

RUSSIAN BANKING SYSTEM

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The choice of the financial system model

- Financial market-based system (US, UK)
 - Relies on the capital market and on segmented banking
 - High economic and organizational prerequisites for the efficiency
- Bank-based system (Europe, Japan)
 - Collects short-term deposits
 - Handles transfers of funds to business
 - Well capitalized to cover ordinary banking risks
 - For transition economies
 - Universal banking
 - Foreign bank entries are preferable

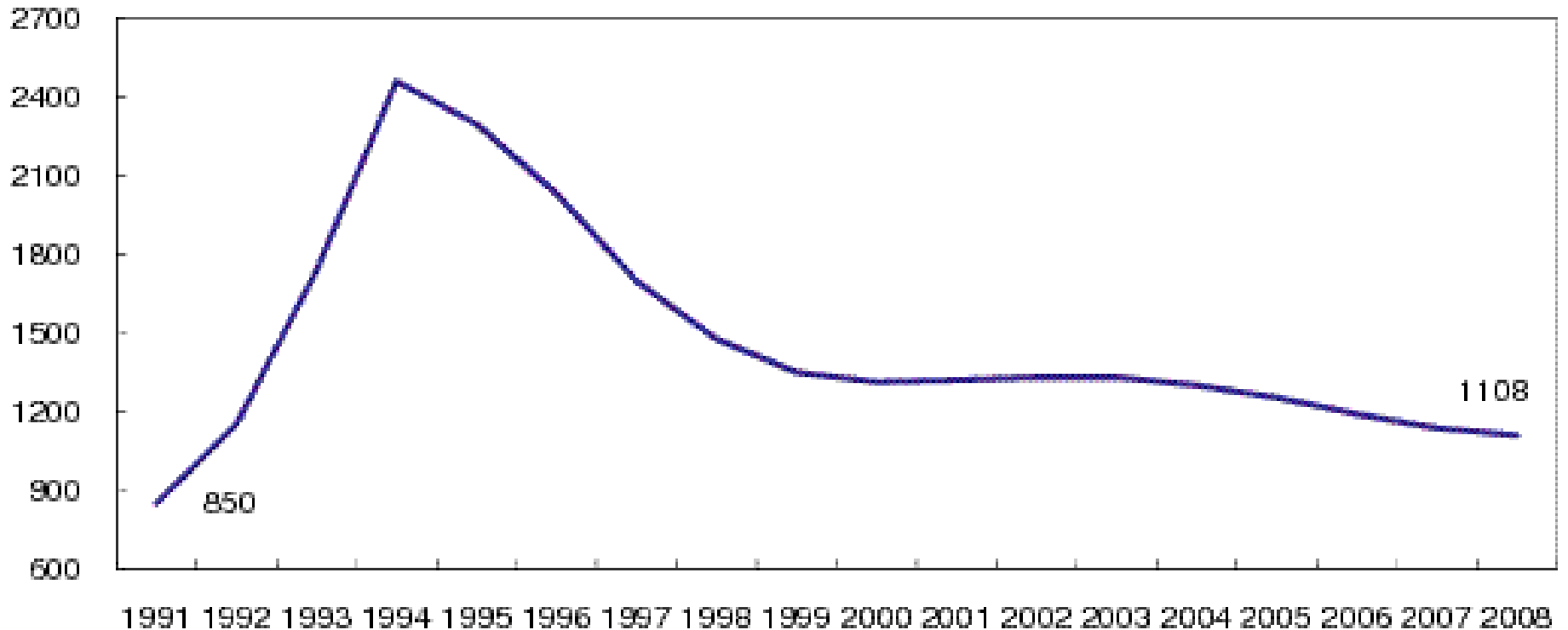
USSR banking system

- Gosbank controlled all banks
 - Vneshtorgbank - foreign currency, debt, and trade
 - Sberbank - the state savings bank
 - Stroibank - state enterprise credits
- The system channeled funds to state enterprises according to government decisions and, thereby, controlled enterprises, financed government debt, and foreign trade

