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Russian State Bank Secretly Financed Rosneft Sale After Foreign Buyers Balked

By Reuters

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It was billed as the deal that proved Russia remained open for business.

"I want to congratulate you", Russian President Vladimir Putin told his trusted ally Igor Sechin, after greeting him with a warm handshake in the Kremlin in December, 2016.

Sechin had just announced the sale to Qatar's sovereign wealth fund and giant commodity trader Glencore of a 19.5 percent stake in Rosneft, the state oil giant that he runs.

The 10.2 billion euro ($11.57 billion) privatization deal was designed to replenish Russia's coffers, depleted by falling energy prices and Western sanctions.

Some Russian officials hailed it as proof that despite growing political isolation from the West

the country could still attract global investors.

But now, nearly two years after the sale was first announced, nine sources with knowledge of the transaction have told Reuters that VTB, a Russian state-owned bank, itself financed a large share of the acquisition, undermining the deal's stated aim to bring foreign money into the country.

Based on accounts from five of the sources, the value of the Russian loan to the Qatari sovereign wealth fund is around $6 billion.

VTB denied it issued a loan to the Qatari sovereign wealth fund, called the Qatar Investment Authority (QIA).

"VTB has not issued and is not planning to issue a loan to QIA to finance the acquisition."

VTB data for September published by the Russian central bank showed that VTB loaned 434 billion roubles ($6.7 billion) for up to three years to unnamed foreign borrowers after having raised 350 billion roubles via loans from the central bank itself.

VTB's financial results, published on Nov. 8, showed that during the third quarter the volume of loans to its 10 biggest borrowers had gone up by 403 billion roubles, or approximately $6 billion.

VTB declined to comment on the transactions, and the central bank did not respond to questions.

The QIA declined to comment. The Kremlin did not comment. Rosneft did not respond to questions about the VTB loan to Qatar.

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"Effective" Privatization

Rosneft - the world's biggest listed oil company by output - is the jewel in Russia's corporate crown.

But with Russia under sanctions, and facing the prospect of more sanctions to come, Sechin faced an uphill task in finding buyers or creditors willing to risk their own money to acquire a stake in Rosneft.

The sanctions, imposed by the United States and European Union in the aftermath of Russia's 2014 annexation of Ukraine's Crimea region, limit the access of Russian firms to international debt markets.

In the end, to get foreign investors on board, Russia has had to loan them billions, according to the sources' account. Two sources familiar with the deal said that having a third party finance a large part of the acquisition was a condition for Qatar taking the stake.

With oil prices today significantly higher than in late 2016, Russia's need for foreign money has subsided.

But should it need to tap international markets again, the story of the Rosneft sale points to the challenges it could face in bringing investors on board, especially as the United States levies more sanctions against Russia.

The nine sources who told Reuters about the VTB loan to Qatar included a source close to VTB management, a Russian central bank official and a Russian government source familiar with foreign investments in Russia.

At least four of the sources were directly involved in preparations for the loan. All the sources requested anonymity because they are not authorized to discuss the deal.

In response to questions about how the privatization of its stake as a whole was conducted, Rosneft said the deal was market-based and transparent and in the interests of all shareholders.

It said all decisions relating to the deal underwent the relevant procedures for corporate approval, that the deal was supported by governments where participants are based, and was subject to compliance procedures in the relevant jurisdictions.

"This is a unique example of an effective privatization," Rosneft said in a statement.

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From Gulf to Japan

As the end of 2016 drew nearer, Sechin, one of Putin's closest lieutenants, was under pressure. The government had publicly announced it would sell a 19.5 percent stake in Rosneft by the end of the year.

The state budget, battered by a collapse in oil prices, an economic slump and the impact of Western sanctions, was showing a deficit of 3.5 percent. Russia's economy was in its second year of recession and there was no prospect of a quick improvement in public finances.

By the autumn, Sechin, who is now 58, thought he had a buyer: the United Arab Emirates' sovereign wealth fund Mubadala.

According to two sources familiar with the developments, Mubadala agreed to buy the stake. But negotiations hit a snag after Rosneft twice changed the price tag, the two sources said, prompting the Emiratis to walk away from the deal.

Mubadala declined to comment. Rosneft did not address questions about the Mubadala discussions.

Sechin turned east and started talks with Japanese officials, according to a Russian government official, a source close to Rosneft and a recording of a conversation involving Sechin that emerged as part of an unrelated court case in which Sechin was a witness.

The talks were held primarily with the Japanese Economy, Trade and Industry minister, Hiroshige Seko.

