The experience of restructuring banks' external debt in Kazakhstan

January 2011

The crisis evolution in Kazakhstan

Pre-crises situation **(before August 2007):**

- **Favorable macroeconomic environment, high demand for credits in Kazakhstan and low price of foreign funding promoted external borrowings by domestic banks in the pre-crisis period**
- **In these conditions, rapid development of the construction sector and mortgage landing in Kazakhstan resulted in forming "price bubble" in the real estate market**

August 2007:

- **As conditions in international financial markets tightened in August 2007, local banks found it more difficult to raise external financing**
- **Banks started to undergo liquidity deficit**
- **Lack of credit financing had a negative impact on construction sector and real estate market**

October 2008:

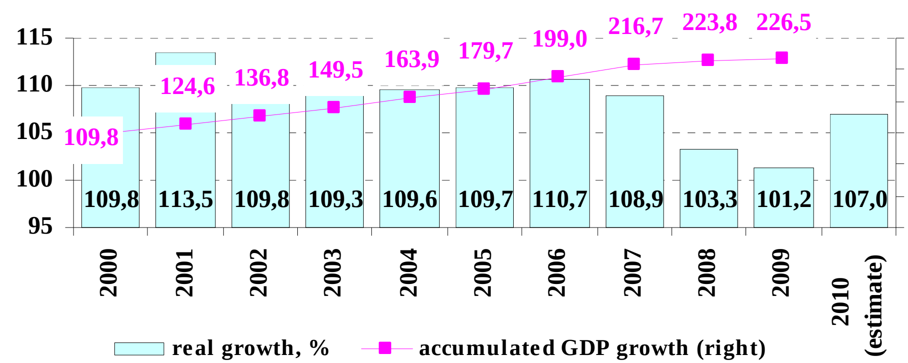
- **Bankruptcy of Lehman Brothers triggered second wave of crisis: collapse of stock indexes in the global financial markets and surge in the risk premiums**
- **Substantial drop in the capital inflows and sharp fall in world market prices on energy resources has shown itself in slowdown of economic growth**
- **The lending activity of Kazakhstani banks shrank and development of the sectors dependent on the banking loans has almost stopped.**

Macroeconomic environment in the beginning of 2009

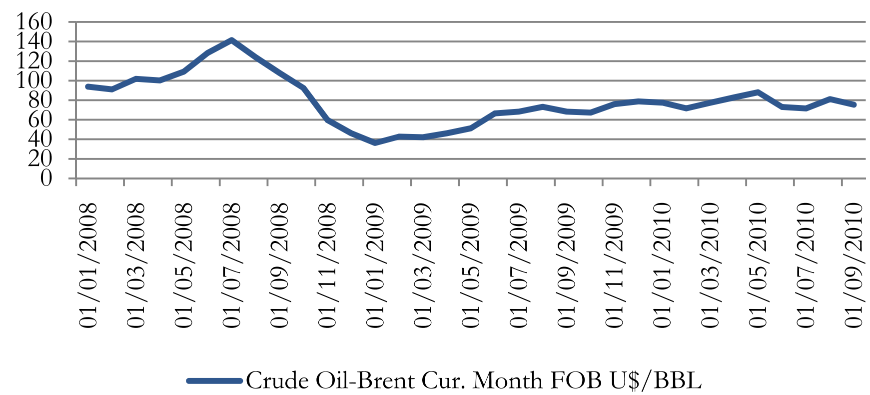
Internal and external risk factors affecting the economy:

- **Domestic economy slowdown**
- **Increased burden on the country's international reserves as a result of neighboring currencies devaluation and low commodities prices**
- **Evident necessity of exchange rate adjustment to the new equilibrium and as a result the need of public financial support to the banks with high external debt**
- **Several banks external over-indebtedness and lack of domestic private sources of funding**
- **Lack of liquidity in the domestic financial markets**
- **Worsening of banks' assets quality**

