

A man in a suit is shown in profile, looking out a window. The background is a bright, out-of-focus view of a city or office building.

Legal practicalities of Ukrainian Non-Performing Loans

In order to speed up recovery from distressed assets held under their management, the Deposit Guarantee Fund (DGF) organises auctions for non-performing loans (NPL) and other assets. Simultaneously, the National Bank of Ukraine (NBU) has agreed to remove currency controls that had previously complicated the ability of foreign entities to repatriate funds.

Foreign investors may enter the Ukrainian NPL market by purchasing assets at auction through a locally incorporated special purpose vehicle (SPV).

As is clear from its progress in the World Bank's Doing Business Index, Ukraine has significantly simplified the process for registering a company in recent years. There is no minimum authorised capital requirement¹, or state registration fee for incorporating a Limited Liability Company (LLC), and the registration process is usually completed in one business day.

A parent company may easily finance its subsidiary with interest-bearing or interest-free loans as the NBU has simplified the process for registering loan agreements with non-residents. The former system, that required registration of foreign currency loans from non-residents, with the NBU, has been changed to a system operated by commercial banks that allows non-residents to provide hryvnia-dominated loans to Ukrainian residents.

To mitigate all potential risks which might invalidate an NPL purchase, any subsidiary should also be registered as a financial institution with the authorities.

¹ Any capital declared at incorporation must be paid in to the company within six months unless otherwise provided by the Charter

Ukrainian NPLs: corporate or consumer?

Now that the Ukrainian NPL market is open to foreign investors, their question will be what to buy.

As highlighted [in our recent analysis](#), corporate debt accounts for three-quarters of the Ukrainian NPL market, with just under half of all NPLs held by the DGF. Of that, around one-third is consumer debt.

Corporate debt is frequently perceived as a more attractive form of investment. Provided the borrower is still operating, they are typically more likely to agree to debt restructuring, and will often own valuable property that significantly increases the likelihood of successful debt collection. Furthermore, recent changes in mortgage legislation have considerably increased mortgage holders' rights by ensuring that a mortgage taken out by a solvent entity, remains valid should the company subsequently be liquidated.

Nevertheless, it is worth noting that Ukrainian debt collection agencies have a strong track-record of collecting consumer NPLs, both through voluntary repayment and enforcement proceedings, in recent years. However, opportunities to foreclose on secured consumer loans are more limited, due to:

- A general ban on the foreclosure of non-Hryvnia loans secured on a borrower's home;
- A requirement to obtain permission from the authorities (board of trustees) to foreclose on loans on property in which children under the age of 18 live
- A blanket ban on any organisation, except banks, becoming a mortgage holder of agricultural land plots.



