BATTERED AND BRUISED BUT READY TO MOVE FORWARD

BTA Bank has been at the centre of a financial storm involving a state bail-out, Kazakhstan's real estate crash and rotating central bank governors. However the tools to stabilise the situation now appear to be in place.

WRITER *Philip Alexander*

When the state holding and investment fund Samruk-Kazyna began moves to take majority stakes in BTA Bank and Alliance Bank in February 2009, Kazakhstan's financial crisis had entered a new phase. In the same week, Grigoriy Marchenko, reappointed governor of the National Bank of Kazakhstan (NBK) after a four-year absence, devalued the Kazakh tenge exchange rate about 18% against the dollar. The outgoing NBK governor, Anvar Saidenov, moved to BTA first as an adviser to, then as a replacement for, CEO Roman Solodchenko.

In practice, the exchange rate position of most major banks was neutral – their external borrowings were matched by loans made to clients in foreign currencies, equivalent to about half their total loan portfolios. Unfortunately, the same could not be said for retail customers earning their wages in tenge. And while rental on commercial property is paid in dollars, the global credit squeeze deprived many construction and development companies of the funds to finish their projects.

With such uncertainty hanging over bank assets, international capital markets are reluctant to refinance their liabilities. Even the sovereign seems unlikely to re-access the Eurobond market soon — at least if the finance ministry listens to Mr Marchenko in his advisory capacity. "We would definitely advise against it because it is quite obvious that international borrowing would be prohibitively expensive, and the government still has a substantial amount in the National Fund [its oil stabilisation fund]," he says.

This leaves a question mark over how far the government can afford to refinance the banks, says Ivailo Vesselinov, Commonwealth of Independent States (CIS) economist for Dresdner Kleinwort in London. He calculates external debt payments due before the end of 2010 at $45bn, compared with cumulative foreign exchange reserves (both at the National Bank and in the National Fund) of just $46bn in February 2009.

"We remember very well from the 1990s what borrowing from the IMF means, and we would not like to repeat it"
Grigoriy Marchenko

Mr Marchenko says the new exchange rate level of about Tg150 per dollar should be stable, and that foreign exchange reserves are starting to recover. "Commercial banks no longer need to use the central bank's tenge/dollar swap operations. Dollar liquidity was available at all times, and demand for dollars was quite strong until February, but after the government announced measures to refinance the real economy there has been a slowdown in demand in March and even more so in April, as people have accepted the new exchange-rate corridor."

He says the central bank began net buying of dollars again from April, and he dismisses as "complete baloney" newswire reports that the government was thinking of introducing capital controls to stem foreign exchange outflows. "The law already says that the government can introduce capital controls if necessary, but there are no plans to introduce them. We signed up to the IMF article on free convertibility of the current account in 1994, and in 2007 to the article on free convertibility of the capital account."

OIL RELIANCE

Max Wolman, an emerging market debt portfolio manager for Aberdeen Asset Managers, says the new exchange rate could be sustainable if oil prices continue to trade above $50 per barrel. But if the authorities need to make a new adjustment, he says they are unlikely to do so until the second half of 2009, when some of the heaviest external debt repayments will have been made.

One choice for the government would be to approach the IMF for emergency funding, but Mr Marchenko makes his views on this very clear. "We remember very well from the 1990s what borrowing from the IMF means, and we would not like to repeat it," he says.

The remaining viable choice is to ask creditors to write down the debts of those banks where the state has stepped in, and the new management teams of BTA and Alliance have already begun the process of restructuring their external debt. Alliance defaulted on the principal repayments of its commercial paper programme in April 2009, although it continued to pay the coupon. BTA appointed law firm White & Case, together with Goldman Sachs and later UBS, as restructuring advisers. There were immediate rumours that creditors had sought to exercise 'change of control' clauses in BTA's loan agreements to claim acceleration of the bank's debts.

"It is technically not a nationalisation, because it was an issuance of new shares, but many counterparties are taking the position that the acquisition by Samruk-Kazyna of more than 75% of the shares does violate the change of control clause in their loan contracts, and the acceleration right is unilateral to the creditor," says Curtis Masters, financial services partner at law firm Baker & McKenzie's office in Almaty.