Banking system at the first phase of economic transition

- Two-tier banking system:
 - Central Bank of Russia (CBR or Bank of Russia)
 - Commercial banks
- Emerged without any solid foundation
 - Low capital requirements for a license
 - Almost no bank supervision
- Large quantity of institutions
 - Gosbank ⇒ Central Bank of Russia
 - Vneshtorgbank ⇒ Vneshekomombank
 - Sberbank (the only institution of efficient savings mobilization)
 - Stroibank ⇒ specialized banks by industry
 - Numerous additional small banks

Number of banks



There are still many banks, most of which are very small

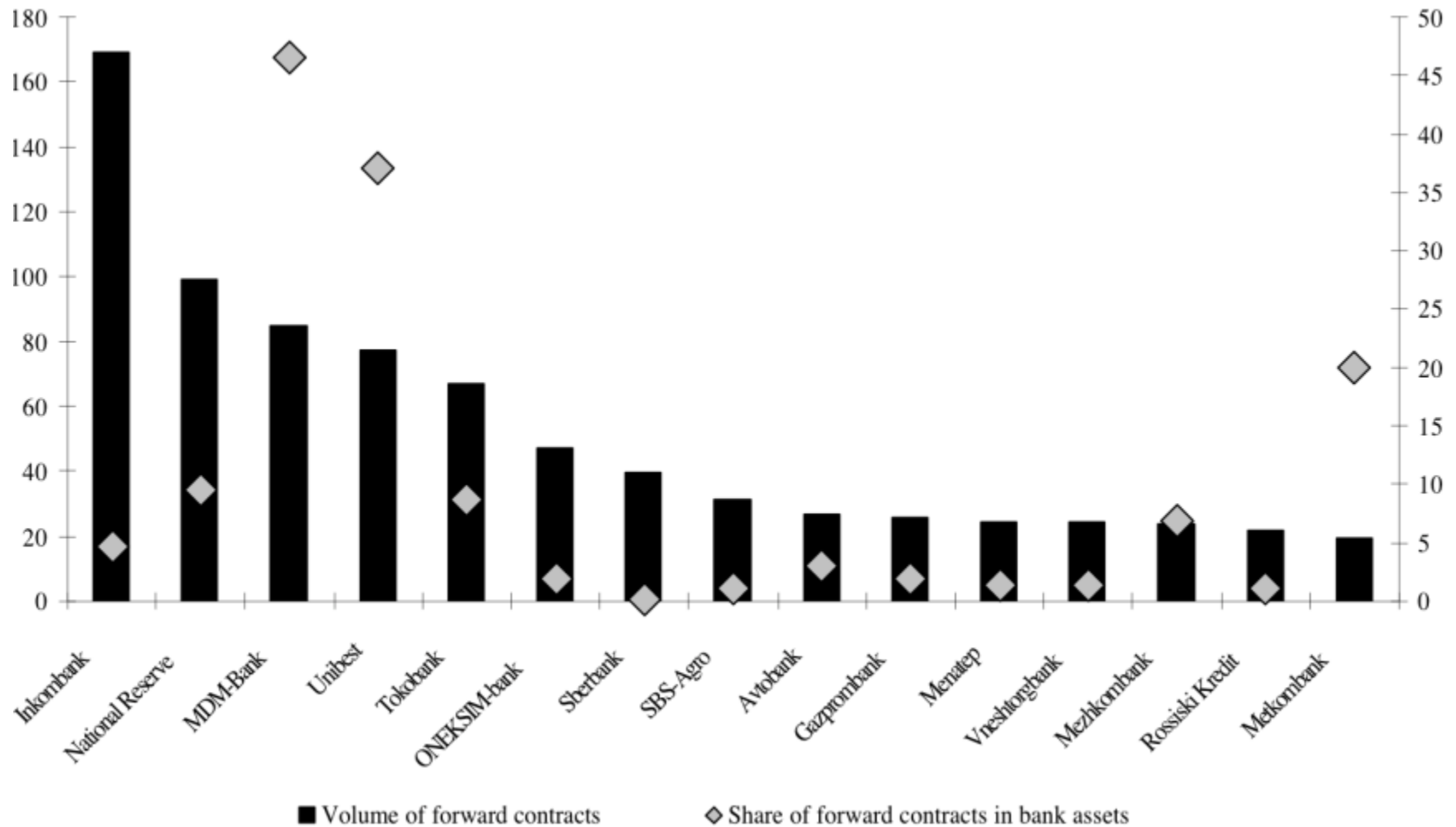
Performance of banks – 1992-1995

- Inexpensive credits from the Bank of Russia
- Large portfolio of non-performing loans – as a result of money lending based on political considerations rather than on credit worthiness
- Banks promised depositors extremely high interest rates, hoping to pay from earnings on loans, but paid it from fresh deposit – financial pyramid schemes
- Bank earned profits from “current accounts” (with almost no interest rate) of former state enterprises and state agencies
- Banks exchanged rubles for dollars, lent dollars to those with licenses to export commodities – these short-termed loans were extremely profitable
- Foreign banks were kept out till 1995

Performance of banks – 1995-1998

- Inflationary profits disappeared \Rightarrow banking crisis?
- Frightened government chose to subsidize banks
- Government bonds are the largest source of income – 40% of all receipts
- Interest payment received on loans to the real sector made up about 35% of income
- Speculation on foreign currency
- Forward obligations to hedge the currency risks
- Some regulatory tightening

Russian banks with the largest forward positions



The banking crisis - 1998

- No huge losses on securities due to insider information - 13% of net charges to capital of banks
- Immense losses on loans, many of which have never been returned - \$64.3 billion or 34% of net charges to capital of banks
- Foreign exchange losses – 28% of net charges to capital of banks

Positive changes after the 1998 crisis

- Rebuilding of customer confidence (including private investors)
- Restructuring of several large banks
- Maintenance of technological and material base for banking business
- New shareholders' acquisitions
- Stabilization of banking proceeds
- Write off of Non performing loans and formation of loan loss provisions
- Formation of five clusters of commercial banks, besides Sberbank

