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RUSSIA'S LONG AND WINDING ROAD TO A MORE EFFICIENT AND RESILIENT BANKING SECTOR

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by Geoff Barnard

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ABSTRACT/RESUMÉ

Russia's long and winding road to a more efficient and resilient banking sector

In the decade following the 1998 financial crisis Russia's banking system grew much larger and stronger – indeed, growth rates were dangerously high – but even before the onset of the current global crisis it continued to play a limited role in intermediating savings and investment, especially for small and medium-sized enterprises. Moreover, despite important improvements, some weaknesses in prudential supervision remained, and the Russian banking sector continued to have too many very small banks doing little if any banking business. This paper discusses the policy imperatives in the short term, in the face of the ongoing economic crisis, and reforms that could be implemented over the longer term to improve the efficiency and resilience of the financial system and raise Russia's potential growth rate. While the current crisis is painful for the banking sector as well as the broader economy, it may facilitate a restructuring of the system that will be positive in the long run, as well as new approaches to regulation that will make banking less crisis-prone.

This Working Paper relates to the *2009 OECD Economic Survey of the Russian Federation* (*www*.oecd.org/eco/surveys/russia).

JEL Classification: E58, G21, G28, O52, P29
Keywords: Russia; economy; transition; banking; deposit insurance; prudential supervision; accounting; international financial reporting standards; transparency; corruption; state ownership; Sberbank

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Vers un secteur bancaire russe plus efficace et résilient en Russie

Pendant la décennie après la crise de 1998 le système bancaire russe est devenu beaucoup plus grand et fort – les taux de croissance étaient même inquiétants – mais même avant le début de la crise mondiale actuelle il a continué à jouer un rôle limité dans l'intermédiation de l'épargne et l'investissement, surtout pour les petites et moyennes entreprises. D'ailleurs, malgré des pas en avant importants, il restait des faiblesses dans la surveillance prudentielle, et le secteur bancaire avait toujours trop de banques minuscules qui avaient très peu de vraies activités bancaires. Cette étude aborde les principaux défis pour la politique envers les banques à court terme étant donné le contexte de crise économique, et les réformes qui pourraient être mises en œuvre à plus long terme afin d'augmenter l'efficacité et la stabilité du secteur bancaire et de hausser le taux de croissance de la production potentielle. La crise actuelle, tout en étant douloureuse pour le secteur bancaire et l'économie, pourrait faciliter une restructuration du système qui serait positive à long terme, ainsi que des nouvelles approches à la réglementation qui aideront à diminuer la vulnérabilité du système aux crises.

Ce Document de travail se rapporte à *l'Étude économique de l'OCDE de la Fédération de Russie 2009* (www.oecd.org/eco/etudes/russie).

Classification JEL : E58, G21, G28, O52, P29
Mots clés : Russie; économie ; transition ; banques ; assurance de dépôts ; surveillance prudentielle ; comptabilité ; normes comptables internationales ; transparence ; corruption ; propriété de l'État ; Sberbank

RUSSIA'S LONG AND WINDING ROAD TO A MORE EFFICIENT AND RESILIENT BANKING SECTOR

By Geoff Barnard[1]

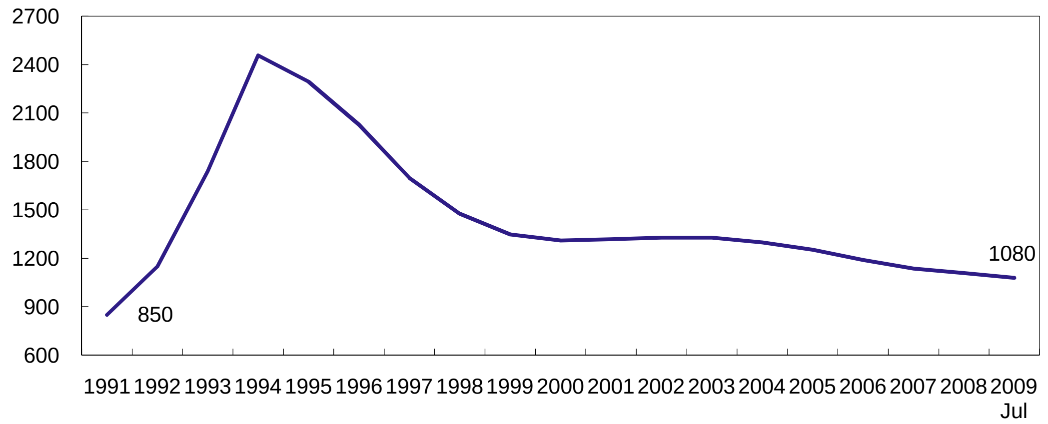
The Russian banking system 1992-2009 – gradual maturation punctuated by crises

Early transition years

1. Until the end of the Soviet era there were no private banks, and no competition within the public sector. The banking sector did not intermediate savings and investment on the basis of price signals in a manner conducive to an efficient allocation of capital. The situation changed dramatically however, during the initial transition period, from 1992, as the central bank issued a huge number of banking licenses (Figure 1).

Figure 1. **Number of banks**

End of period



Source: Central Bank of Russia.

