@gide.com

RESIDENT PARTNERS

BERTRAND BARRIER
barrier@gide.com

DR JULIAN RIES
julian.ries@gide.com

DR OLEKSIY FELIV
oleksiy.feliv@gide.com

You can also find this legal update on our website in the News & Insights section: gide.com

This newsletter is a free, periodical electronic publication edited by the law firm Gide Loyrette Nouel (the "Law Firm"), and published for Gide's clients and business associates. The newsletter is strictly limited to personal use by its addressees and is intended to provide non-exhaustive, general legal information. The newsletter is not intended to be and should not be construed as providing legal advice. The addressee is solely liable for any use of the information contained herein and the Law Firm shall not be held responsible for any damages, direct, indirect or otherwise, arising from the use of the information by the addressee. In accordance with the French Data Protection Act, you may request access to, rectification of, or deletion of your personal data processed by our Communications department (privacy@gide.com).