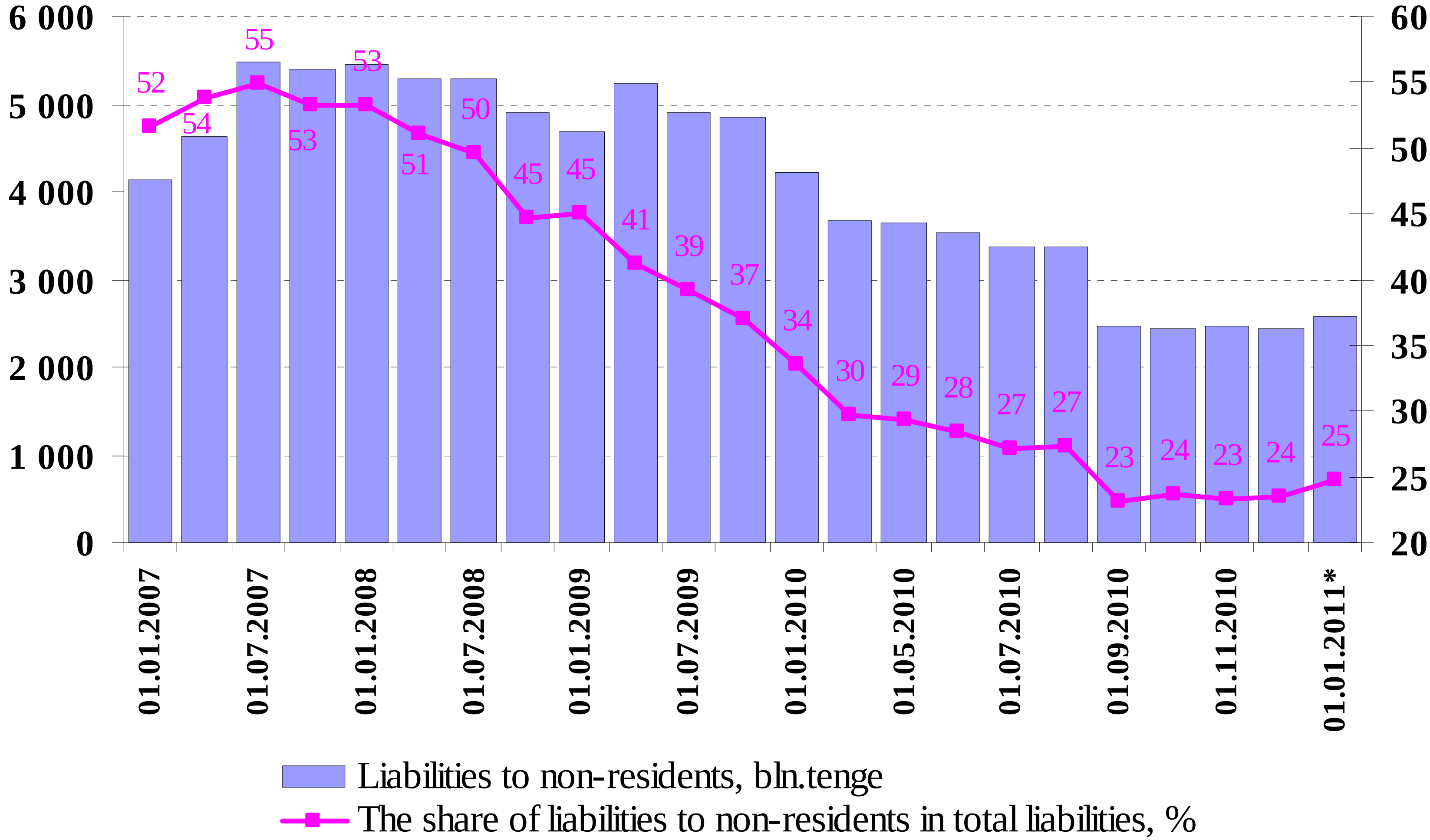
GDP, real growth, %



Crude Oil-Brent Cur. Month FOB U$/BBL

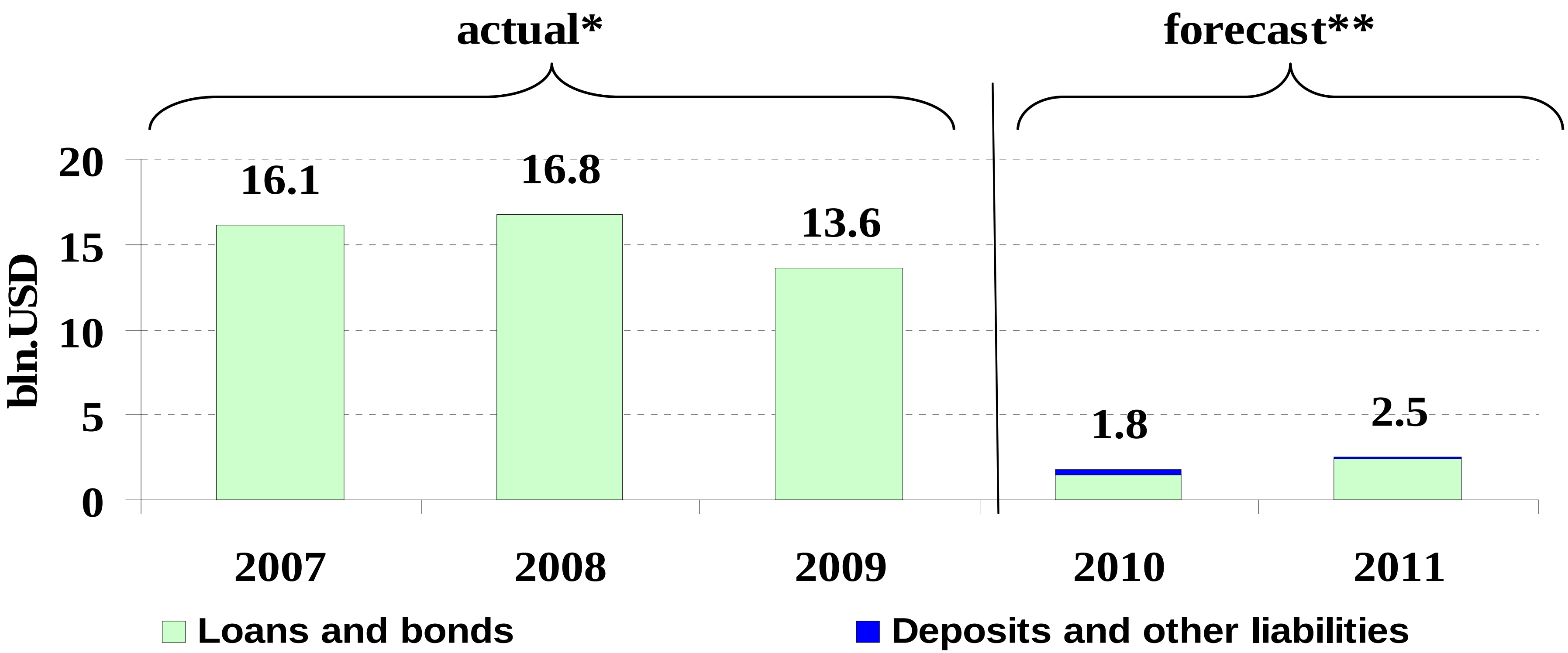


Role of external liabilities as a source of banks' funding



*Preliminary estimate

External debt-servicing burden



**Actual service in 2007-2009 is for loans (excl. REPO & overnight) and bonds*

*** forecast for 2010-2011 on debt as of 31.12.2009 г., excl. debt of 3 banks under restructuring (ALB, BTA and Temir)*

External funding as a source of vulnerability

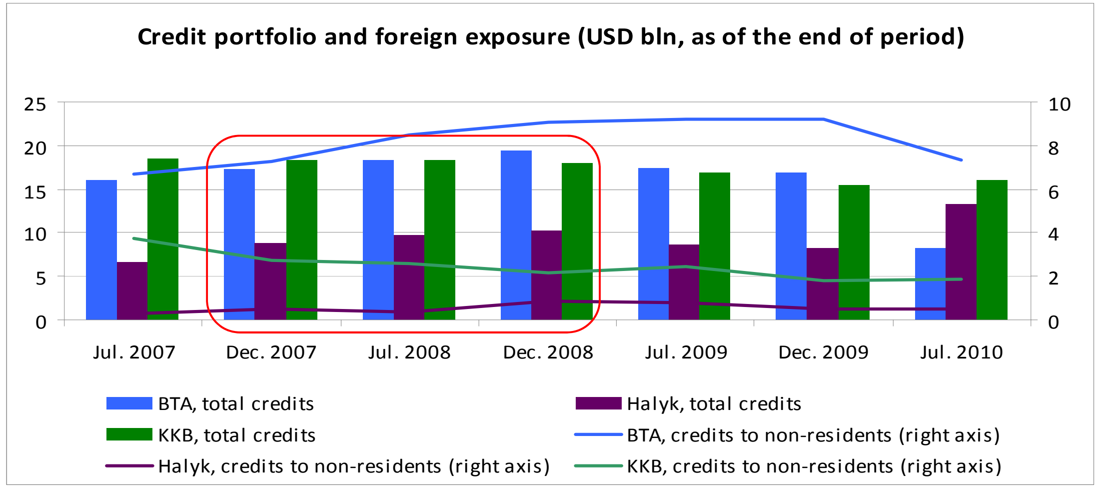
Liabilities to non-residents / Total liabilities, %		
Bank	*01.07.2007*	*01.09.2010*
BTA Bank	63.31	32.69
Alliance Bank	70.49	39.13
Temir Bank	50.49	6.99
KKB	60.70	30.62
Average for other 11 major banks (excl. restructuring banks & KKB)	35.22	13.10