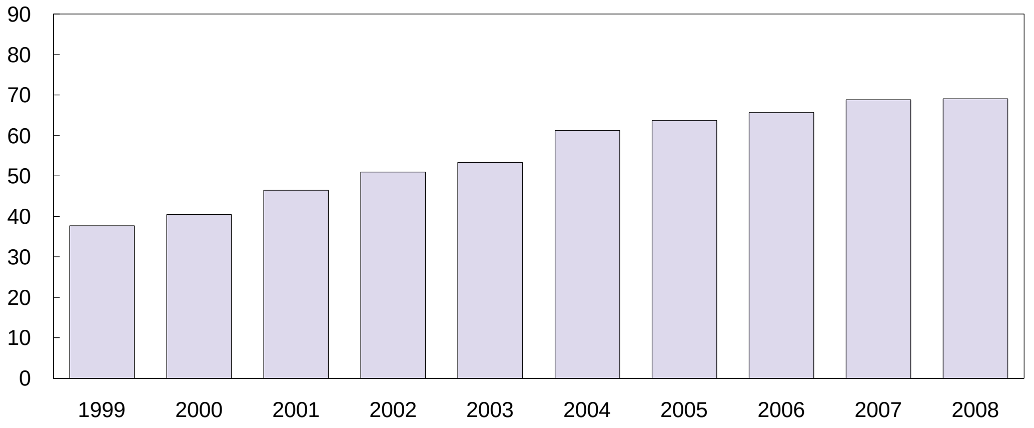
1. Senior Economist in the Economics Department. This Working Paper draws on Chapter 4 of the OECD's *2009 Economic Survey of the Russian Federation*, which was prepared under the responsibility of the Secretary General and discussed at the Economic and Development Review Committee on 9 April 2009. The views expressed in this paper do not necessarily reflect those of the OECD and its Member countries. The author is grateful for the valuable comments received on earlier drafts of this text from Andrew Dean, Bob Ford, Andreas Wörgötter and other colleagues in the Economics Department, as well as for discussions with officials from the Central Bank of Russia. Special thanks go to Corinne Chanteloup for research assistance, to Josiane Gutierrez for editorial support, and to Mikhail Matovnikov for factual input.

2. There were several reasons, beyond the usual considerations governing entry to any industry, to want to establish or acquire a bank during the early years of transition. Unlike other enterprises, banks were allowed to deal in foreign exchange and could hold correspondent accounts with foreign banks, which meant that owning a bank facilitated capital flight – net private capital outflows were equivalent to more than 5% of GDP a year on average in the 1990s – and/or money laundering.[2] Secondly, banks could be used as corporate treasuries for groups of non-financial enterprises. This was attractive given the lack of trust in unrelated parties, which in turn was in large part a function of the low level of confidence in the rule of law and the protection of property rights. In addition, banks provided a vehicle for securities speculation. Given also that minimum capital for a bank was set as low as USD 100 000, the proliferation of banks in the early 1990s is not surprising.

3. Some of these reasons for owning a bank were also reasons why the banking sector played only a limited role in intermediating savings and investment in the 1990s. Insofar as they were lenders, banks largely funnelled loans to related companies at rates of interest that had more to do with tax optimisation than true cost of capital. Lending, however, was relatively limited, amounting to little more than a third of bank assets in 1999 (Figure 2). Bank profits were highly reliant on securities transactions. In particular, during the period of fixed exchange rates from 1995 through the onset of the financial crisis in August 1998, banks were able to borrow dollars and buy government treasury bills (GKOs), earning substantial interest margins.[3]

Figure 2. **Lending to total assets**

Percentage



1. Loans, deposits and other funds placed with organisations, individuals and credit institutions.

Source: OECD calculations based on Central Bank of Russia.

4. Pathologies in the banking sector were far from being the only factor in Russia's poor macroeconomic performance in the mid-1990s and descent into crisis in 1998, but they did contribute. Risk management and prudential supervision were weak, accounting standards for banks were below international standards, and ownership of banks was opaque, while screening for fit and proper ownership

2. In the Russian context most "money laundering" by banks constitutes the transfer abroad of funds associated with violations of tax laws, rather than the legitimisation of the proceeds of illegal activities.

3. The spread between domestic rouble yields and dollar rates reflected the low (but rising) probability of a devaluation – the so called peso problem – permitting supra-normal profits for holders of rouble securities as long as the devaluation didn't happen.

of banks was largely non-existent. Lending to smaller companies was especially underdeveloped, while consumer and mortgage lending remained embryonic.

The 1998 crisis and its aftermath

5. The financial crisis that erupted in August 1998 had several crippling effects on banks. The quadrupling of the rouble-dollar exchange rate in a short period was devastating for banks reliant on borrowing abroad to fund purchases of rouble securities, while on the asset side, the government defaulted on its domestic bonds, and went on to impose on holders of the defaulted debt a restructuring involving deep discounts. At the same time, the sharp recession pushed up non-performing loans (NPLs), and bond and equity prices collapsed. Many banks, including some of the largest private ones, failed. There was a flight of deposits to the public banks (especially Sberbank, the largest bank in the system), which benefitted from a government guarantee – by December 1999, Sberbank alone accounted for some 80% of household deposits.

