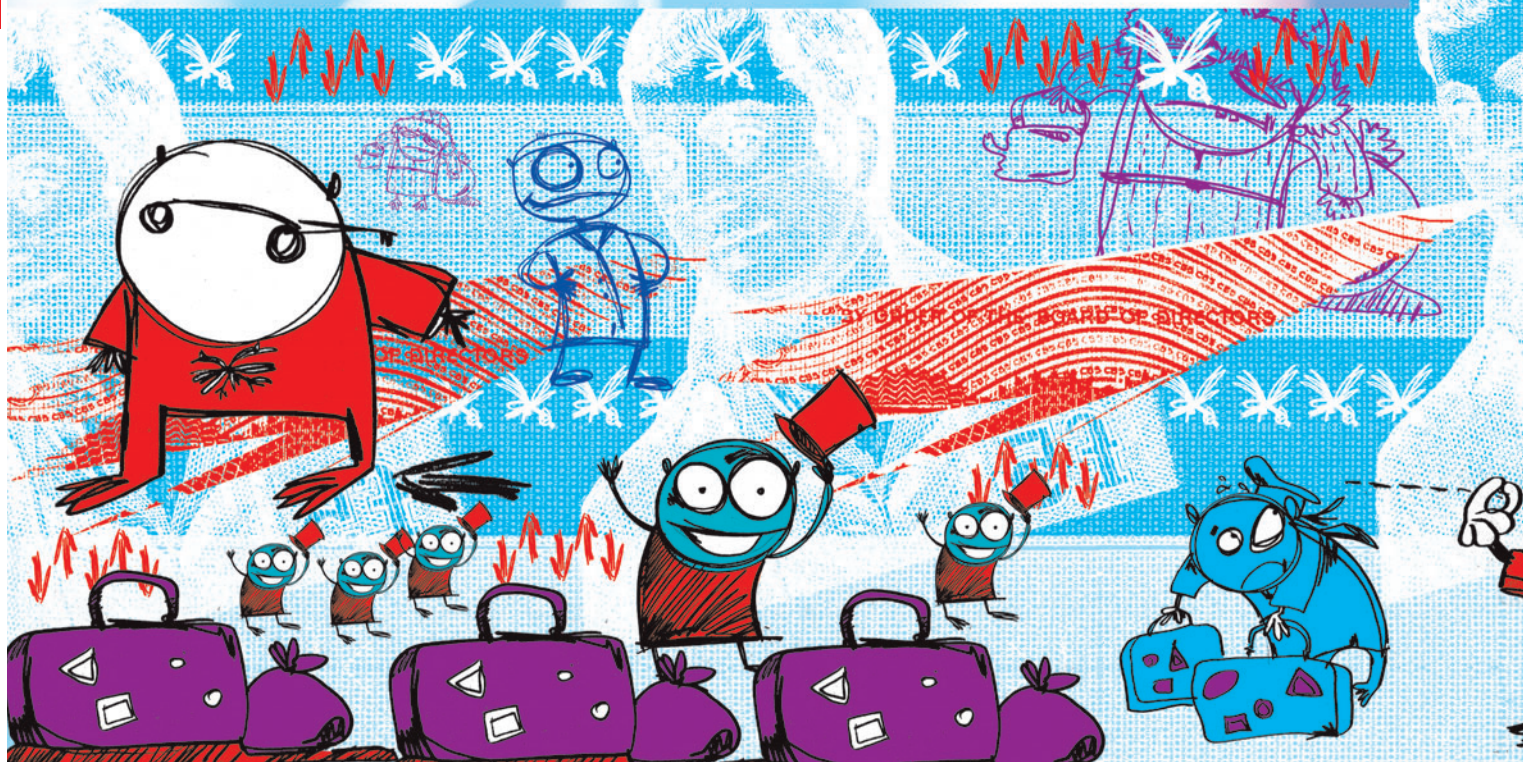


Vitaliy Shapran, Vladimir Dukhnenko

Not everyone is here yet

Europe's largest bank holding companies will become major players in the Ukrainian financial market in the next few years. This will help resolve the issue of Ukraine's European integration



Thirty banks, which are partly foreign-owned, are presently registered in Ukraine, with eleven of them being fully foreign-owned. Since the beginning of 2005, the number of foreign-owned banks grew to eleven, while their share of the aggregate share capital of all Ukrainian banks grew by two-and-a-half times to comprise 23.4%. In other words, foreigners now own almost a quarter of shareholders' equity of Ukrainian banks. Assets of foreign-owned banks constitute nearly 40% of the banking system aggregate assets. Foreign banks that enter the Ukrainian market tend to be market leaders within the EU, the intergovernmental union which Ukraine is trying to become a member of. It is impossible to imagine Ukraine entering the EU with its banking sector sealed off from foreign capital.

Polar enclaves

The acquisition of Ukrainian banks by foreigners helps to disclose who owns each one of the banks. *Expert* used the databases of information disclosure systems to come up with several groupings of foreign-owned banks in Ukraine. The international financial institutions enclave includes six banks, with the leading role played

by governments of USA, Germany and Poland. Another six banks belong to the Russian enclave, led by the government of the Russian Federation. A separate enclave, composed of three banks, is controlled by the French group, Credit Agricole, while UniCredit spearheads yet another two-bank enclave. Eight banks, grouped into another enclave, so far lay no claims to establishing separate banking groups in Ukraine. Finally, two banks stand out, as their investors fail to affiliate with any of the well-known foreign financial industrial groups. Rather, it appears that their investors could be a mere offshore cover, shielding the identity of their Ukrainian owners.