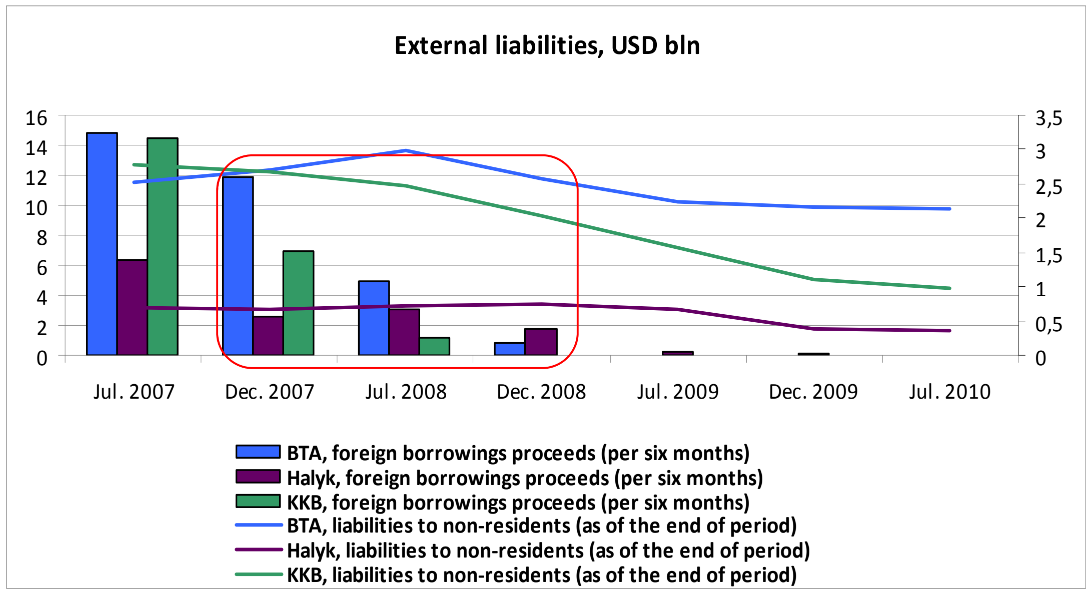
Systemic banks in Kazakhstan acted differently:

1)Halyk **was keeping to the balanced policy in crediting and foreign funding as before**

2) KKB **was reducing its credit portfolio and refinancing the debt**

3) BTA **was <u>increasing its credit portfolio and especially foreign exposure (!)</u> despite all the risks it had assumed earlier and, simultaneously, was obtaining foreign crediting**





Non-economic factors (fraud of the former governance of problematic banks)

Fraud and illegal activity of the former managers of BTA Bank and Alliance:

- Affiliated and connected lending and inadequate collateral

- Fictitious capitalization and non-transparent sources of capital

- Money laundering

- Non-transparent decision making and absence of risk management

- Lack of economic and professional foresight

Two extreme options: possible consequences

Three different problematic banks:

- **BTA Bank was systemically important bank (24.5% of total banking assets and 25.1% of banking credit portfolio as of 01.01.2009; 18.6% of total number of transactions of banks in payment system)**
- **Alliance Bank – large but not systemically important**
- **Temir Bank – if restructuring didn't succeed would be liquidated**

If we had chosen bankruptcy option we would face:

- **Lost confidence to the whole banking system**
- **Lost confidence to financial authorities**
- **Large-scale bank-run of depositors**
- **Full-fledged destabilization in the whole financial system**
- **Lasting speculative pressure on the national currency**
- **Capital-run from the country**

If we had chosen bail-out option we would face:

- **Moral hazard problem**
- **Lost confidence to financial authorities**
- **Significant burden on state finance**
- **Forming "addiction" of banks to the state support**
- **Decrease of the level of competitiveness in the banking sector**

Kazakhstani Banks Restructuring Framework

RESTRUCTURING AGREEMENT TIMELINE

Oct 08	■ Promulgation of the Financial Stabilization Law, aimed at enhancing the Government reaction to risks in the financial system, and strengthening the powers of the FMSA
Nov08-Feb 09	■ Elaboration and implementation by the Government of Kazakhstan of the Anti-Crisis Plan (ACP)
Feb 09	■ Capital injections and rescue measures implemented through Sovereign Wealth Funds Samruk-Kazyna ■ Senior Management of the Banks is replaced ■ Appointment of Independent Advisors for the formulation & implementation of the banking sector restructuring ➢ "**No direct bailout / burden-sharing strategy**" devised by Independent Advisors along side Government & authorities ➢ Debt restructuring framework elaborated and communicated to market ➢ Forging of the asset recovery process into the debt restructuring
	■ Adoption of a "New Restructuring Law" to provide adequate legislative framework to Bank restructurings – UNCITRAL compatible

	BTA BANK	ALLIANCE	TEMIRBANK
■ Appointment of financial and legal advisers for each of the banks	Mar 09	Mar 09	Oct-Nov 09
■ Appointment of representative Creditors Steering Committee members for each of the restructured banks ■ Due diligence on the Loan Portfolio performed jointly between Banks and Steering Committees advisers	Sep 09	Jun 09	Dec 09
■ Signing of a Memorandum of Understanding between the Banks, Samruk-Kazyna and the Steering Committees on the terms of the Restructuring Plan	Sep 09	Jul 09	
■ Negotiation with the appropriate Steering Committee representatives of the treatment of Trade Finance claims (eligibility criteria and repayment terms)	Oct 09 -Mar 10	May-Jul 09	
■ Application to restructuring and submission of the Restructuring and Recapitalization Plan submitted to the FMSA (regulator)	Sep 09	Jul 09	Nov 09
■ Signing of the Term Sheet and Publication of the Information Memorandum	Apr-May 10	Oct 09	Dec 09-Feb 10
■ All Creditors' vote approves the Restructuring Plan	May 10	Dec 09	Mar 10
■ Distribution of restructuring considerations and closing	Sep 01	Mar 10	Apr 10