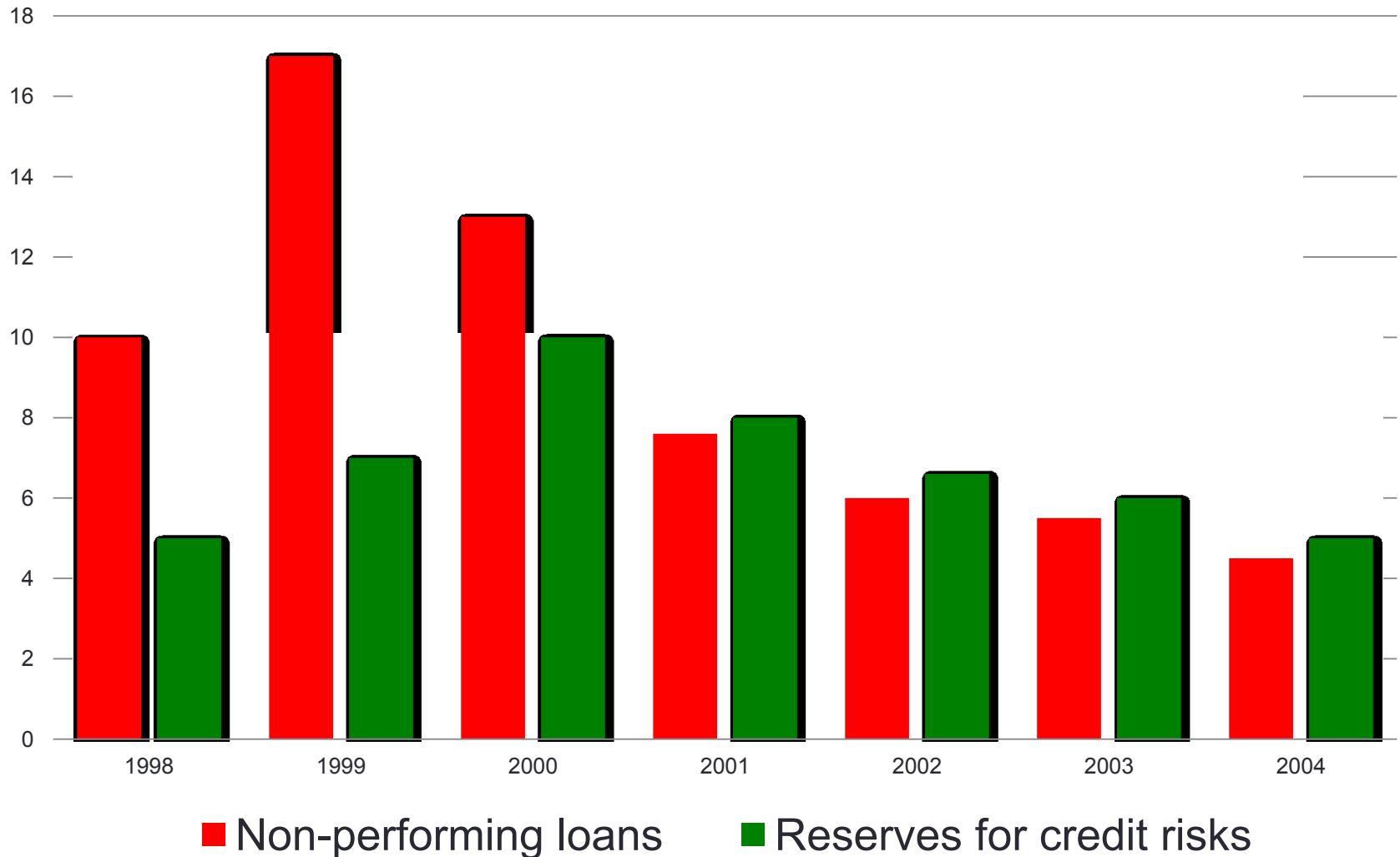
Performance of banks – since 1998

Year	Number of banks	The average volume of assets per bank, mln RUB	The average volume of the own capital per bank, mln RUB	The average volume of the loans per bank, mln RUB
1998	1641	418	76	127
1999	1476	643	72	203
2000	1349	1075	142	336
2001	1311	1647	223	590
2002	1319	2186	342	909
2003	1329	2875	438	1216

Key indicators of the banking system

Year	Assets / GDP, %	Capital / GDP, %	Loans / GDP, %	Deposits / GDP, %	Spread in interest rates, % per annum
1998	36,07	4,04	11,41	16,36	24,74
1999	30,07	3,98	9,40	14,62	26,03
2000	29,56	4,01	10,59	15,12	17,93
2001	31,89	4,99	13,26	16,47	13,06
2002	35,17	5,36	14,87	18,48	10,75
2003	39,14	5,85	17,06	20,29	8,63