If the deal was agreed, the owner of the stake would have become a large state Japanese investment fund such as GPIF, the government pension investment fund which has over $1.4 trillion assets under management, or state-run Japan Oil, Gas and Metals National Corp (JOGMEC), three sources familiar with the discussions told Reuters.

That deal also ran into difficulties, according to Sechin's account in the recording played in court, when Japan insisted on linking it to progress in a territorial dispute with Russia dating back to the end of World War Two.

Eventually, the deal collapsed.

Japan's Ministry of Economy, Trade and Industry did not respond to questions. Rosneft did not address Reuters' questions about discussions with Japan. JOGMEC's press service said it could not comment. GPIF said it could not comment on a discussion between governments because it was not directly involved.

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Qatar to the Rescue?

Still without a buyer, Sechin focused on two new potential suitors: Qatar's investment fund QIA and global commodities trader Glencore.

Neither was prepared to put up all of the asking price, according to three sources.

In the past, Rosneft had gone to major Western banks, such as Deutsche Bank and JP Morgan, to finance transactions, but the big international lenders have announced no major new loan deals with Rosneft since sanctions were imposed in 2014.

In stepped Intesa Sanpaolo, a mid-sized Italian lender which had little experience in large Russian corporate deals.

By early December, 2016, financing for the deal was falling into place. The buyers put in some of their own money: Qatar gave 2.5 billion euros and Glencore 300 million euros.

The rest was debt, of which Intesa put up 5.2 billion euros. The balance, according to Glencore at the time, would come from unnamed Russian banks.

The amount coming from the Russian banks was about $2.5 billion. Two banking sources close to Rosneft told Reuters that VTB was one of the banks that between them put up $2.5 billion in loans back in 2016.

Those sources said the other Russian banks involved were Gazprombank and Otkritie, which, like VTB, have Kremlin connections, although Otkritie was privately held at the time.

It is not clear what share of the $2.5 billion each of the three banks contributed.

That contribution from VTB towards the $2.5 billion was separate to around $6 billion that, according to the nine sources, VTB provided to Qatar this year.

In response to questions about the initial $2.5 billion in loans, VTB said it did not provide financing but it was the coordinating bank on behalf of Rosneft.

Otkritie declined to comment. Gazprombank did not respond to questions.

For the larger portion of the financing -- the 5.2 billion euros loaned by Intesa -- the Italian bank's intention was to syndicate the loan, a common industry practice designed to spread the risk and dilute the burden on the bank's own capital.

But two banking sources and a source familiar with the Italian side of the deal said the syndication failed because European banks approached by Intesa were worried about the risk that providing finance for Rosneft, even if indirectly, would result in them falling foul of Western sanctions on Russia.

Rosneft and Sechin are both subject to U.S. sanctions.

Intesa declined to comment.

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Another Setback

At the time of the December 2016 announcement and in the weeks afterwards, Russian officials spoke publicly of a long-term partnership with the new Rosneft shareholders, Qatar and Glencore.

But it became clear that the agreement was still in flux when, in September 2017, Sechin said a deal had been signed for Chinese energy firm CEFC to buy 14.2 percent of Rosneft from Qatar and Glencore.

Explaining why the original deal had not stuck, he told Russian state television the new shareholders were finding the cost of servicing the debt too high.

The Chinese deal though, was never closed. Before it was sealed, CEFC's founder and chairman Ye Jianming was taken in for questioning and investigated by Chinese authorities for suspected economic crimes.

Since then there has been no word on the status of the investigation, or if Ye has been charged. He was named, however, in a high-profile graft trial of a senior Communist Party official, state broadcaster CCTV reported last month.

Neither Ye nor CEFC responded to calls from Reuters seeking comment.

Once again, Sechin was in search of a buyer.

Finally, in May this year, Qatar agreed to take on the part of the stake that had been covered by Intesa.

Officially, no one has said how the new deal with Qatar is being financed, or who is providing the finance.

It is clear that Intesa’s role has ended.

A document dated Sept. 6, 2018 and lodged with Singapore's official business register, where the vehicle that held the stake on behalf of Qatar and Glencore is registered, stated that Intesa had ceased to be the creditor for the stake and no longer held shares as collateral.

The document did not state who was the new creditor. According to the nine sources familiar with the arrangement, that new creditor is VTB.

At a reception at the Italian embassy in Moscow last November to receive an award "for services to Italy", Sechin, champagne glass in hand, linked arms with a grey-haired Russian man in fashionable glasses.

It was Andrey Kostin, the chief executive of the bank that helped to finance the privatization – Russia's VTB.

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