Kazakhstani Banks Restructuring Operating Structure

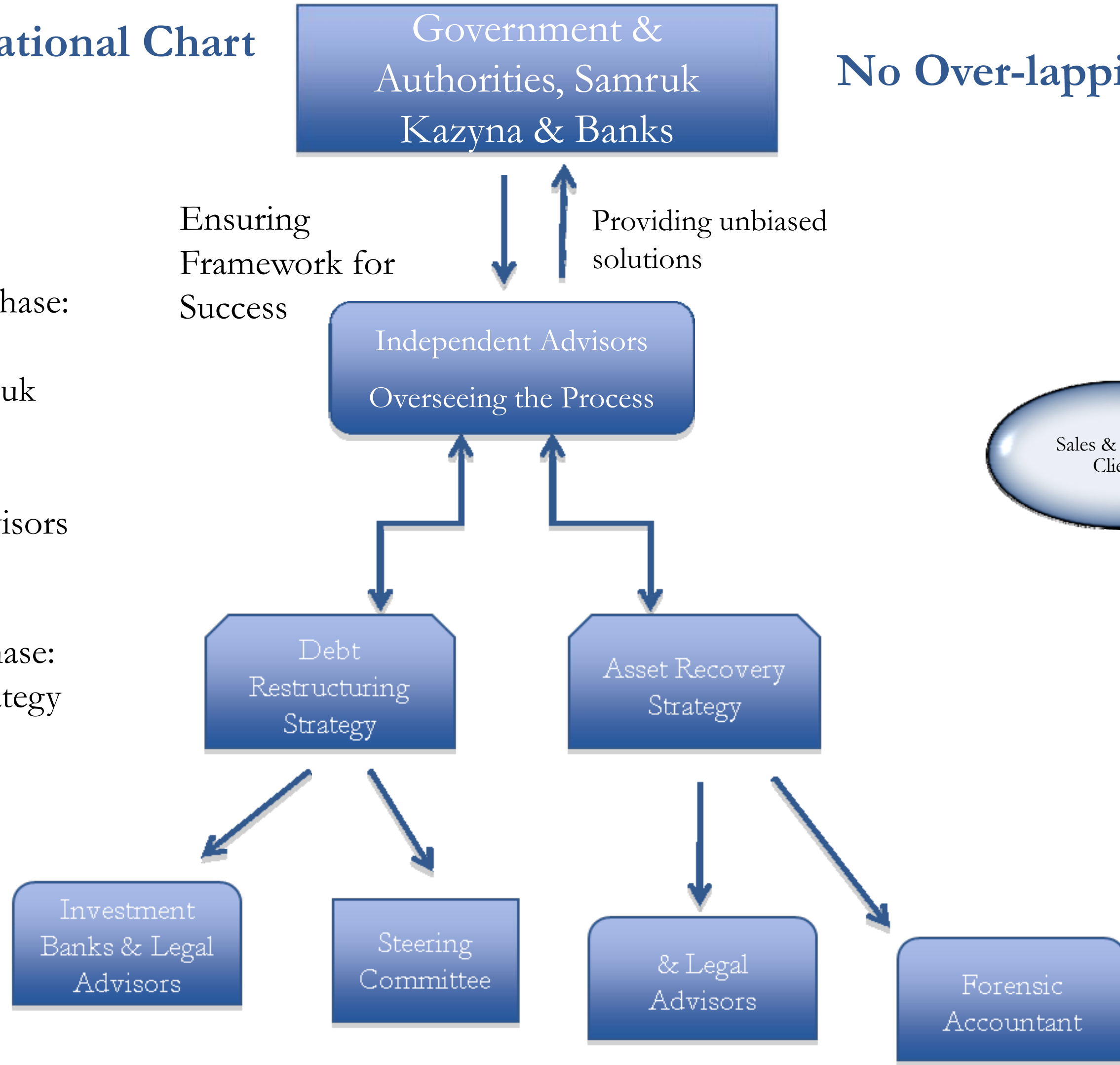
Process Organizational Chart

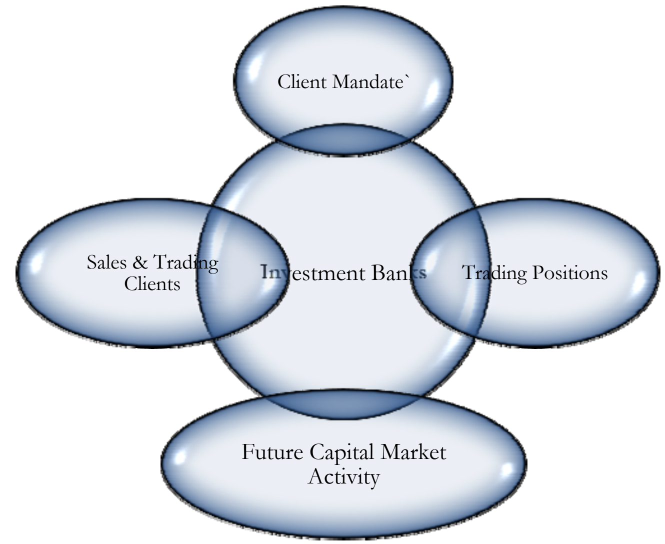
No Over-lapping Spheres of Interest

Developmental Phase: Government & Authorities, Samruk Kazyna & Banks working with Independent Advisors

Implementation Phase: Articulation of strategy

Execution Phase: Building the right teams and forming steering Committees





Debt restructuring (main facts)

	BTA	Alliance	Temir
Liabilities subject to restructuring	12 bln.USD	4,5 bln. USD	1,4 bln.USD
Value of debt reduction	6,4 bln.USD	3,3 bln.USD	0,7 bln.USD
Bank's shares ownership by Samruk-Kazyna (as a result of restructuring)	81,5%	67,0%	80,0%
Average recovery rate for creditors (rough estimation)	40%	30%	30%
Consultants	Lazard Ltd, UBS White& Case LLP (initially Goldman Sachs)	Lazard Ltd White& Case LLP	Citi UK Denton Wilde Sapte
Overseeing consultants	Marcia Favale-Tarter John Howell		

Burden Sharing Restructuring Framework Adhered to Best Practices

CREDITORS

Addresses BS weakness and Banks as a going concern

SAMRUK KAZYNA

Partners in the Process

Liquidity Support

- Funds used to sustain banks operating activities

Preserves Sovereign's Fiscal Profile

- Economy not hampered by Sovereign indebtedness

Moral Hazard

- Severely curtails the risk of moral hazard

Corporate Governance

- Creditor involvement enhances corporate governance

Transparency & Disclosure Fundamental to the Process

TOTAL RECAPITALIZATION

Creditors Support
Creation of Equity
(debt cancellation and bond conversion into equity)

Samruk-Kazyna Support
Equity issue
(bond conversion into equity)

Asset Recovery; a means for creditors to recuperate losses

Presentation of JSC Alliance Bank Restructuring

CREDITORS
$ 4.4 bn

SAMRUK KAZYNA
$ 0.9 bn

TOTAL ELIGIBLE DEBT : $5.3bn

OPTION 1
BUY BACK

- Fixed Price with a 77.5% Haircut
- $500 mn cash available

OPTION 2
DISCOUNTED ROLLOVER

- 7 Year maturity and 50% discount
- Recovery Notes to participate in recoveries from written down amounts

OPTION 3, 4 & 4A
ROLL-OVER

- No Haircut
- Maturities between 10 and 20 years

OPTION 5
CONVERSION TO EQUITY

- Conversion of debt into equity after a discount between 75% and 80%

Recovery Notes to participate in recoveries from written down amounts

TOTAL RECAPITALIZATION

$3.6bn

Creditors Support
Creation of Equity ($2.7bn)
(debt cancellation and bond conversion into equity)