6. Following the crisis, however, the banking system began a rapid and sustained rebound. A key factor was the resumption of economic growth, which took off in 1999, as the huge real effective depreciation of the rouble resulted in strong import substitution. With the principal exception of import businesses, the solvency of the corporate sector improved rapidly. In particular, with the oil price rising from the lows of under USD 10 a barrel in 1998 to the high-twenties in 2000, the fortunes of the important energy sector took a sharp turn for the better.

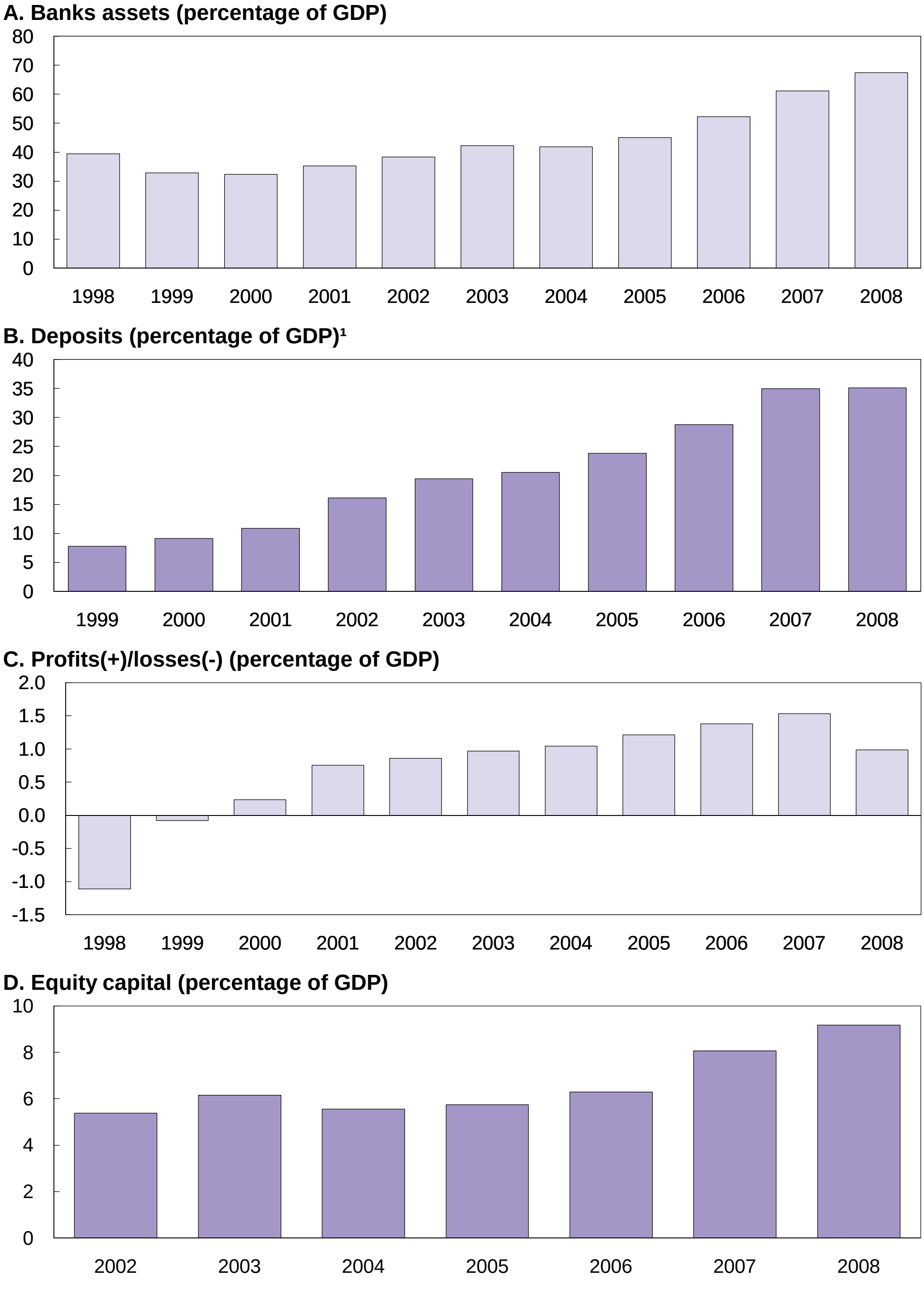
7. In support of the improved macroeconomic conditions, a number of structural reforms were also underway at this time. In the wake of the crisis numerous changes were made to the banking laws to streamline bank bankruptcy, permit earlier resolution of failing banks, and tighten regulation on fit and proper ownership of banks. Also, in 2001 an anti-money laundering agency was launched and in the following year Russia was removed from the Financial Action Task Force blacklist. In 2002 the CBR released a strategy for the banking sector covering the period through 2008, which involved several important reforms.