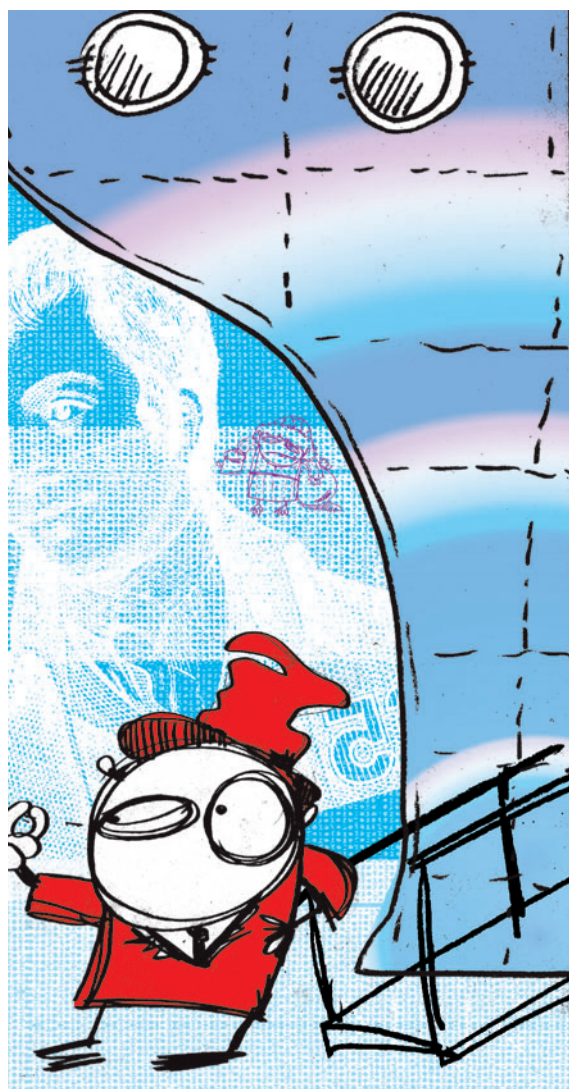
The 2006 first quarter financial indicators of foreign-owned banks reveal two important trends. Firstly, liabilities of foreign owned banks include a substantial share of inter-bank loans and other banks' funds, comprising up to 35% of their balance sheet total. In other words, foreign banks use their subsidiaries to invest their resources. Secondly, fully owned foreign banks are marked by high levels of profitability (of sales and of shareholders' capital), which implies that they will pay more in profit taxes than their Ukrainian competitors.

Banks comprising the Russian enclave have not yet become comfortable in the Ukrainian

financial market. At the end of the first quarter of 2006, subsidiaries of the Bank of Moscow and Vneshtorgbank had an excessively high ratio between shareholders' equity and assets — 51% and 75% respectively. Despite the speculation regarding the dominance of Russian banks in Ukraine, the assets of the Russian enclave amount to \$1.44bn, a meagre 9% share of the total assets of all foreign-owned banks.

UniCredit, an Italian group, is even less active. The performance of its two banks, HVB Ukraine and Pekao Ukraine (recently renamed UniCredit Bank), lags far behind those of the market leaders. Nevertheless, after its acquisition of HVB, a German group, UniCredit is likely to adopt a much more aggressive strategy in the Ukrainian financial market.

The biggest enclave encompasses a group of banks formed around international financial institutions. Thus, EBRD, the core of this enclave, directly participates in the share capital of two Ukrainian banks: ProCredit Bank and CredoBank. The former is partly owned by the German ProCredit Holding AG, which is controlled by IPC, a German group specialising in project consulting, and DOEN, a Dutch fund. ProCredit Holding AG co-owns 19 banks, scattered throughout the world. Therefore, the Ukrainian ProCredit Bank remains part of the



global project aimed at developing a network of microfinance banks — until recently, it used to be known as the Bank of Microfinance.

CredoBank, which has recently changed its name from Kredyt Bank (Ukraine), was initially set up as the Western Ukrainian Commercial Bank. This bank has quite a history with foreign investors. In 2004, its principal investor, the Polish Kredyt Bank S.A., itself a subsidiary of the Belgian financial holding KBS, divested itself from its shareholding interests, justifying its move by its inability to further invest into the Ukrainian banking infrastructure. A new investor was soon found. This turned out to be PKO Bank Polski, half-owned by the Polish government. As of 1 April 2006, the PKO Bank Polski commands \$30bn worth of assets, or two-thirds of all Ukrainian banks' assets.

Until 2005, the EBRD co-owned TBIF Financial Services (The Netherlands), controlled by Kardan, an Israeli financial industrial group. In 2004, the EBRD sold its stock in the company but retained its partnership with Vienna Insurance Group (VIG). In the latter half of 2005, VIG and Kardan Group signed an agreement whereby 40% of Kardan Financial Services will become the property of VIG. Kardan Financial Services controls TBIF Financial Service, which plans to increase its stake in

the share capital of Kiev-based VABank from 27% to 50%. And VA-Bank remains a key infrastructural part of the Ukrainian equity market: after all, it is the bank which operates the transactions within the First Securities Trading System (PFTS), Ukraine's principal trading platform.