Samruk-Kazyna Support
Equity issue ($860m)
(bond conversion into equity)

Presentation of BTA Bank Restructuring

CREDITORS
$ 12.2 bn

SAMRUK KAZYNA
$ 4.5 bn

TOTAL ELIGIBLE DEBT : $ 16.7 bn

SENIOR PACKAGE 1

- Cash payment equal to 11% of claims-$1bn cash available
- 8-year Senior debt at a discount of 73% to claims
- 15-year Subordinated debt
- Allocation of 12.6% of equity

SENIOR PACKAGE 2

- 11-year OID roll-over option at a discount of 54.3%
- 15-year Subordinated debt
- Allocation of 1.4% of equity

SENIOR PACKAGE 3

- 2-year facility and 1-year amortisation
- Max. amount of US$ 700 million
- Restricted to TF transactions meeting eligibility criteria

JUNIOR PACKAGE 1

- Tenge-denominated debt
- 20-year maturity
- Limited to KZT 28 billion

JUNIOR PACKAGE 2

- Mandatory conversion into equity of perpetual bonds and subordinated bonds holders, excluding KPFs
- Allocation of 4.50% of equity

Recovery Notes to participate in recoveries from written down amounts

TOTAL RECAPITALIZATION
$11.25bn

Creditors Support
Creation of Equity ($6.8bn)
(debt cancellation and bond conversion into equity)

Samruk-Kazyna Support
Equity issue ($4.45bn)
(bond conversion into equity)

Presentation of Temir Bank Restructuring

TOTAL ELIGIBLE DEBT : $ 1.4 bn

2011 INTERNATIONAL NOTEHOLDERS

- Cash payment equal to 19.70% of Principal
- Allocation of pro-rata share of international noteholders' debt on 20% of new international debt ($60.75M)
- Allocation of pro-rata share of international noteholders' debt on 20% of equity

2014 INTERNATIONAL NOTEHOLDERS

- Cash payment equal to 20.03% of Principal
- Allocation of pro-rata share of international noteholders' debt on 20% of new international debt ($60.75M)
- Allocation of pro-rata share of international noteholders' debt on 20% of equity

SECURED DOMESTIC NOTES

- 75% of principal converted into subordinated KZT notes with maturity extended by 10Y and fixed coupon at 8%
- 25% of principal converted into new secured KZT notes with variable coupon (of CPI+1%)

UNSECURED DOMESTIC NOTES & BTA DEPOSITS

- 100% of principal converted into subordinated KZT notes with maturity extended by 10Y and fixed coupon at 8%

TOTAL RECAPITALIZATION

$804mln

Creditors Support
Creation of Equity ($650mln)
(debt cancellation and bond conversion into equity)

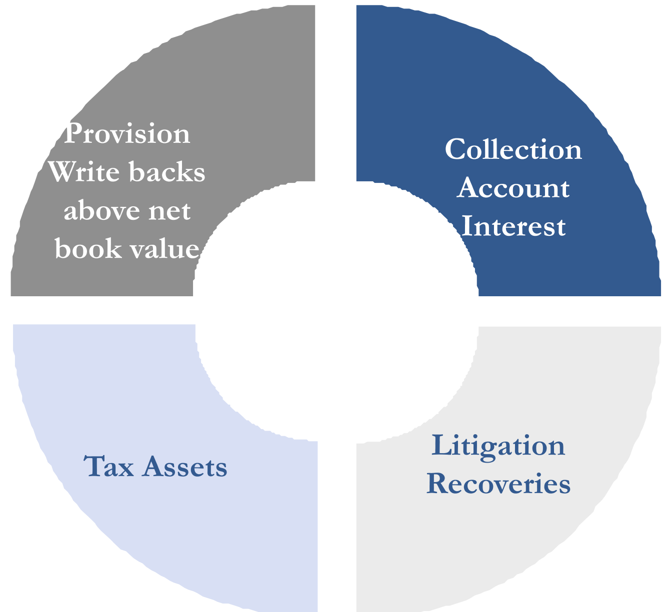
Samruk-Kazyna Support
($154mln)

Creditors get upside potential from the allocation of Equity and Recovery Units

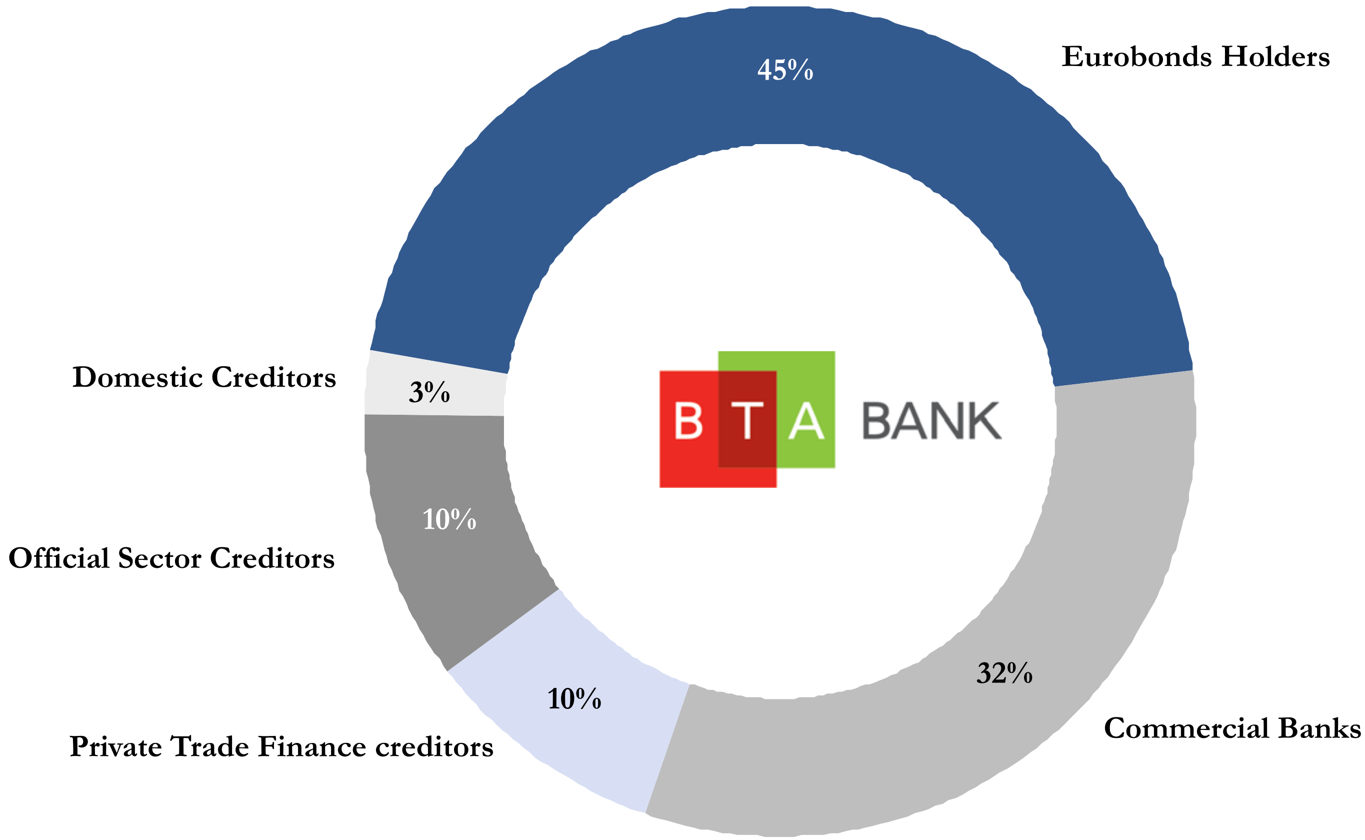
Although there was a burden sharing between the Creditors and SK, the restructuring packages provides the tools for investors to potentially retrieve their losses