8. Given the favourable macroeconomic background and significant efforts to improve regulation, bank assets, deposits, capital, profits, and market capitalisation mushroomed (Figure 3). All groups of banks experienced rapid growth in assets and deposits in that period, so that there was little change in the market share of state-owned banks, domestic private banks, and foreign banks (Figure 4). Sberbank's share of household deposits fell from 80% to under 60% between late-1998 and 2002. At the same time, however, Sberbank expanded its share of other deposit and loan segments, as did VTB.

9. The post-crisis period witnessed a gradual but fairly steady consolidation of the sector (Figure 1). After the initial wave of bank failures in the wake of the 1998 crisis, there were very few bank bankruptcies or license withdrawals for reasons of capital insufficiency. Initially, consolidation happened largely *via* the acquisition of regional banks by Moscow-based private banks trying to build national branch networks.[4] Later, the main contributor to consolidation was the removal of licenses from (generally small) banks for money laundering offences.

4. Among the major groups formed at that time *via* the acquisition of regional affiliates was the MDM-Bank group, which included Conversbank and Petrovsky, among others, and the Uralsib group, which included Nikoil and Avtobank.

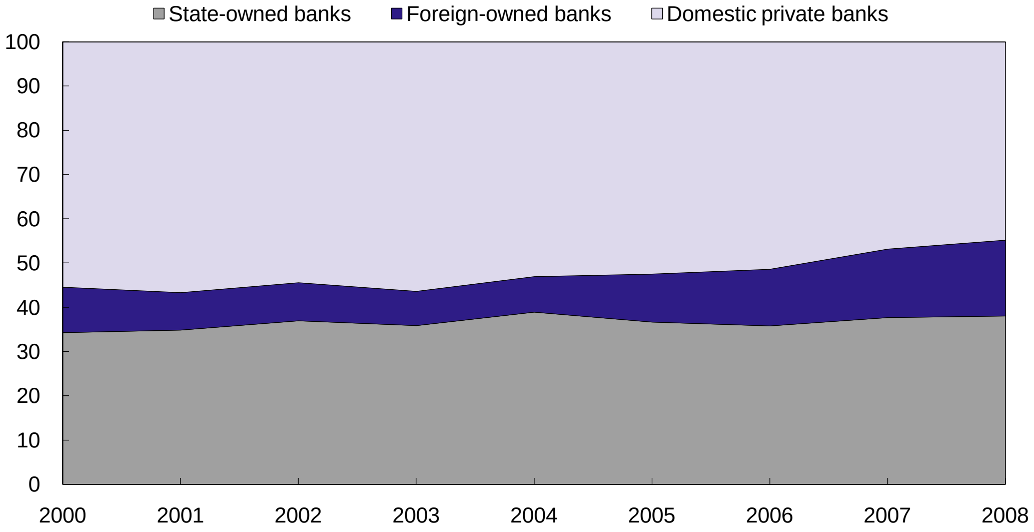
Figure 3. **Post-crisis recovery of the banking system**



1. Deposits of individuals, individual entrepreneurs and organisations (financial and non-financial). A methodological change in 2002 makes earlier data not directly comparable.

Source: OECD calculations based on Central Bank of Russia and Federal Service for State Statistics.

Figure 4. **Ownership structure of the banking system**
Share in total assets



Source: Interfax.

Strong growth 2002-August 2008

10. The major implementation phase of the joint CBR-government medium-term strategy for the banking sector, released in 2002, was 2004-06. Among the main elements of the strategy were: the introduction of deposit insurance (Box 1), including the use of screening criteria for admittance to the scheme that amounted to a new licensing procedure; the requirement that banks report financial data to the CBR on an IFRS basis (Box 2); the disclosure to the CBR of banks' shareholder structure; making the methods of calculating loan loss reserves more similar to IFRS; the streamlining of prudential ratios; the sale by the state of most stakes owned in banks; tightened procedures for increasing authorised capital; and the creation of a system of credit bureaus.

Box 1. **Deposit insurance in Russia**

The Central Bank of Russia began accepting applications to join the deposit insurance system from March 27 – June 27, 2004, when 1 137 banks indicated they would like to join. A list of the first group of banks to join the deposit insurance system was published on October 21, 2004 and by end-March 2005 the Central Bank banking regulation committee had completed consideration of applications by all 1 137 banks under all criteria.

The committee approved 819 banks to join the deposit insurance system (including repeat applications). It also granted deposit licenses to seven banks that had not previously operated on the retail market. As a result the deposit insurance system included 824 banks at the close of the first quarter of 2005. These banks held 98% of deposits by individuals in Russian banks and accounted for 90% of the assets in the banking system.

Eighteen banks that filed applications to join were rejected and lost their banking licenses, while another 51 banks that had previously accepted deposits from individuals opted against participating in the deposit insurance system. Household deposits are of no interest for the business of some banks (*e.g.* investment banks, and certain subsidiaries of foreign banks). Other banks that for one reason or another have yet to join the deposit insurance system may still do so.

The deposit insurance agency regularly conducts public opinion surveys about depositor behaviour and deposit insurance awareness. The *2008 Survey* revealed that only 38% of the population is aware of existence of deposit insurance in Russia.

Box 2**. The move to International Financial Reporting Standards for Russian banks**

IFRS was first used in Russia by large banks issuing Eurobonds or seeking ratings during the 1990s. The CBR required annual IFRS audits and financial statements as from 2004, in addition to the normal Russian Accounting Standards (RAS) accounts for tax purposes.