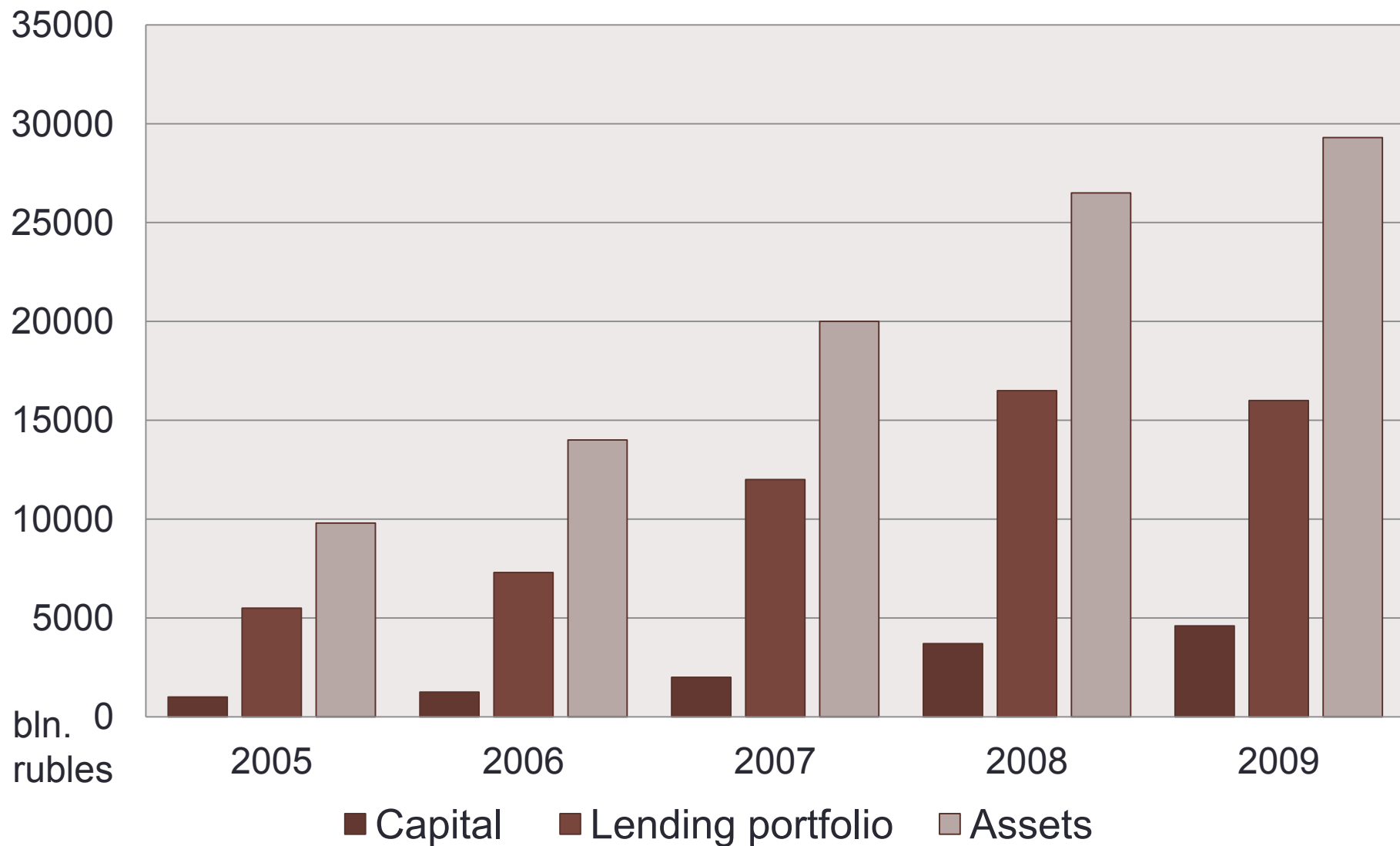
Non-performing loans and Reserves for credit risks



Commercial bank clusters

- Sberbank
- Other state-owned banks
- Banks of energy and raw material sectors
- Banks of other (non-energy) industry sectors
- Foreign banks and joint ventures
- Other (small and middle-sized) banks

