

• Author: [Tatiana Stanovaya](#)

## State capture



Governmental representatives and systemic liberals close to the power elite are still falling over themselves to extol the success of the complex transaction involving the sale of 19.5% of Rosneft shares over a month after the deal was finalized. According to the cold calculations of the average financial expert, everything is seemingly as it should be: the budget has been swiftly replenished while Rosneft gained a private investor and minimized the risk of internal corporate conflict and the company remains under the direct operational and strategic supervision of its loyal, state-controlled management. The transaction is criticized only by liberal experts and members of the opposition who highlight both its lack of transparency and the unanswered questions surrounding sources of financing. However, “Rosneft’s privatization” leads us directly to far more critical issues pertaining to state institutions and the state’s control over its assets.

The two-step plan, under which Rosneft’s shares were purchased, has been [described in detail by RBC daily](#). The first step involved a loan issued by VTB bank to the Singaporean company QHG Shares (founded by Glencore which subsequently merged with a subsidiary of the Qatar investment fund - QIA) in rubles. The loan was immediately disbursed to Rosneftegaz in an amount equivalent to 19.5% of Rosneft’s shares. The aim of the first step was to transfer the money for the oil company’s shares to the Russian budget as soon as possible, as Rosneftegaz, indeed, did. However, the scheme was at odds with the instructions of President Vladimir Putin who ruled out the possibility of privatization achieved through the use of loans from state-owned banks. As it later transpired, VTB did not intend to provide credit to the merged Glencore and QIA, although it would obviously profit from the transaction.

After the first step was completed, VTB transferred its rights to receivables to Rosneftegaz. However, whether the company has repaid the debt to the state-owned bank remains unknown. VTB officially claims that Rosneftegaz has fulfilled all its obligations to the bank. Truth be told, Rosneftegaz’s deal involving the sale of its own stock of Rosneft shares to the QHG Shares consortium was financed using its own (perhaps borrowed?) money. To cut a long story short, Rosneftegaz resorted to a complex mechanism in order to plug the budget hole while the real investor was making funds available for the purchase.

The deal could have probably ended after the first step were it not for the lingering, unpleasant scent of indecency. Foreign banks were supposed to be investors at least formally, and Sechin did his utmost to convince them. They met him half-way: the Italian bank Intesa, a partner of Rosneft’s for a long time, agreed to loan part of the required amount (5.2bn euros). It is noteworthy that the news that the bank was considering becoming involved in the transaction emerged on December 20 when Rosneft’s stock had already been sold, although the Financial Times did report that the Italians were prepared to finance the deal on December 8 (the negotiations were perhaps in full swing at that time and an agreement had been reached on key issues).

The most puzzling element of the privatization deal are the conditions of the loan issued by Intesa, especially given the fact that Glencore is not in very good shape. According to one interpretation, the bank received 600bn rubles from Rosneft. This money was accumulated through the December issuance of bonds on the Russian market. Russian state-owned banks paid for the repurchase of securities. However, according to QHG Shares’ documents, 19.5% of Rosneft’s shares have been retained as collateral by Intesa (the Russian subsidiary of Intesa Sanpaolo). It turns out that Rosneft’s shares, worth 10.2bn euros, serve as collateral for a loan worth half that sum, as reported by the RBC daily. According to documents from the Singaporean

company, the collateral held at Intesa covers all the rights of QHG Shares arising from the acquisition of Rosneft's shares including the right to any sums paid out (for example, Rosneft dividends). This means that the 600bn generated from the sale of Rosneft's bonds was, in all likelihood, directed not to the Italian bank, which secured itself to the maximum, but via Rosneftegaz to VTB in accordance with the agreement on the transfer of funds from the bridge loan (when Rosneftegaz became a creditor of QHG Shares). Bloomberg reported earlier that Rosneftegaz had received permission to deposit 1.8tn rubles at Gazprombank.

Assuming this is true, let us revisit the first step, Rosneftegaz paid for its own Rosneft shares with money from state-owned companies which purchased the company's bonds. The paradox of this ploy lies in the fact that Rosneftegaz ceased to be the bearer of these shares, yet is indebted to VTB (and perhaps also to Rosneft if the money was returned to VTB?).

All this, in fact, will not come as very comforting news for the state from a strategic point of view, despite the fact that the budget was swiftly replenished through a deal that seemed to be a real bargain. Hence, we arrive at a series of flaws which are not apparent at first glance and which, nevertheless, expose the true scale of the budget's vulnerability.

To begin with, being the owner of Rosneftegaz, Rosimushchestvo (the Federal Property Management Agency) reduced its assets by 19.5%, representing the shares that used to belong to Rosneft. It received the market price for the shares but it also inherited liabilities owed to VTB which transferred its right to receivables worth 692bn rubles from QHG Shares to Rosneftegaz. It turns out that the state-owned company issued a loan to the buyer of its assets using another company's money and is now left saddled with the debt.