In September 2002 the CBR created a special committee to introduce IFRS, which included representatives of CBR departments, the Ministry of Finance, and parliament. The CBR began training specialists in its supervisory divisions to regulate banks based on IFRS.

The number of banks preparing financial reports to international accounting standards in 2000 was 125, and this grew to 130 in 2001 and 185 in 2002. Most banks published IFRS financials unwillingly and with several restrictions in 2000, but by 2002 reports were readily available on bank web sites. In order to develop the new accounting methods, train specialists, and select an auditor, many banks in Moscow and the regions began publishing IFRS reports without waiting for it to become mandatory.

From 1 January 2004 Russian banks were required to begin compiling IFRS financial reports once a year and to undergo an audit to international standards.

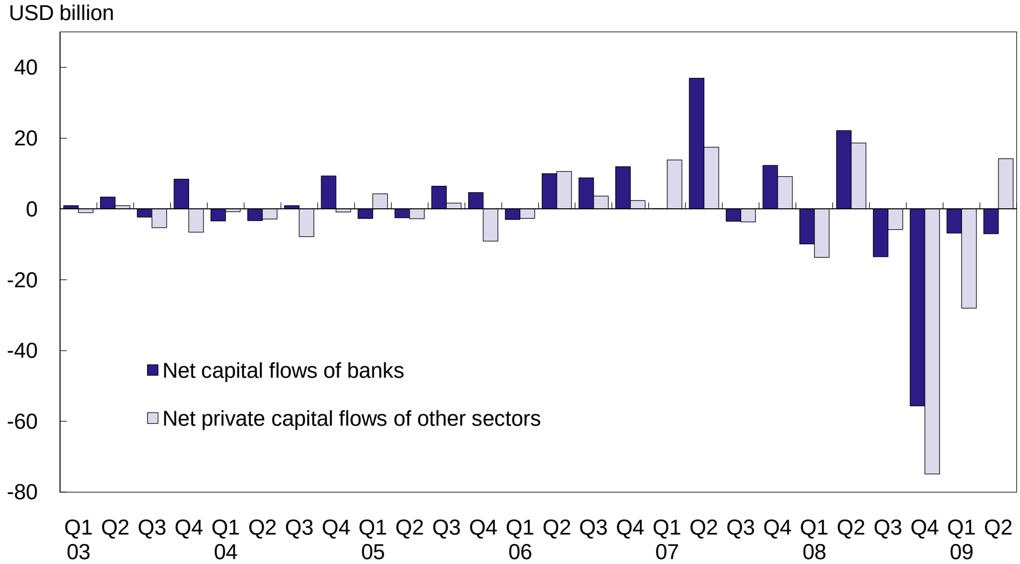
There are several differences between RAS and IFRS for banks, including the treatment of provisioning, consolidation, disclosure, and valuation of assets. IFRS brings together in a single document a wide range of information necessary to make a credit or investment decision. To achieve similar information using RAS a large number of documents must be prepared that are more cumbersome to use. The typical balance sheet for second- tier accounts to RAS includes 400 – 500 entries, the income statement includes 150-200 entries, and most other forms are less bulky but are riddled with unclear symbols, codes, and so on. Analyzing such a mountain of information, especially for a period of several years, requires proper software and highly trained specialists. It is no wonder that for most creditors RAS are extremely difficult to use. Moreover, this information is often inaccessible to the outside creditor and collecting other information requires consulting various sources.

On the other hand, financial reports prepared to RAS are often useful in analysing a Russian bank, especially because they are available at a higher frequency. It is often important, in examining a bank's financial reports, to be able to see how it looks at various periods during the year rather than just at the end of the year. For example, banks' liquidity usually increases noticeably at the end of the year, and auditors rarely mention discrepancies between end-year indicators and the average level of liquidity during the year.

11. The implementation of the 2002 strategy document contributed to the improved soundness of the banking system until the onset of the global financial crisis. On the other hand, the measures in some cases could have gone further. In particular, screening for deposit insurance turned out to be largely a missed chance to weed out weak banks and achieve rapid consolidation of the sector, which would have eased the burden of prudential supervision for the CBR. Very few banks, and none of any significance, were turned down for entry to the system. As to the sale of state-owned stakes in banks, shares in hundreds of banks were sold, but the three largest banks remained state-owned, and significant new state banks or quasi-banks – the Russian Development Bank and the agriculture bank – were created. Reform in that area therefore amounted to a focussing of state ownership rather than a withdrawal.