- **In addition to cash and new debt instruments, the restructuring packages offered equity and recovery units to the different categories of creditors**
- **The restructured banks have strongly committed to implement aggressive recovery strategies in order to retrieve the maximum value from their old loan portfolios**
- **In this purpose, the banks have put all their efforts in recovering and restructuring their provisioned portfolios**
  - Strong Governance of Recovery Team including Creditor involvement
  - Significant dedicated bank management personal commitment
  - Strong advisory teams (Lovells and PWC for BTA)

SOURCES OF PROVISION RECOVERIES



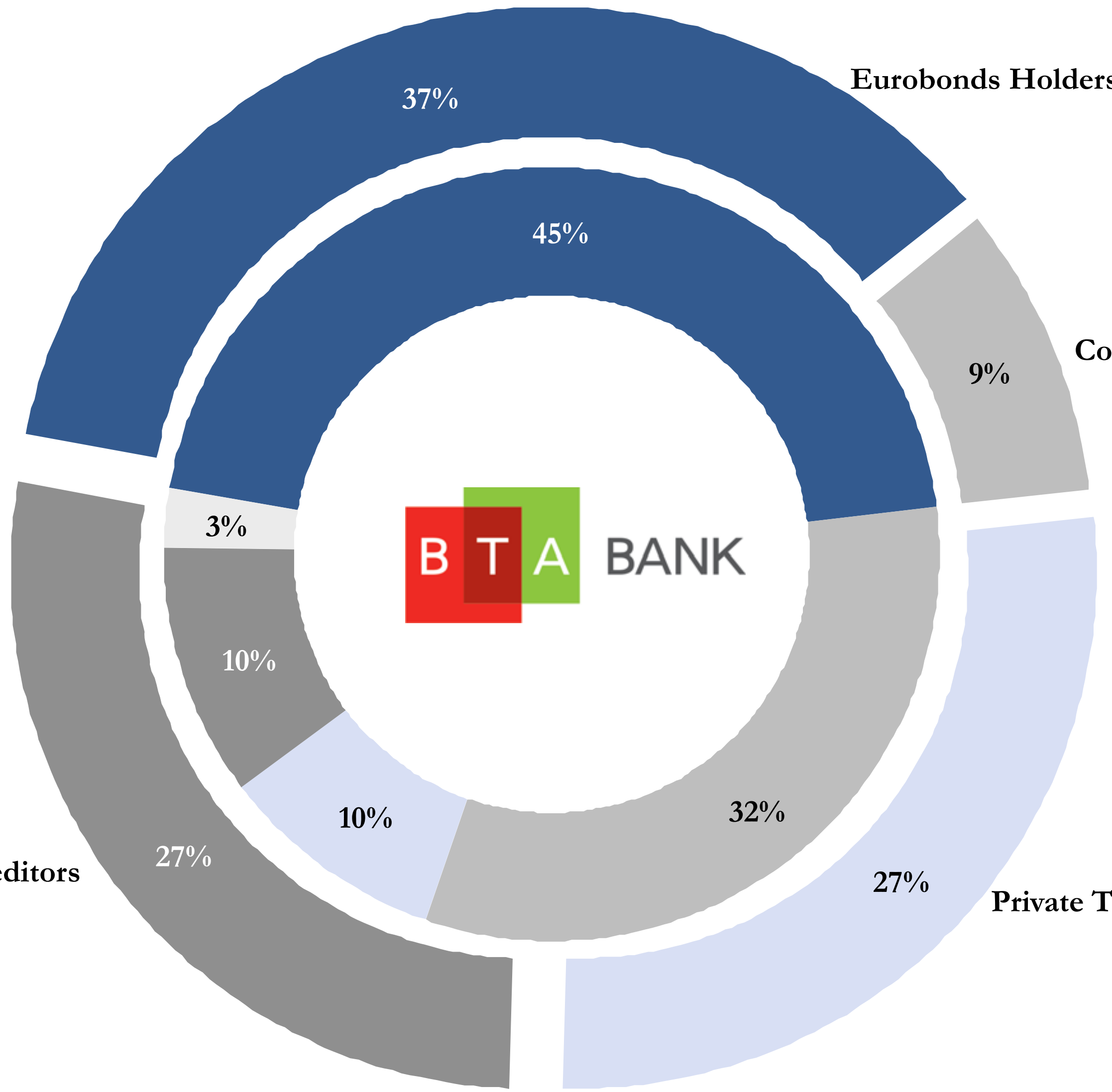
Debt Breakdown



Composition of the Steering Committee

Steering Committee Members

- Bank of Singapore Limited
- Commerzbank Aktiengesellschaft
- D.E. Shaw Group
- DEG
- Euler Hermes
- Fortis Investment
- Gramercy Advisors LLC
- Standard Chartered Bank
- The Royal Bank of Scotland
- US Ex-Im Bank
- Wells Fargo Bank, National Association