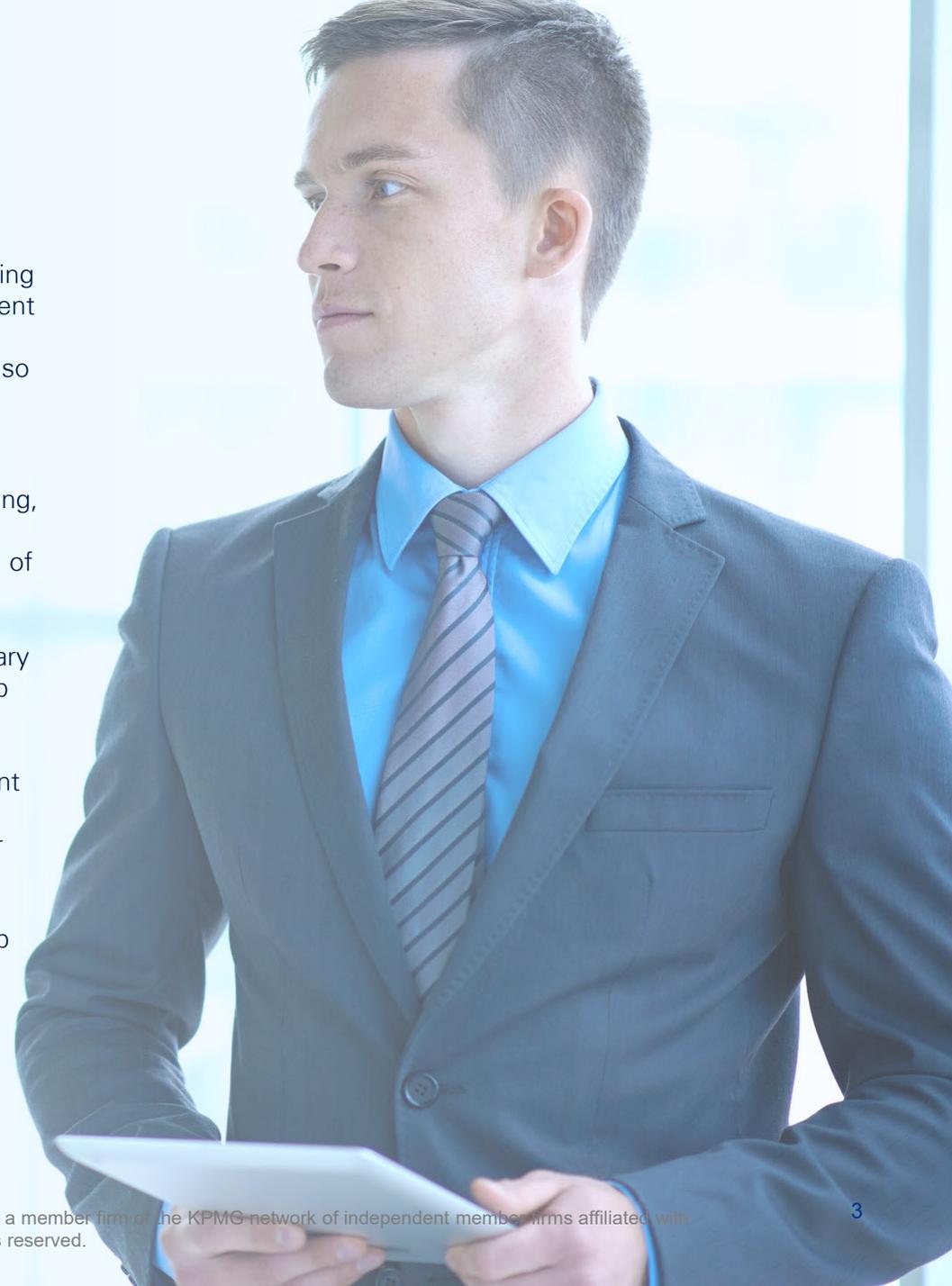
Managing your debt

Ukrainian legislation enables debt to be restructured at any time, by signing an addendum to the loan agreement, setting out changes to the repayment schedule, the interest rate or repayments. No formal approval from the courts, the NBU or other authority is required. Alternatively, the lender also has the right to transfer management of the debt or sell it to a local collection agency.

If a debtor refuses to repay a debt voluntarily, or to agree to a restructuring, Ukrainian legislation provides for:

- Judicial enforcement through an application to the court for collection of the debt, or to foreclose on mortgages, with a subsequent further enforcement procedure
- Extrajudicial enforcement by applying for an endorsement from a notary allowing further enforcement procedures or registration of ownership rights on the pledge/mortgage

Recent changes in legislation enable creditors to use private enforcement agents, instead of state court officers, to collect debts, which can significantly speed up the process. Enforcement may include freezing or seizing funds from a borrower's bank account and/or repossession and subsequent sale of their property at auction. Moreover, mortgage legislation allows creditors of secured loans to simply register ownership rights to the mortgaged assets, instead of pursuing litigation.



Repatriating your returns

Although the Ukrainian NPL market has been opened up to foreign investors, the cost of repatriating funds successfully collected from borrowers should be taken into account when assessing the overall rate of return.

Funds can be repatriated to the parent company in the form of dividends from a locally incorporated SPV, subject to a withholding tax rate of between 5 per cent and 15 per cent, depending on the number of shares held and the jurisdiction of registration of the parent company.

The NBU has however, confirmed its intention to remove the current limit of EUR7 million for dividend payments transferred outside Ukraine and to allow foreign investors to freely repatriate profits.

If a subsidiary has been financed with an interest-bearing loan, any interest payments are subject to similar tax implications – withholding tax at a rate of between 2 per cent and 15 per cent.²

² Gross profits (any funds received over and above the price paid for the NPL) may be taxed in the jurisdiction of registration of the company

Summing-up

Considered as a whole, recent and planned changes in Ukrainian legislation aimed at greater market liberalisation create significant opportunities for foreign investors to enter the Ukrainian NPL market.

However, as with all investments, investors should seek appropriate expert advice, conduct their own proper due diligence, and thoroughly evaluate the risks, opportunities and potential returns offered by the Ukrainian NPL market before investing. At KPMG Ukraine, we have the local market expertise and insights to assist you with your investment appraisal.

KPMG services and contacts

Services

Financial services

- Advice on the acquisition process via the auction platform
- Pre-acquisition financial due diligence of assets and to help for investors to determine which assets to bid for, and at what price
- Assistance in defining strategy in respect of potential cooperation with local players

Legal

- Pre-acquisition legal due diligence of the assets
- Comprehensive support during the acquisition processes (support during participation in the auction, concluding an agreement, re-registration of the asset)
- Legal advice on available options for further management of the assets, including enforcement strategy

Tax

- Comprehensive tax support in the course of NPL acquisition (including tax and regulatory analysis of effective and secure acquisition structure and analysis of resulting tax consequences)

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