12. While banking reforms were important, the biggest reason for the rapid expansion and rising profitability of the banking sector during this period, as had been the case in the first few years following the 1998 crisis, was the benign macroeconomic climate. Indeed, the later period saw even more favourable economic conditions for the growth of the banking sector. The strong rise of the oil price from 2004 through mid-2008 resulted in huge current account surpluses which were the main driver of domestic liquidity. With the CBR using massive foreign exchange intervention to resist nominal appreciation of the rouble against the dollar-euro basket, especially during a period in which the dollar was falling against the

Figure 5. **Net private capital flows**

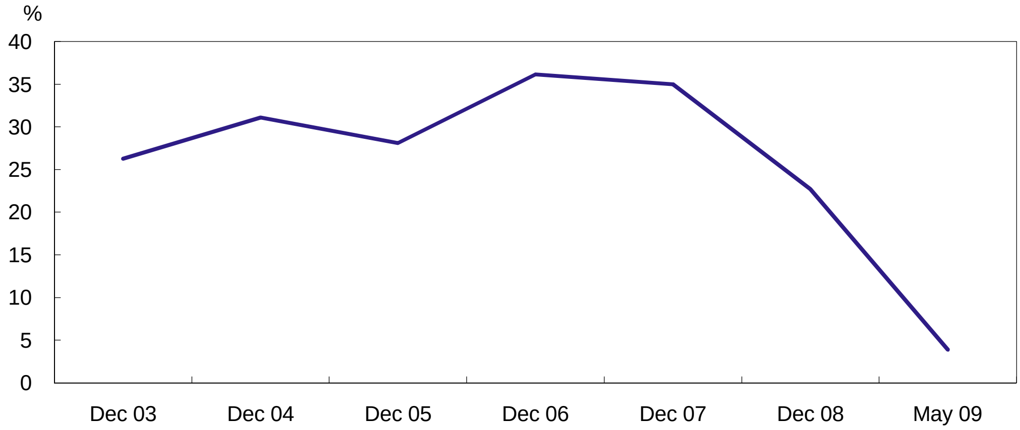


Source: Central Bank of Russia.

euro, banks and corporates increasingly saw the rouble-dollar exchange rate as a one-way bet. Given also the low interest rates and compressed spreads for emerging market borrowers generally and Russian borrowers in particular (reflecting Russia's strong macroeconomic fundamentals), Russian entities had both the incentive and the ability to borrow in dollars and invest or lend in roubles. Thus, in addition to the current account surpluses there were latterly net capital inflows as well (Figure 5), which also fed through to bank liquidity and domestic demand. Meanwhile, the strong rise in the equity and housing markets spurred lending and boosted profits of banks, and until mid-2008 this lending growth attained dizzying and indeed worrisome proportions (Figure 6).

Figure 6. **Growth of bank lending in real terms**

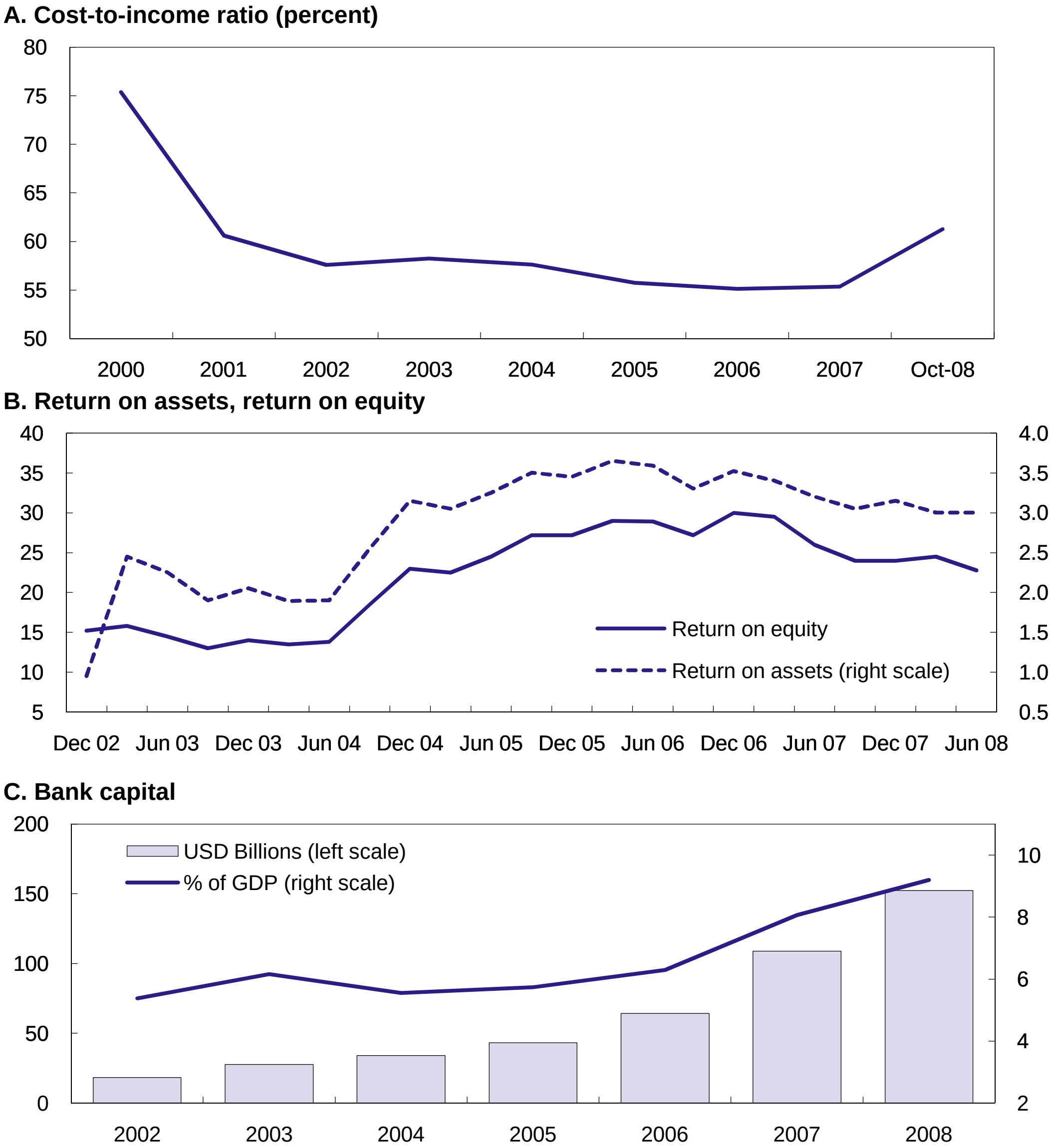
Change in bank loans deflated by CPI[1]



