

Securitization

First Securitization of Auto Loans in Ukraine

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In 2008 Ukraine succeeded in finalising a new securitization deal right before the global market of structured products fell. After the successful completion of its debut USD180 million true sale cross-border securitization of residential mortgages in early 2007, PrivatBank approached the market with another securitization deal in May 2008, which became the first securitization of auto loans in Ukraine. This has reconfirmed the feasibility of securitization as such in Ukraine and should become a good basis for future deals when capital markets revive.

How Securitization Works

At its core, asset securitization involves transferring a pool of certain profit-generating assets (bank loans, credit card receivables, etc.) from their originator to a special-purpose vehicle which then issues marketable securities backed by the pooled assets. Such a technique allows the owner of the assets to remove them from its books, lower funding costs and improve its liquidity, while providing investors with higher level of protection against the credit risk of the borrower as the assets are transferred to a special-purpose vehicle. Thus, offering certain benefits to both sides securitization is named among the most important financial innovations of the last few decades and has become a popular product for banks and other financial institutions. Although the general concept of securitization is simple, in practice securitization is often hard to effect and the parties have to carefully structure the deal, taking into account legal and accounting issues.

2008 Privatbank Securitization Framework

The PrivatBank securitization was a challenging exercise for the working group, especially on the legal side. It was important to preserve all the essential elements of a true-sale securitization and ensure their validity under Ukrainian law.

The deal was structured as a true-sale to Ukraine Auto Loan Finance No.1 Plc, a special-purpose vehicle (SPV) incorporated in England for the purpose of issuing asset backed securities, of the assets comprising the claims under the USD denominated auto loans advanced by PrivatBank to its customers, together with the first ranking pledges over the collateral (automobiles) securing such loans. The purchase of the assets by the SPV was funded through the issue of USD 110 million asset backed notes maturing in 2018. The issue comprised USD 85,800,000 Class A notes rated Baa3 by Moody's and BBB- by Fitch, USD 18,700,000 Class B notes having the rating of Ba3 assigned by Moody's and B assigned by Fitch, and USD 5,500,000 Class C notes which were purchased by PrivatBank and were not rated.



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True Sale

Since one of the motives behind the securitization was the improvement of capital adequacy, the transaction had to be structured in a way for the bank to be able to remove the assets from its books. This was achieved through assignment of claims under the loan agreements by means of conclusion of the framework sale agreement and implementing sale and purchase transaction between PrivatBank and Ukraine Auto Loan Finance No.1 Plc. Under Ukrainian law, assignment of claim implies that full title to such claim is transferred to the new creditor, thus leaving little doubt that the transaction is a "true sale", which is essential for the investors not to be affected by the performance or bankruptcy of the originator. Such assignment does not require the ob-

ligor's (bank's customer) consent and may be performed through an agreement between the original creditor and the new creditor executed in the same form as the underlying loan agreement. At the same time, in order to avoid the discharge of payments by the obligors to the original creditor (although the servicing of the assets was further carried out by PrivatBank, the payments were to be made to a different account), such borrowers have been notified by PrivatBank of the assignment of claims under the loan agreements. This process may be administratively cumbersome, given the number of loans usually transferred in the process of securitization, but it should be taken care of in order to avoid certain negative consequences possible under Ukrainian law.

The transfer of claims under the pledge agreements securing the relevant loans, being accessory to the loan claims, does not require a separate agreement between the parties and they passed to the SPV together with the loan claims by operation of law. One essential issue in this regard is the registration of the change in the identity of the pledgee with the State Register of Encumbrances of Movable Property. Although the absence of such registration does not affect the validity of the transfer as such, it may preclude the new creditor from retaining the priority of its claims in relation to the collateral against any other registered pledgees.

Bankruptcy-remote SPV

Another important structuring issue which arose in the PrivatBank securitization deal, was the bankruptcy-remoteness of the SPV. In other words, the SPV's activities should be limited in order to decrease the likelihood of bankruptcy as a result of such activities and the SPV and its assets should be adequately insulated from the bankruptcy of the originator. While the former point appears to be quite easy to achieve, insulation of the SPV's assets comprising the loan claims and the pledge claims required particular analysis from the legal team working on the transaction. As in many securitization deals, following the sale of the assets to the SPV PrivatBank continued to service the loans. The major reasons for using such an approach were optimisation of the transaction costs and PrivatBank's extensive background in servicing such kind of loans.

Being advantageous in economic terms, this poses certain legal concerns. Under Ukrainian law, in the event of liquidation of a bank (as a result of bankruptcy or otherwise) all property owned by such bank (including funds on the bank's accounts) is included in the liquidation estate, which is then used to satisfy the outstanding claims of the bank's creditors. In such circumstances, money collected by PrivatBank as bank servicing payments from the borrowers and not transferred to the SPV by the time of potential bankruptcy would generally form a part of its liquidation estate, which would adversely affect the scheduled cash flow from the borrowers to the SPV and further to the investors. This risk was mitigated by entering into an asset management agreement governed by Ukrainian law. The concept of asset management under Ukrainian law gives extensive rights to the manager of the assets, including the right to use and dispose of such assets. At the same time, assets under the bank's management are not included in its liquidation estate. Although such approach looks like an ideal decision for the purposes of securitization, it should be noted that the legal concept of asset management under Ukrainian law is not comprehensively regulated, has not been widely used in practice and, therefore, should be considered with all due thoroughness.

Currency Control

Ukrainian currency control regulations are rather restrictive and generally do not allow payments by Ukrainian residents abroad without an individual licence from the National Bank of Ukraine. Thus, it was important to identify a specific exemption that would allow transferring abroad the proceeds generated by the assets without the need to obtain any licences. The structure used on the PrivatBank transaction is based on the exemption from the NBU licensing regime established for the repatriation of foreign investments and proceeds from such investments. In particular, under Ukrainian investment laws, the purchase of property rights (which include auto loan claims) by a non-resident qualifies as a foreign investment.

Conclusion

Although today cross-border securitization is not on top of the list for Ukrainian banks as foreign financing is not something they can easily get, securitization of assets should remain an effective financial instrument which allows the originator's direct financing costs to be reduced and provides significant indirect benefits. And while PrivatBank has been the first and so far the only one among Ukrainian financial institutions to have taken a chance with this innovative process, securitization may become an attractive financing alternative for others to consider in the future.

PRO file

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Sayenko Kharenko is a transactional law firm which is well reputed for its ability to handle the most sophisticated and innovative transactions involving Ukraine. The firm's clients include many of the largest multinational corporations and financial institutions, including Fortune 500 and Forbes International 500 companies and international public organisations. The firm also works closely with and acts regularly as local counsel to major US and European law firms.

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The firm provides sophisticated legal advice in banking and finance, capital markets, competition law, corporate law, mergers and acquisitions, real estate, and tax planning. It has special industry expertise in the oil and gas, electricity, telecommunications, media and finance sectors.