The IPO-borns

Raiffeisen Zentralbank (RZB) and Orszagos Takarekpenztar (OTP), Austrian and Hungarian groups closely affiliated with the Ukrainian banking system, also have direct links with the EBRD. Currently, the EBRD owns 2% of Raiffeisen International Bank-Holding AG, a share that used to be much higher. More importantly, the EBRD continues its co-operation with CIS subsidiaries of RZB, supplying them with loan schemes for micro-financing small businesses and with bank warranties. The EBRD also used to own the Hungarian OTP, which recently bought Raiffeisenbank Ukraine.

The culmination of RZB's development was its spring 2005 IPO in the Vienna Stock Exchange (VSE) whereby the bank's Austrian owners attracted about €1.1bn. At the time of the offering, Raiffeisen Zentralbank's share prices rose from €32.5 to €39, and continued to grow into early June 2006, when they were being traded for as much as €67 at the VSE. After the IPO, 70% of the shares of Raiffeisen

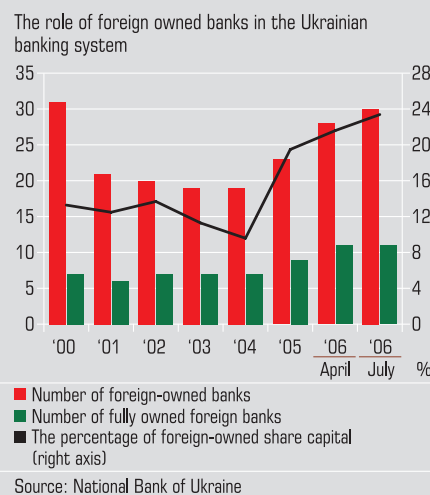
International belong to Raiffeisen Zentralbank Österreich AG. The remaining 30% are freely traded, with a 14% share controlled by institutional investors.

RZB spent almost 80% of the funds acquired in the course of its IPO on the acquisition of JSPPB Aval in the second half of 2005. After the IPO, the Austrian holding company managed to augment its assets by 40% in one year. However, after the purchases of Russian and Ukrainian banks, the holding company saw its capital adequacy coefficient decline from 11.8% in January 2005 down to 9% in January 2006. It appears that the Austrians overestimated their capacity: the rate of the shareholders' capital growth was insufficient to cover the rapidly escalating liabilities. This could be the reason behind the group's decision to sell its second Ukrainian subsidiary, Raiffeisenbank Ukraine, instead of merging it with Aval.

We anticipate that Raiffeisen International will conduct another IPO, which is likely to be undertaken after the group finishes its restructuring, necessitated by its ambitious bank purchases in Eastern Europe. Given that Raiffeisen Zentralbank Österreich AG controls 70% of Raiffeisen Int., it can afford to augment its subsidiary's capital by 40% using other investors' funds and still retain its controlling block (over 50%). Current share prices will ensure that an additional IPO can attract up to €4bn. Aware of

Fully owned foreign banks are marked by high levels of profitability, which implies that they will pay more in profit taxes than their Ukrainian competitors.