1. Loans, deposits and other funds placed with organisations, individuals and credit institutions.

Source: OECD calculations based on Central Bank of Russia.

Figure 7. **Banking sector development and efficiency**

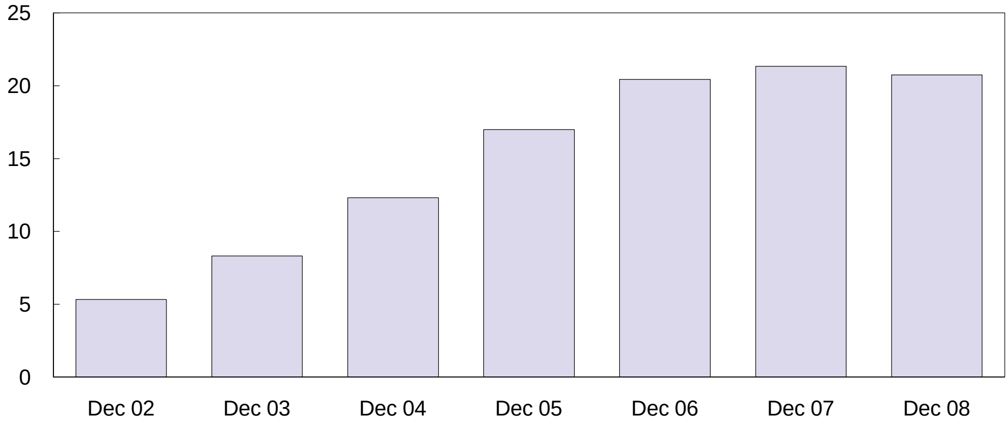


Source: OECD calculations based on OECD Bank Profitability database, Interfax 100 database, OECD Economic Outlook 84 database, Russian Federation of State Statistics and Central Bank of Russia.

13. Indeed, by a range of measures the banking sector achieved a dramatic expansion in the years leading up to the 2008 crisis. Deposits rose nearly seven-fold between 2002 and 2007, increasing from 16% to 35% of GDP. Bank assets likewise grew strongly as a percentage of GDP, moving Russia out of the category of emerging economies with the most underdeveloped banking sectors, although it still lagged behind a number of other eastern European economies. Bank capital increased massively, despite the measures taken to limit the artificial inflation of capital, while efficiency as measured by cost-income ratios or return on assets improved markedly, to levels that were towards the upper end of international comparators (Figure 7).

14. While most dynamics of the sector were clearly positive, there were some indications of growing imbalances. The speed of expansion of lending in general and certain segments in particular gave rise to fears about credit risk management and the possibility of a bust to follow the boom. The explosive growth of consumer lending was one salient area of concern. This market grew from a negligible share of overall loans to 20% in the period 2000-07 (Figure 8). Lending to construction and real estate also grew extremely rapidly, fuelling a bubble in housing prices, especially in Moscow and to a lesser extent St. Petersburg and other major cities. Residential real estate prices in Moscow rose from about USD 1 000 per square meter in 2002 to USD 3 000 at the start of 2006 and USD 6 000 in the summer of 2008. This growth far outstripped increases in rental rates.

Figure 8. **Consumer lending**
End of period, as a percentage of total[1]