It is precisely the state which is losing the very same thrift box, in the form of Rosneftegaz, that Vladimir Putin [boasted](#) of during a press conference. Rosneftegaz is yet another budget - said Putin when he explained the need to maintain the "safety cushion" Rosneft provided the state. However, Rosneftegaz's resources, generated mostly from Rosneft dividends, are spent both on programs of the very same oil company and Igor Sechin's pet projects (for example, a joint venture with the participation of the United Aircraft Corporation and Commercial Aircraft Corporation of China aimed at developing a wide-body aircraft). Apparently, the thrift box no longer belongs to the treasury, but to Igor Ivanovich, which is most certainly not the same thing. Rosneftegaz constitutes a Sechin fund rather than a state provisional reserve. It lies even more squarely in the hands of Sechin now, in the wake of the sale of 19.5% of its shares. Secondly, the entire scheme leads to institutional erosion of the role of the authorities and it is the Cabinet of Ministers which passes regulations concerning corporate interests instead of corporations abiding by government regulations. This is precisely what happened when Rosneft's shares were sold at a lower-than-forecasted price according to official government papers.

The problem was that Sechin cited the sum of 10.5 billion euros as the total revenue generated from the sale of the company's shares when presenting the deal to the president on December 7, which fell within the limit of 710.8 billion rubles. However, it became clear almost immediately that investors did not manage to collect this sum (the consortium allocated as little as 10.2 billion euros). The media reported that Rosneft had decided to bridge the gap using dividends, but this plan soon started to falter. It would take very little imagination to put forward a completely different hypothesis concerning the mystery of the missing 300 million euros. Most likely, Sechin agreed with Glencore and QIA that they would receive some of the dividends upfront which could be used to finance the deal. Hence, Rosneft immediately reviewed its dividend policy in December and raised the upper limit on dividend payments from 25% to 35%. However, for one reason or another it has not managed to pool 10.5 billion euros as part of the deal (perhaps, Sechin simply indulged in wishful thinking during his meeting with Putin). As a result, Rosneft had to bluff its way through, by offering to repay the difference through the transfer of its own dividends to the budget, which was ultimately effected. Afterwards, it transpired that Rosneft had overpaid and an about-turn was promptly carried out. This explains the [amendments](#) to Rosneft's press-release which referred to a 'new dividend policy' and even government regulations were [amended](#). Under these circumstances, the 18 billion rubles already allocated to the budget, is no longer a Rosneft dividend payment as it becomes a "payment in advance of income from increased dividends", as journalists were [informed](#) by an insider. In other words, Rosneft has, in fact, changed its mind and plans on recovering 18 billion rubles - this money will probably be deducted from 2016 dividends.

Observers have grown accustomed to the ongoing erosion of the role of the government, which has been offset

by the relatively strong role played by the president. However, even presidential instructions were ignored in the case of Rosneft's privatization: Putin demanded, at one point, that state-owned companies should not be sold using funds from state-owned banks. In the situation described here, we cannot disregard the fact that nearly a quarter of the total loan amount was provided precisely by state-owned banks, even if we put the involvement of VTB aside (VTB stepped in but then withdrew from the scheme). This is related to the fact that the banks acted as intermediaries in the privatization by purchasing Rosneft's bonds and issuing a loan to the QHG Shares consortium. In the latter case, according to media reports, Sechin managed to attract only two entities: Gazprombank, controlled by friends of Putin, and VBRR (the Russian Regional Development Bank) - a subsidiary of Rosneft itself. In other words, it was not easy to convince even state-owned banks to provide funding, and the scheme was akin to a special operation.

Thirdly, despite the generation of funds from the sale of 19.5% of Rosneft's shares, the Reserve Fund transferred 1tn rubles to the budget anyway, "just in case", as requested by representatives of the Ministry of Finance. Even before the Rosneft deal, the Deputy Minister of Finance Tatyana Nesterenko stated that the Ministry of Finance wanted to err on the side of caution in case the privatization was delayed. However, they did not balk at accepting greater amounts from the Reserve Fund, even though the budget had already been replenished. In December, the Ministry of Finance sold 6.87bn dollars, 6.44bn euros and 1.21bn pounds sterling from the Reserve Fund for 966.9 billion rubles to cover the budget deficit. Therefore, all this commotion and furor about finalizing everything before New Year's Eve was just a charade aimed at covering-up the implementation of the privatization scheme "in Sechin's way".

Finally, fourthly, the sale of Rosneft's shares has dealt a major blow to privatization ideology in Russia. Members of the government usually referred to as "systemic liberals" have always opted for privatization as a means of denationalizing the economy. The government believed that sales of businesses to private investors would increase the effectiveness of asset management. Official rhetoric changed immediately after the deal. Dmitry Medvedev said: "It does not matter what color the cat is as long as it catches mice".

The head of state sang a completely different tune just a few days later: "Russia is selling stocks of shares in state-owned companies in order to improve the structure of the economy and not because we are short of money" - these words were uttered by Putin during the closing press-conference. Through these words, he contradicted what Medvedev had said. And it seems that this was neither an act of cunning nor hypocrisy but merely an attempt to save face in a situation whereby Sechin gains further personal control over assets which were state-owned only yesterday. He prevents involvement of strategic investors since he is afraid that his managerial monopoly can be undermined. Putin, however, opts to turn a blind eye to this since he customarily solves short-term problems at the expense of long-term objectives. From a strategic point of view, the institutional damage caused by the sale of 19.5% of Rosneft's shares will dwarf the sum of 692 bn rubles. This money will very soon be eaten away when this year's financial results are announced.

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