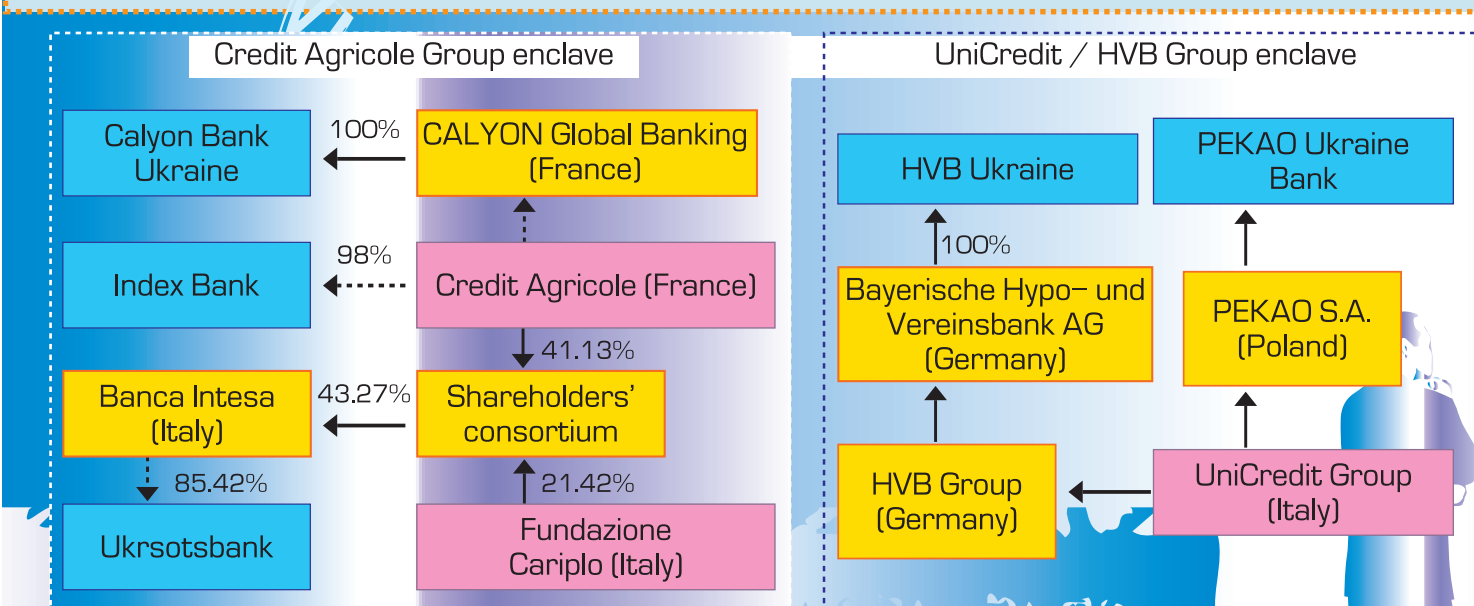
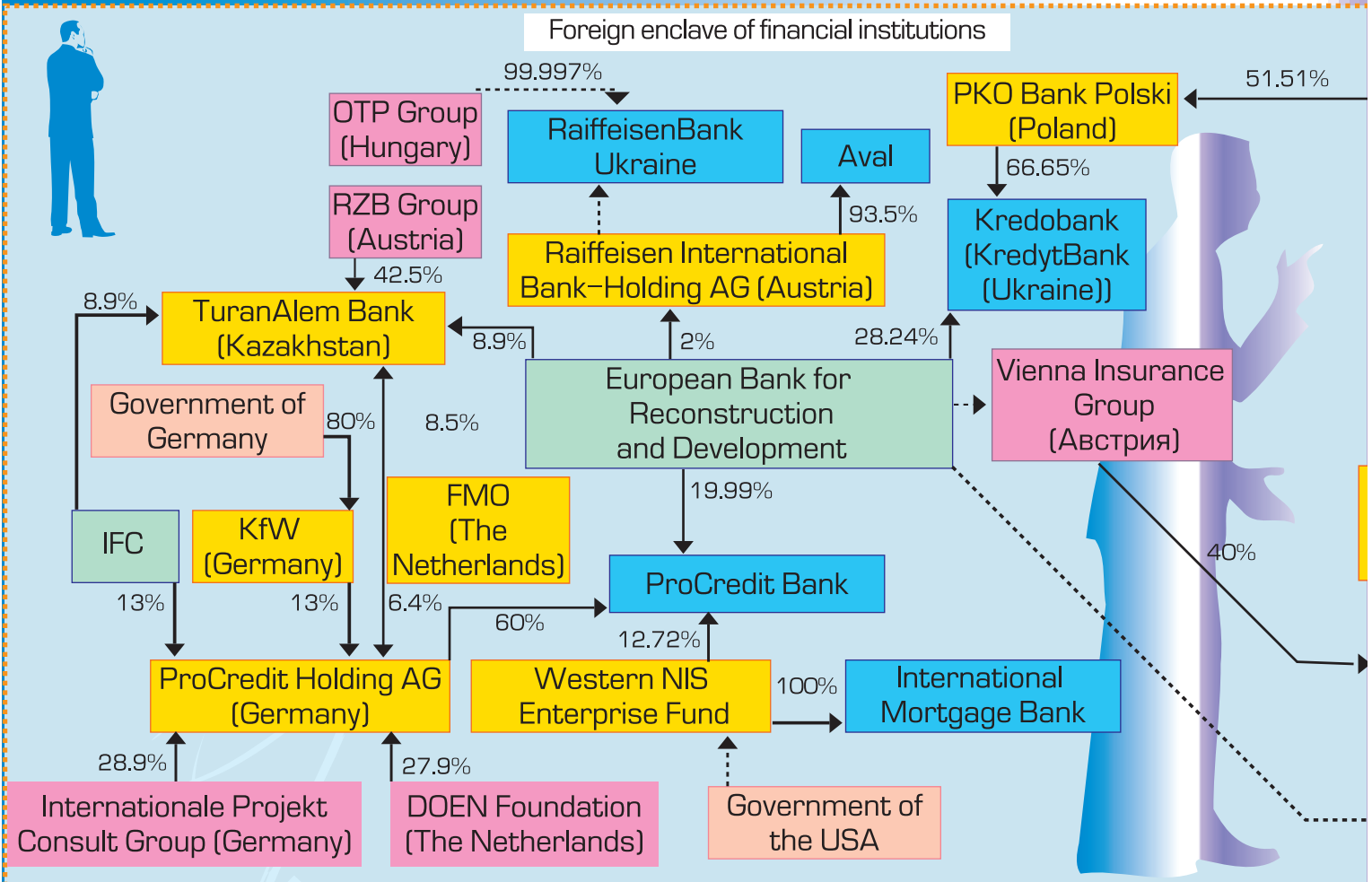
The share of foreign-owned shareholders' equity in Ukrainian banks has increased sharply over the last one and a half years



the fact that such funds are not available through the VSE, Raiffeisen International is conducting a road-show in the USA and in the UK. If the IPO is successful, the Austrians might continue their purchases in the region.

The Austrian banking group Erste, RZB's competitor, has been looking to purchase a bank in Ukraine for some time. Normally, Erste prefers to buy formerly state-owned banks, but because the Ukrainian government is uneasy about selling these, the Austrians decided to buy half of Prestige Bank, set up by Aval's former shareholders. However, as Prestige was registered by the National Bank of Ukraine several of months ago, what Erste ended up buying was a license to conduct banking activity. Erste used to have ties with the EBRD and increased its capitalisation in the course of its IPO back in 1997. Therefore, as of early 2006, the assets of Erste group exceeded €152bn, which is almost twice the