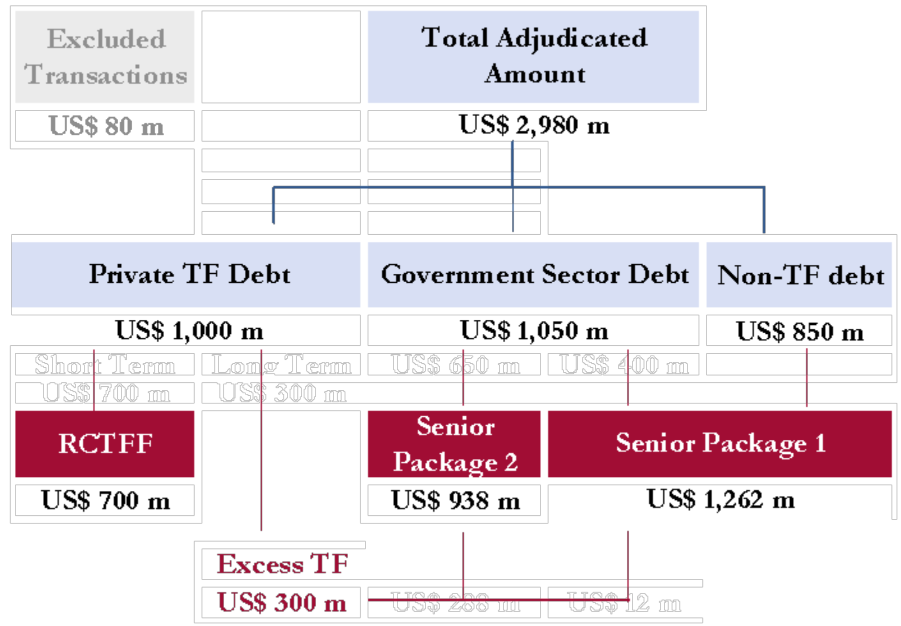


Treatment of Private Sector Trade Finance Debt

Eligible "True" Trade Finance debt has been subject to very tight eligibility criteria

- **Alliance Bank and BTA Bank have set, together with the relevant members of the Steering Committee of Creditors, very tight eligibility criteria for the election of "True" Trade Finance debt**
  - Documented underlying trade-related transaction had to be proven in order to qualify as Trade Finance debt
  - Standby letters of credit, loan repayment guarantees or transactions where there was no specific underlying import or export trade transaction were excluded from the Trade Finance debt portfolio
- **The Restructured Banks then subsequently appointed an Independent Adjudicator (Watson, Farley & Williams) to adjudicate Trade Finance Claims according to these criteria**
  - For Alliance Bank, US$293million of claims adjudicated between July and October 2009, of which US$97 million Trade Claims confirmed
  - For BTA Bank, US$ 2.98billion of claims adjudicated between March and May 2010, of which US$1.10 billion private sector Trade Claims were confirmed

TREATMENT OF BTA TRADE FINANCE DEBT



Treatment of Private Sector Trade Finance Debt

ALLIANCE

May – July 2009

Eligibility criteria defined with Creditors' Steering Committee on a stock of debt of US$300 million

July – October 2009

US$293million of claims adjudicated

US$97 million Trade Claims confirmed

March 2010

US$ 194 million restructured pari passu with other senior claims

US$ 97 million Trade Claims repaid w/o haircut over 12 months

ELIGIBILITY DEFINITION → **ADJUDICATION PROCESS** → **RESTRUCTURING TREATMENT**

BTA BANK

October 2009 – March 2010

Eligibility criteria defined with Creditors' Steering Committee on a stock of debt of US$3 billion

March – May 2010

US$3billion of claims adjudicated

US$1.1 billion private sector Trade Claims confirmed, of which **US$210 million of short term claims**

September 2010

US$700 million private sector Trade Claims repaid w/o haircut over 36 months

US$400 million private sector Trade Claims restructured pari passu with other senior claims

What makes the Restructurings different?

A burden sharing strategy instead of conservation or full public bailout

- Restructuring was a joint effort by bank creditors and core shareholder, Samruk-Kazyna, who contributed massively to the Bank's recapitalization
- A different approach; the government hired independent advisors who provided unbiased restructuring and asset recovery advice that served to form the restructuring strategy and framework.
- The details and execution of the restructuring plan was the result of a complex negotiation process involving thorough scrutiny of banks financials and business plans by the Steering Committees and all of the advisors
- The unique Steering Committee composition ensured a fair representation of all creditors' classes
- Specific to BTA - this is the first example of a successful, large-scale bail-in of a systemic bank in the world

Banks remained fully operational throughout the restructuring process

- Despite the moratorium on domestic and international debt, Banks remained fully operational
- Individual depositors were not affected by the restructuring
- Day-to-day operations with client accounts were mostly carried out as normal
- Banks were not under conservation or external administration

What makes the Restructurings different?

Troubled Assets vs. performing assets

- No " Good Bank "- " Bad Bank " approach
- Creditors have access both to performing and impaired assets of Banks and will be entitled to all recoveries
- Creditors will have a share of control over BTA's asset recovery process

Trade Finance

- A realistic restructuring was only to be achieved through a balance between the interests of trade finance creditors and other financial creditors: Inter-creditor Equity
- The trade finance portfolio had to undergo a detailed analysis in order to separate genuine trade finance business from ordinary senior financial debt

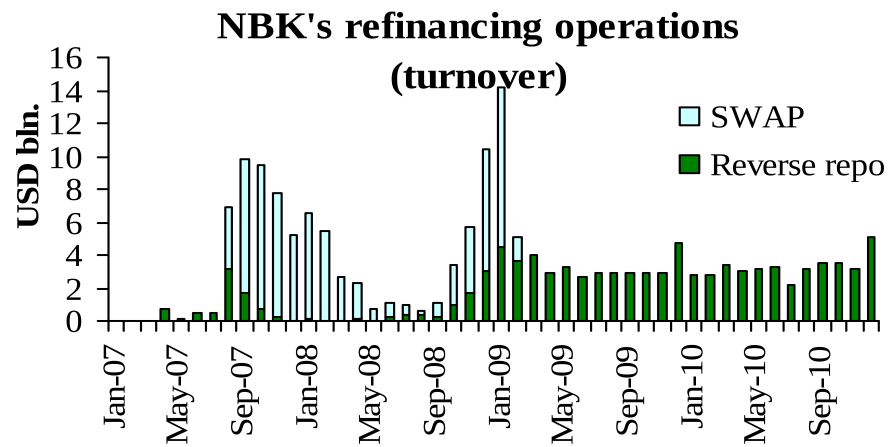
Supporting role of public entities (national companies)

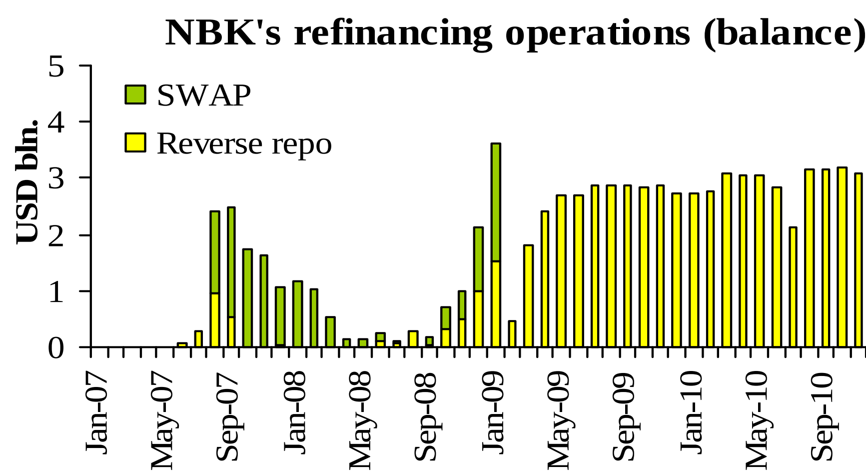
as of May 01, 2010 (thous. tenge)	BTA Bank	Alliance Bank	Temir Bank	Total group (3 banks)
Term and demand deposits of National Companies *	149 676 759	77 000 000	14 313 325	240 990 084
Total accounts of clients (excl. SPV)	**594 139 122**	**151 864 381**	**163 849 570**	**909 853 073**
Total accounts of legal entities (excl. SPV)	**421 391 866**	**95 925 923**	**138 684 895**	**656 002 684**
Share of National Companies deposits in total clients accounts (%)	**25.19**	**50.70**	**8.74**	**26.49**
Share of National Companies deposits in accounts of legal entities (%)	35.52	80.27	10.32	36.74