Performance of banks – 2000s



The largest banks

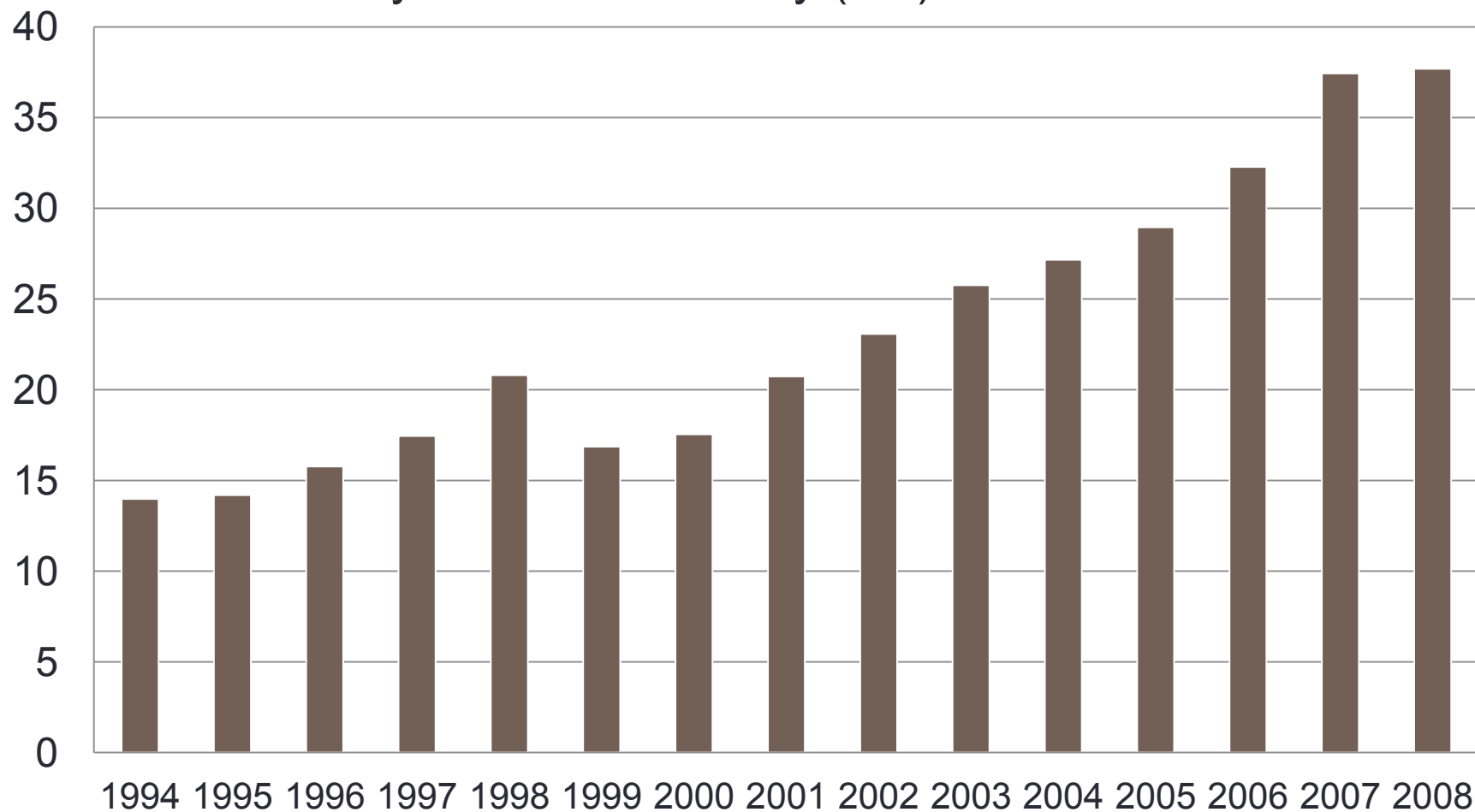
Bank's name	% of total banking assets	Ownership
Sberbank	23,7	State
VTB	8,0	State
Gazprom	4,7	State
Rosselhozbank	2,9	State
Bank of Moscow	2,8	State
Alfa-Bank	2,5	Private domestic
UniCredit Bank	2,1	Foreign
Raiffeisenbank	2,1	Foreign
VTB-24	2,0	State
Rosbank	1,7	Foreign

State-dominated banking sector

- Among largest banks only two are private ones, three - foreign-controlled, five - state-controlled (including big three)
- During the financial crisis 2008-2009:
 - Government's market share of state-controlled banks has topped $\frac{1}{2}$
 - State-controlled banks used as liquidity channel (esp. Sberbank, Rosselkhozbank)
 - Private banks faced funding problems, resulted in foreign-controlled banks' sale
- Little possibility to turn back towards the privatization of banks in short-to-medium term

The size of the banking system

Money and Quasi-Money (M2) as % of GDP



Conditions for further development

- The external factors
 - The oil price levels
 - The level of interest rates on capital markets
 - The demand on the energy resources
 - Russia's international investment ratings
- The internal (domestic) factors
 - Macroeconomic stability
 - The ruble rate appreciation toward the main world currencies
 - Money supply
 - The availability of the financial instruments on the national market