Corporate structure of foreign owned banks in Ukraine,

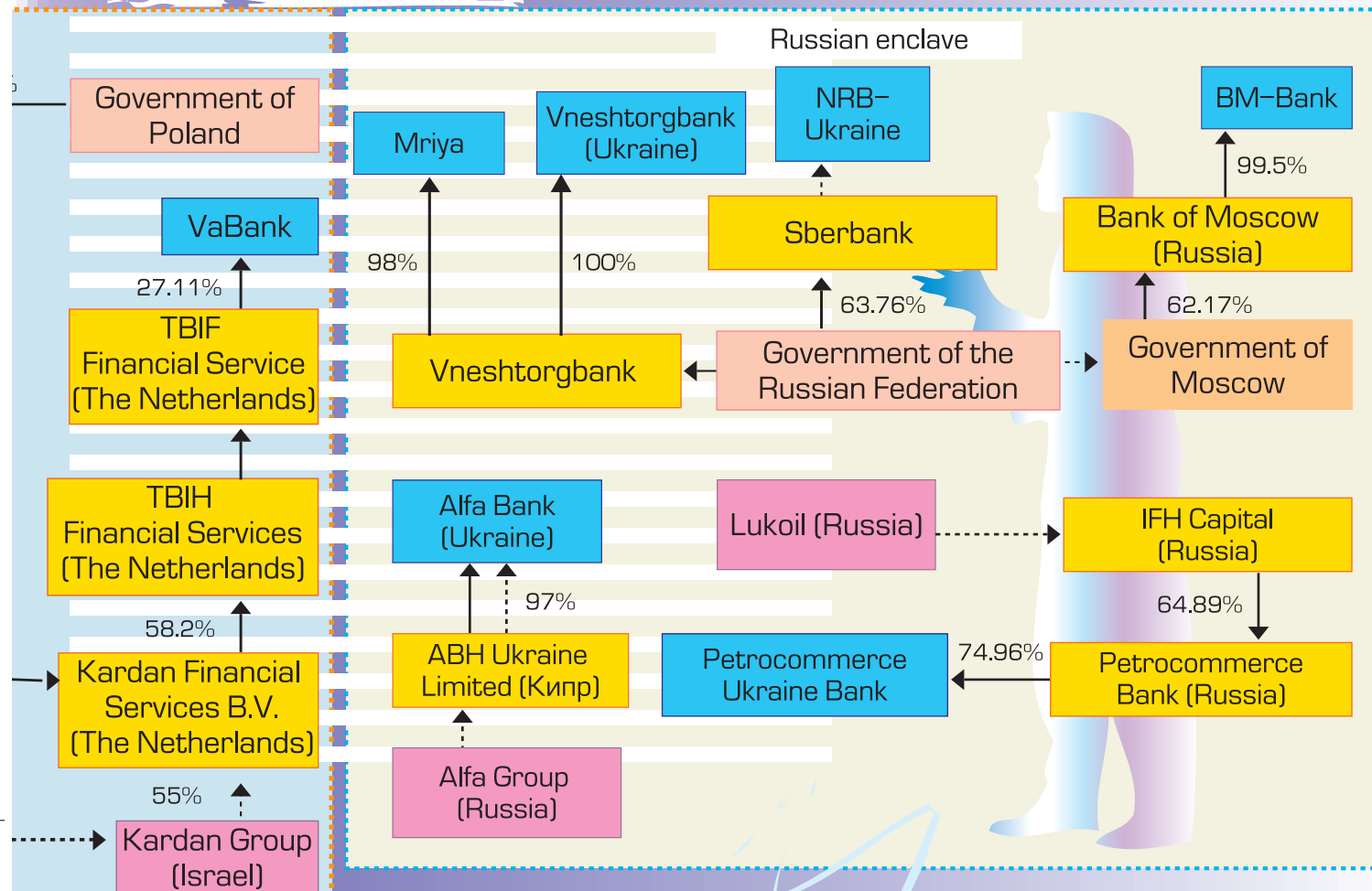


Note: Blue boxes designate banks registered in Ukraine; in yellow boxes are legal entities through which control over Ukrainian banks is mediated; and red boxes contain financial groups (conglomerates) which in reality exercise control over Ukrainian banks.

Sources: Stock Market Infrastructure Development Agency of Ukraine (ARIFR), Office for Information Disclosure of the Federal Financial Markets Service of Russia, Office for Information Disclosure of the US Securities and Exchange Commission, official reports and press releases of banks and financial companies.

-----> Mediated control or unfinished deals —> Direct control

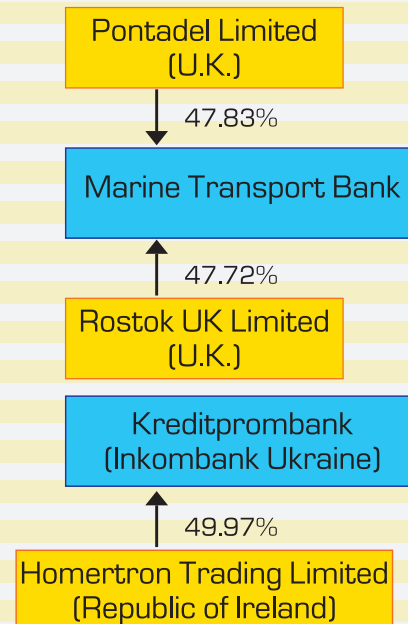
ie, organized into separate enclaves for better clarity