*** According to the banks data (not regular reporting)**

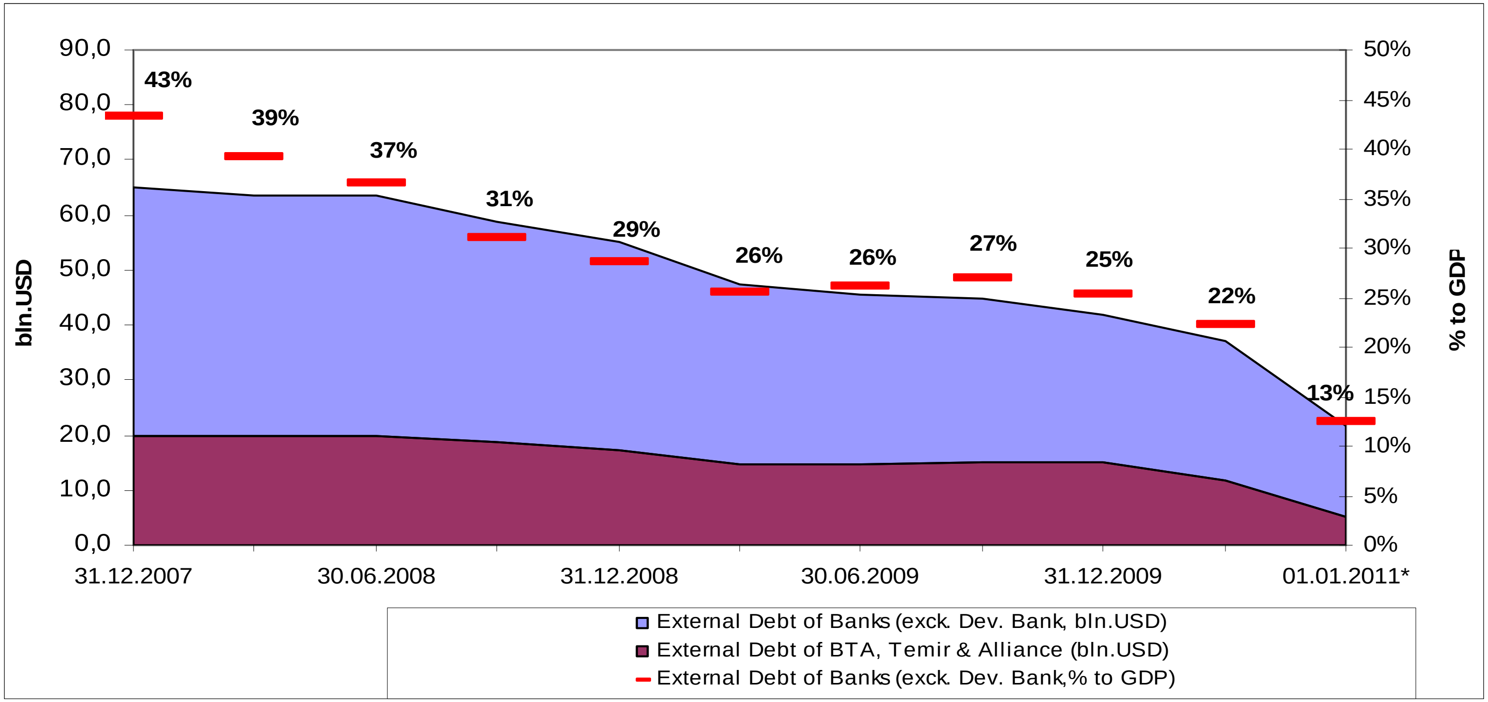
Financial Stability Measures

- ✓ the policy interest rate has been gradually cut from 11% to 7% (its lowest level ever)
- ✓ since 2007, to ensure adequate short-term liquidity, the NBK provides refinancing loans to banks
- ✓ the list of instruments accepted as collateral was expanded
- ✓ the reserve requirements were reduced to the minimum level ever (1.5% for domestic liabilities and 2.5% for other liabilities), however banks still hold excessive reserves
- ✓ in November 2009 reserve requirements for banks under debt restructuring process were set at 0% for all liabilities





Impact of restructuring on external debt of commercial banks (excl. Dev. Bank)



The debt to be written off is estimated to amount 10.4 bln. USD for 3 banks which will reduce the external debt of commercial banks by 40% to around 16-17 bln. USD or approximately 12.5 % to GDP by the end of 2010

The debt amortization period for individual banks under restructuring is increased from 1-5 to 8-20 years with the reduction of average interest rate up to around 9%

25

Suggestions on the further development of the three banks after restructuring

- The restructured banks have mostly maintained client base, wide deposit base and well-organized local branches net
- Currently, the strategic investors' coming in is considered to be the best choice to develop the banks after restructuring
- For better performance and confidence, rebranding may be required

What we are doing now to avoid the repetition of the situation?

New focuses of regulation in the after-crisis period:

- Establishing more restrictions and controls on intra-group transactions
- Establishing additional requirements on transparency of large banking clients
- Establishing additional requirements to financial institutions CEOs
- Establishing requirements on banking conglomerates' structure and management

Results of the restructuring from macro-point of view

Indicator	01.10.2008	01.01.2011
Inflation (y-o-y)	**18.2%**	**7.8%**
Volume of payment system total transactions (from the beginning of the year)	**124.9 TG trln**	**138.5 TG trln*** **
Banks' liquidity (% of total assets)	**14.1%**	**21.3%****
Volume of banks' assets placed in National Bank*	**1094.2 TG bln** **(9.1 USD bln)**	**1381.6 TG bln** **(9.4 USD bln)****
Banking system gross external debt	**41.6 USD bln**	**17.5 USD bln****
In addition, the banking system of Kazakhstan (except the three problematic banks) has showed its solvency; and the three problematic banks have successfully finished their restructuring		

* sum of reserve deposits, time deposits and correspondent accounts in National Bank and short-term notes of National Bank

** approximate estimation

*** as of the end of the 3rd quarter 2010