"To our knowledge, no one has exercised their acceleration right so far and they are waiting for the restructuring plan. An acceleration could cause the bank to collapse, so the counterparties have shown restraint and patience," says Mr Masters.

BTA's CEO Mr Saidenov has stressed that the bank would stay current on its debt repayments until the due diligence and restructuring plan was completed. Advisers were due to present their findings at a board meeting on April 29, but the report may not now be published until Russia's Sberbank has completed its own due diligence, with a view to buying all or part of BTA.

OPAQUE OWNERSHIP

Any negotiations are likely to be complicated by the ownership structure of the bank's foreign subsidiaries. Two of these, in Russia and Kyrgyzstan, are majority-owned by BTA, but of the remainder, in Belarus, Ukraine, Georgia, Armenia and Turkey, BTA holds minority stakes. The majorities are often controlled by offshore investment funds of which the final beneficiaries are unclear.

There is particular confusion over the Ukraine subsidiary, which was previously 49%-owned by BTA, but apparently announced around the time of Samruk-Kazyna's intervention that the parent bank had sold its stake down to just 10%. "Our representatives went to the shareholders' meeting with formal powers of attorney, and we will see what the result is. We want to find out if there were legal grounds for such a decrease of our stake," says Mr Saidenov.

He dismisses claims by the previous management that BTA was due to receive a corporate deposit of about $1bn – possibly from state-owned KazMunaiGaz – that would have cured the bank's liquidity problems without government intervention. "The funds of major national companies are evenly spread between the three or four top banks to spread risks, so we had a proportion of the deposit of KazMunaiGaz, although less than Halyk or Kazkommertsbank. The deposit is still there, so I do not know what the previous management is referring to," says Mr Saidenov.

DIFFICULT SITUATION

The apparent reluctance of the previous owners to co-operate with Samruk-Kazyna – by contrast with Alliance Bank – has made the situation more difficult, according to Ulf Wokurka, who was appointed an independent director of BTA in March 2009.

"What is sad is that the old management has almost entirely disappeared with no proper handover, so the new management is discovering gaps that do not help rebuild confidence. They are dealing with a black box," says Mr Wokurka.

The chief financial officer of state holding company Samruk from 2006 until August 2008, Mr Wokurka is now a managing director at Germany's Metzler Asset Management, with particular responsibility for developing business in the CIS.

Mr Saidenov maintains that the ownership questions should not be an obstacle to restructuring the bank's foreign holdings. "We are flexible, and we had a proposal for our subsidiary in Armenia, but it did not offer a positive return on our investment," he says. "A lot will depend on the business prospects for the subsidiary in each country, the macroeconomic situation, the policy of the regulator, how well run the bank is, and what the control of BTA is on the supervisory and management boards. We will decide case by case." »

"The SME sector is most affected by the current situation, and in many regions it is the leading taxpayer and biggest employer – 60% to 70% of tax revenues in Almaty come from SMEs"

Anvar Saidenov

KAZAKHSTAN BANKS GOVERNMENT FINANCING ALLOCATIONS, 2009 (TGBN)

	Financial sector stabilisation	Refinancing mortgage loans	Refinancing SME loans
BTA Bank	212	40*	22
Halyk Bank	60	24	11.7
Kazkommertsbank	36	24	16
Alliance Bank	24	14	18

Note: SME – small and medium-sized enterprises. *Of which Tg28bn for BTA and Tg12bn for BTA Ipoteka. BTA subsidiary Temirbank has been allocated a further Tg3bn; Source: Kazakhstan Financial Services Authority

> ALL THE BANKS WERE FAIRLY AGGRESSIVE MOVING INTO THE SME SECTOR, SO THERE WAS HUGE COMPETITION TO MAKE HIGH-RISK LOANS, AND THESE SMALL BUSINESSES COULD JUST CLOSE DOWN
> *Max Wolman*

The government has encouraged Kazakh banks to focus their activities at home, by providing funds through Samruk-Kazyna to refinance residential mortgage and real estate development portfolios. In addition, Samruk-Kazyna's microfinance unit, Damu Fund, is providing funds for loans to small and medium-sized enterprises (SME) lending portfolios (see table). The SME fund allocations are to be split 70:30 between refinancing of existing debt and extending new credit. The rates on loans financed by Damu in this way will be capped at 12.5%.