Other Ukrainian banks affiliated with foreign banks

ING Bank Ukraine	100%	ING Group (The Netherlands)
UkrSibBank	51%	BNP Paribas (France)
SEB Bank (Ukraine)	95.02%	SEB Group (Sweden)
Citibank (Ukraine)	100%	Citigroup (USA)
Privatinvestbank	100%	Home Credit (Czech Republic)
Lviv	52.07%	Atorka Group (Iceland)
Universalniy	99.34%	EFG Eurobank (Greece)
Prestige	50.5%	Erste Bank (Austria)

Banks affiliated with little-known foreign companies



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Basic indicators of the operational activity of partly foreign-owned Ukrainian banks as of 1 April 2006

No	Bank	Gross assets, bn USD	Loans, bn USD	Shareholders' equity	Shareholders' equity/assets, %	Difference in interbank rates between assets and liabilities, %	Profitability			ROE of parent holding company, 2005 financial year, %
							ROS, %	ROA, %	ROE (TTM*), %	
1	Aval	3696	2800	374	10.12	-0.02	6.75	0.26	10.40	17.60
2	UkrSibBank	2345	1752	188	8.00	-24.15	3.10	0.10	5.00	20.25
3	Ukrsotsbank	2286	1547	214	9.37	1.36	13.91	0.47	20.12	15.80
4	RaiffeisenBank Ukraine	1456	1250	141	9.68	-34.44	33.62	1.15	47.60	28.90
5	Kreditprombank	693	452	68	9.86	-2.25	8.27	0.24	9.64	N/A
6	Alfa Bank	600	455	40	6.74	-28.52	1.67	0.05	2.88	21.16
7	VABank	510	289	59	11.62	1.90	4.30	0.12	4.12	9.50
8	Index Bank	471	320	37	7.91	-2.47	1.36	0.05	2.72	15.80
9	ING Bank Ukraine	458	301	47	10.28	-13.56	35.79	0.76	29.60	26.60
10	CredoBank	435	345	32	7.44	-10.72	6.28	0.23	12.56	20.10
11	Mriya	415	335	48	11.65	-1.01	22.26	0.94	32.36	9.70
12	Citibank Ukraine	326	20	41	12.71	-9.45	36.30	0.74	23.28	22.10
13	HVB Bank Ukraine	292	222	39	13.23	-30.42	30.51	0.93	28.20	6.32
14	Calyon Bank Ukraine	246	190	22	9.11	-26.24	23.54	0.52	22.84	15.80
15	ProCreditbank	229	200	23	10.27	-4.50	10.16	0.49	19.24	9.32
16	Marine Transport Bank	212	140	28	13.03	6.66	16.20	0.52	16.00	N/A
17	NRB-Ukraine	179	122	22	12.08	-9.99	10.08	0.33	11.00	24.31
18	SEB Bank	123	71	22	17.67	-17.29	2.14	0.07	1.56	15.80
19	Petrocommerce Ukraine	122	79	13	10.93	-4.74	15.84	0.67	24.56	29.80
20	Vneshtorgbank Ukraine	107	77	55	51.05	-28.56	4.15	0.14	1.12	9.70
21	PrivatinvestBank	40	5	10	24.53	4.80	24.86	0.27	4.44	35.30
22	Pekao	35	22	10	30.20	-31.99	6.64	0.21	2.76	16.00
23	International Mortgage Bank	22	16	5	23.62	-1.65	24.83	0.86	14.60	N/A
24	Lviv	20	14	6	29.24	-6.95	10.13	0.35	4.84	15.40
25	BM-Bank	15	6	12	75.30	43.60	-7.15	-5.56	-29.52	17.84
Bank Group Total		15333	9448	1558	17.43	-9.22	13.82	0.20	12.88	18.32
Total		45047	31001	5394	11.97	-2.41	9.20	0.34	11.24	—
Share of total		34.04	30.48	28.88	—	—	—	—	—	—

*Annualised quarterly indicator.

Source: National Bank of Ukraine; calculations by Expert

size of the assets of the Bank of New York and 3.7 times the size of RZB's assets.

Finally, the Hungarian OTP was privatised in 1995 in the course of three IPOs. Its market capitalisation, nearing \$11bn, is not substantial. The bank's shares are listed on the Luxemburg and Budapest stock exchanges, as well as the US PORTAL system. According to *Expert's* information, the OTP is preparing to expand the geography of its stock circulation and list on the world's leading trading platforms, in a move to boost demand for its stock and increase the bank's capitalisation. According to official data, over 85% of the bank's capital belongs to foreign portfolio investors, 3% is owned by its top-management and the company's employees, and a mere 0.3% belongs to the government of Hungary.

French Banca Intesa

Expert's analysis reveals that 17.84% of the shares of the Italian Banca Intesa, which decided to buy Ukrsotsbank in February 2006, belongs to a French bank CALYON. In practice, the degree of control is higher: shareholders of Banca Intesa form a consortium which controls 43% of the votes and actually manages the bank, as all other shareholders own portfolios of

less than 2%. The shareholders' consortium will stay in force until April 2008. Apart from Credit Agricole, it is comprised of Fondazione Cariplo, which owns 9.27%, and Generali Group, a large insurance group, which has 7.27% of the votes. Other consortium shareholders possess less than 5% of the votes. As a result, Credit Agricole amassed 41.13% of the consortium votes, which gives the French group the power to appoint five out of twenty-one members of Banca Intesa's board. As the largest shareholder, Credit Agricole certainly influences the Italian bank's policy, which means that the option of buying Ukrsotsbank could have been conceived in Paris.

The core of the French banking group remains Credit Agricole S.A., which purchased Credit Lyonnais at the moment of its privatisation. With Credit Lyonnais, the bank also inherited Credit Lyonnais Ukraine, which is now called CALYON Ukraine. In the spring of 2006, Credit Agricole S.A. acquired yet another Ukrainian bank — Index Bank. These moves resemble a large-scale chess match that aims at establishing a powerful banking group, capable of competing with the French bank BNP Paribas, which at the end of 2005 had bought UkrSibBank, one of Ukraine's largest banks.

Credit Agricole S.A. has much more investment capacity than Banca Intesa. As of 1 April 2006, Credit Agricole Group had assets worth \$1.35trln, roughly 30 times more than the total assets of all Ukrainian banks. Moreover, Ukrainian inheritance was just one part of the package Credit Agricole acquired with the purchase of Credit Lyonnais. Another was a partnership with the EBRD: given that the EBRD was set up with the initiative of the French government, quite a few former managers of then-state-owned Credit Lyonnais found themselves working for the EBRD. One of these was **Jean Lemier**, who is now President of the EBRD and who, back in the 1990s, was a high-ranking French official and board member of Credit Lyonnais.

Who is the next?

Of the world's top 25 banks, six are directly or indirectly present in the Ukrainian market (Citigroup, BNP Paribas, ING, Credit Agricole, Allianz, UniCredit). The aggregate assets of these banking groups comprise \$8.1trln, which is hundred times more than Ukraine's annual GDP. At *Expert* we think that these are also the banks most likely to expand further. This anticipation is heating up demand on the market so

Almost half of partly owned foreign banks are controlled by international financial institutions

Asset structure of foreign banking enclaves in Ukraine and their potential as of 1 April 2006

Name of banking enclave	Assets in Ukraine, bn USD	Share in foreign owned banks' assets, %	Estimated sum of assets in the world, bn USD	Share of assets in Ukraine, %
International financial institutions	6.348	41.0	145	4.38
Credit Agricole Group	3.003	19.4	1400	0.21
Russian enclave	1.438	9.3	130	1.11
UniCredit Group	0.324	2.1	956	0.03
Banks affiliated with little-known foreign companies	0.905	5.8	N/A	—
Other banks affiliated with foreign banks	3.479	22.4	4900	0.07
Total	15.497	100.0	7531	0.21

Sources: National Bank of Ukraine, banks' data; calculations by Expert

that each new purchase of a Ukrainian bank is likely to turn out more expensive than the previous one. For the likes of UniCredit or Citigroup, there is one substantial problem associated with operating in the Ukrainian financial market: the volume of operations is small enough to be compared to the turnover of some of their subsidiaries in Central Europe and Latin America. These banking giants operate with figures on an entirely different scale. Citigroup, the world's third largest banking group, alone has assets worth \$1.6trln, and a market capitalisation of \$250bn.

However, not all of the top-25 banks have played their trump cards in Ukraine. The prospects look good for Barclays, a British banking group which took part in financing Renaissance, a Russian group that is already in Ukraine, and which also has business links with

the EBRD. HSBC (Hong Kong and Shanghai Bank Corporation), another British group, has so far avoided Ukraine. The world's fourth largest banking group, HSBC operates in many regions all over the world, and its expansion into Ukraine is just a matter of time. Its well-developed offshore services and a far-reaching networks of captives in offshore zones could certainly attract customers in Ukraine.

Santander Group, a Spanish company, is yet to decide on its involvement in the Ukrainian market. In 2005, Santander Group acquired Abbey National, a British bank which itself inquired a few years ago about the potential of the mortgage market in Ukraine.

The strategy of the Allianz Group also remains unclear. The joint venture between this German group and the Russian company ROSNO is already present in Ukraine, where-

as Dresdner Bank has yet to establish a presence. In the long run, Dresdner Bank could be an ideal bank to service the oil and gas cash flows between Ukraine and Russia. Firstly, Allianz is exceptionally active in Russia and, secondly, Matthias Warnig, a high-ranking official of Dresdner Bank who used to coordinate the bank's operations in Russia, used to work for the secret police of the GDR and co-operated with Russian president **Vladimir Putin**.

Japanese banks are still ignoring Ukraine, although Sumitomo has for several years been making inquiries about Ukraine's mining and concentration assets. Generally, the banking sector is not considered a separate type of activity in Japan, where banks usually follow industrial investors in their movements across the globe. Japanese banks, due to their inexpensive