"The SME sector is most affected by the current situation, and in many regions it is the leading taxpayer and biggest employer – 60% to 70% of tax revenues in Almaty come from SMEs," says Mr Saidenov.

Under the mortgage package, interest rates will be capped at 11% for private sector employees and 9% for public sector staff. The full implications of the mortgage modifications for residential mortgage-backed securities (RMBS) programmes by banks such as BTA subsidiary Ipoteka remain to be seen, says Mr Masters. "In a securitisation, the mortgages have effectively been sold to another company, the special purpose vehicle. The question is whether that company can be forced to change the terms of that mortgage at the government's request."

Mr Saidenov says 42% of all BTA loans have some link with real estate risk, through direct lending to developers and construction firms or because loans are collateralised by land or property, and the bank will work to diversify this exposure. The exact level of non-performing loans (NPLs) is one of the issues awaiting clarification, but according to Fitch Ratings, the bank has provisioned for almost 25% of its entire loan portfolio.

IN THE BALANCE

The medium-term prospects may be promising if oil prices remain high, but investors have yet to be lured back. Mr Wolman fears that it could be just the start of problems with SME portfolios as the economy decelerates. "All the banks were fairly aggressive moving into the SME sector, so there was huge competition to make high-risk loans, and these small businesses could just close down," he says.

Mr Wolman thinks NPLs are under-reported, and definitions need to be brought into line with international norms. "My understanding is that if a repayment is due and the borrower can't make it, the bank will extend the maturity and then classify it as a restructured loan rather than an NPL. But if you are not getting the income, then it should be classified as an NPL," he says.

Despite allegations of deliberate renationalisation from BTA's previous owners, the bank's new management is adamant that the government does not plan to involve itself too heavily in the country's banks.

"I would say the managerial resources at BTA and Alliance are first class by Kazakh standards. They are experienced, ambitious and dynamic and I'm pretty sure they can cope. But I am concerned that all this will stop progress on Samruk-Kazyna's core objectives of promoting economic diversification and innovation, and modernising the state-owned companies such as KazPost, infrastructure, utilities and so on," says the fund's former chief financial officer Mr Wokurka.

LEARNING THE LESSONS

Mr Saidenov believes the bank's strength in trade finance and retail and its SME franchise across Kazakhstan will allow it to function successfully. "Naturally, it is a testing period for everyone at the bank, but the new management is impressed by the professionalism of the staff, there were no large-scale firings, and two board members, in charge of retail and SMEs, kept their posts," he says.

One lesson he has drawn is that loans to non-residents should be kept under tighter control – they reached 47% of the bank's entire portfolio. "When I was a board member of the [Kazakh] Financial Services Authority [AFN], I know the AFN regularly asked for this situation to be changed, and there were a number of agreed programmes, but they were not implemented and then the risks materialised as the global situation deteriorated," says Mr Saidenov.

In Kazakhstan, more forceful regulation will be a priority. Mr Marchenko, who has Mr Saidenov's old seat on the AFN board, says he is closely following the global discussions on macro-prudential regulation and monetary policy. "It is obvious that a healthy ratio of foreign liabilities in the overall liabilities of banks should not exceed 30%, and we are currently discussing whether to make this limit mandatory. We are also discussing counter-cyclical measures in terms of capital requirements and provisioning," he says.

He is sceptical about the effectiveness of Basel II, because it gave what he regards as too much power to ratings agencies "who only visit Kazakhstan once or twice a year".

When he points out that he raised these concerns back in 2006, Mr Marchenko sounds like a man who likes a challenge. "At that time, people were saying I had lost my touch, I'd become too conservative. Things would be different this time," he says.