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34 / PROSPECTIVE ECONOMICS AND FINANCES / BANK EXPANSION

World's top 25 banks can be bought for US \$2.3

Assets of the world's top-25 bank holdings as of 1 April 2006*

No	Bank	Country	Assets, bn USD	Market capitalisation, bn USD	Loans' share in assets (except for loans to financial institutions)	Shareholders' equity/assets	Market capitalisation/shareholders' equity (P/B)	Market capitalisation/assets (P/A)	Net income (profit) in 2005 financial year, bn USD	Growth of net income (profit) in the last financial year
1	United Bank of Switzerland	Switzerland	1669	115	12.34%	2.16%	3.19	6.89%	10.68	75.00%
2	Mitsubishi UFJ Financial Group	Japan	1595	137	45.83%	4.14%	2.08	8.59%	6.58	127.14%
3	Citigroup	USA	1586	248	37.52%	7.25%	2.16	15.64%	4.84	45.78%
4	HSBC Holdings**	Great Britain	1551	185	47.71%	6.38%	1.87	11.93%	15.08	16.00%
5	BNP Paribas**	France	1520	82	24.47%	3.22%	1.67	5.39%	7.02	18.68%
6	ING Group	The Netherlands	1441	87	37.47%	2.98%	2.02	6.04%	8.58	26.31%
7	Bank of America Corp.	USA	1375	222	45.02%	9.38%	1.72	16.15%	16.46	18.00%
8	Royal Bank of Scotland**	Great Britain	1352	99	53.70%	4.96%	1.48	7.32%	13.49	65.20%
9	Credit Agricole Group	France	1350	54	34.59%	2.89%	1.38	4.00%	5.11	50.00%
10	Mizuho Financial Group	Japan	1332	97	43.92%	2.70%	2.69	7.28%	N/A	—
11	JP Morgan Chase	USA	1274	152	33.91%	8.48%	1.41	11.93%	8.48	89.71%
12	Allianz Group	Germany	1246	63	37.72%	4.01%	1.26	5.06%	5.317	93.30%
13	Deutsche Bank Group	Germany	1242	59	15.06%	2.98%	1.59	4.75%	4.179	42.76%
14	ABN Amro Holding	The Netherlands	1170	53	31.28%	4.70%	0.96	4.53%	5.498	23.76%
15	Credit Suisse Group	Switzerland	1101	65	14.99%	3.00%	1.97	5.90%	4.432	4.03%
16	Societe Generale**	France	1020	61	26.67%	3.33%	1.79	5.98%	5.335	35.51%
17	Santander Group	Spain	977	91	55.37%	4.71%	1.98	9.31%	7.464	72.50%
18	UniCredit Group	Italy	956	76	53.14%	4.60%	1.73	7.95%	2.964	19.38%
19	HBOS	Great Britain	940	62	63.94%	3.51%	1.88	6.60%	8.55	17.00%
20	Sumitomo Mitsui Financial Group	Japan	912	75	54.39%	4.17%	1.97	8.22%	5.87	193.16%
21	Barclays Bank**	Great Britain	908	77	63.22%	3.63%	2.33	8.48%	8.976	15.28%
22	Fortis**	Belgium	874	42	38.44%	2.75%	1.75	4.81%	4.728	67.65%
23	Commerzbank	Germany	760	23	46.58%	4.47%	0.68	3.03%	2.068	59.67%
24	Industrial & Commercial Bank of China**	China	756	35	50.53%	4.10%	1.13	4.63%	N/A	—
25	Rabobank Group	The Netherlands	607	23	55.02%	5.11%	0.74	3.79%	2.499	16.17%
Group Total			29514	2283	39.30%	4.44%	1.74	7.74%	164.20	51.83%

*Highlighted banks have subsidiaries in Ukraine. **These bank holdings do not release quarterly balance reports, thus calculations were based on data for the beginning of 2006.

Sources: Bank holdings' official reports and press releases. Reuters. Bloomberg; calculations by: Expert (exchange rates used for calculations were \$1.2/€1; \$1.74/£1; \$0.79/\$Fr1; ¥117.3/\$1)

loans, remain one of the most promising sources of future investment in Ukraine. However, it will not start working until Ukraine creates conditions appropriate for the operation of Eastern investors. Sumitomo Financial Group is an exception: in its 2005 financial report the group announced its intention to develop its leasing business in Russia and Eastern European countries.

Europeans will become the most important

At present, the asset size of the Ukrainian banking system is not comparable with any of the top-20 foreign banking groups. The development of corporate relations in Ukraine continues to fend off the largest players of the global market of banking services. This props up Ukraine's imperviousness to foreign expansion and wins time for the national banks to prepare to be sold out, or to set up their own financial industrial groups. It has to be remembered that such banks as Société Générale, Dresdner Bank and Credit Suisse First Boston gave up waiting for the boom in

the Ukrainian banking sector and recently left the Ukrainian market. The example of the expansion of the Austrian banks clearly demonstrates that the banking system of even a small European country can develop on its own.

However, the main source of strength for the Ukrainian banking sector does not lie in imposing restrictions on foreign acquisition of Ukrainian banks' share capital, but rather in developing an equities market that can supply the banks with the resources they need. Such reasoning stimulates many banks to consider public and private listings. The private listing of Forum Bank in Frankfurt; Megabank's floatation on the PFTS; and Transbank's preparation to list on the PFTS are the first robins that signal the banks' realisation of the benefits of friendship with minority shareholders. However, given the record profits of transnational corporations in a highly auspicious 2005 financial year, these robins may have sung too late to save the independence of the Ukrainian banking system. Even if the National Bank of Ukraine introduces a cap on

foreign ownership of bank shares, the existing system for monitoring shareholder structure will make it fairly easy to circumvent these restrictions. Provided that favourable social and economic conditions in Ukraine persist, *Expert Ukraine* predicts that the expansion of foreign banks will continue, and their share of the aggregate assets of the Ukrainian banking system will grow. In the next few years, all large Ukrainian banks will acquire foreign shareholders, while the share of foreign capital in the national banking system will reach 50%.

The looming purchases of Ukrainian banks are most likely to be done by Finansbank (Turkey), Société Générale (France), and HSBC, HBOS and Barclays (UK). BNP Paribas and UniCredit Group are expected to expand their presence in the Ukrainian market. In the long run, the bank holding companies of the European top-25 will become key players in Ukraine. For Ukraine, this means that the prospects for EU integration will become better and more realistic than they are at present. ■