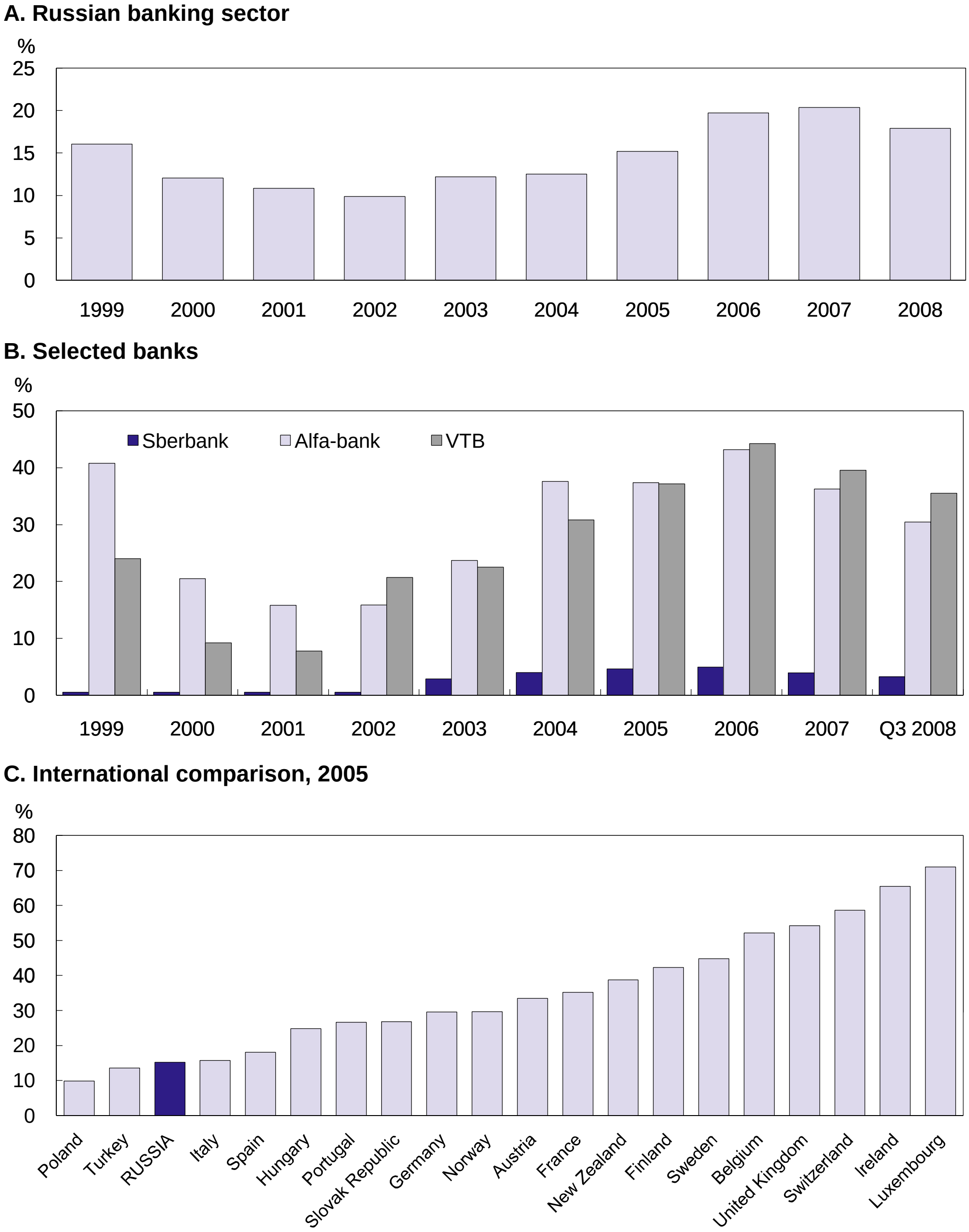
1. Total lending is loans, deposits and other funds extended to organisations, individuals and credit institutions.

Source: OECD calculations based on Central bank of Russia and Federal Service for State Statistics.

15. Another alarming feature of the last few years leading up to the crisis was the rate of growth of banks' external debt. Gross foreign liabilities of banks grew from 12.5% of total liabilities in 2004 to 20.4% in mid-2007, before access to international markets began to be disrupted (Figure 9, Panel A). That exposure was also relatively concentrated among the large and medium-sized private banks. State-owned banks as a group and Sberbank in particular had less exposure to external debt, although the second largest bank, VTB, was an exception to that rule (Figure 9, Panel B). At the level of the banking system as a whole, foreign liabilities were not particularly large by international standards (Figure 9, Panel C), although until mid-2007 they were rising at an accelerating rate.

16. Until the collapse of Lehman Brothers in September 2008, Russia's financial system appeared to be weathering the worsening international conditions quite well. The appearance of stability and continued growth in the Russian banking system after the first wave of turbulence in international markets in August 2007 may, however, have been at least partly an artefact of overly vigorous official support for the sector early on, which delayed but arguably ultimately aggravated the impact of the crisis on the banking sector. The unfolding of the subprime crisis in the United States in the summer of 2007 had already dented appetite for risk in international capital markets, reducing Russian banks' ability to fund themselves abroad. In the autumn of 2007 the CBR and the government reacted quickly to sustain liquidity in the system, *via* the expansion of the list of eligible securities for CBR refinancing (the Lombard list), the auctioning of government deposits to commercial banks, and a reduction in reserve requirements in October 2007. Liquidity support permitted a further leg of loan expansion, with the state banks taking the lead. Most indicators of system-level liquidity (Figure 10, Panel A), capital, and profitability remained healthy through August 2008, and Russian banks sporadically regained access to foreign borrowing, such as in the second quarter of 2008. Interbank interest rates remained sharply negative in real terms until late 2008 (Figure 10, Panel B).

Figure 9. **Exposure to foreign liabilities**



Source: OECD calculations based on OECD Bank Profitability database, Central Bank of Russia and Interfax.

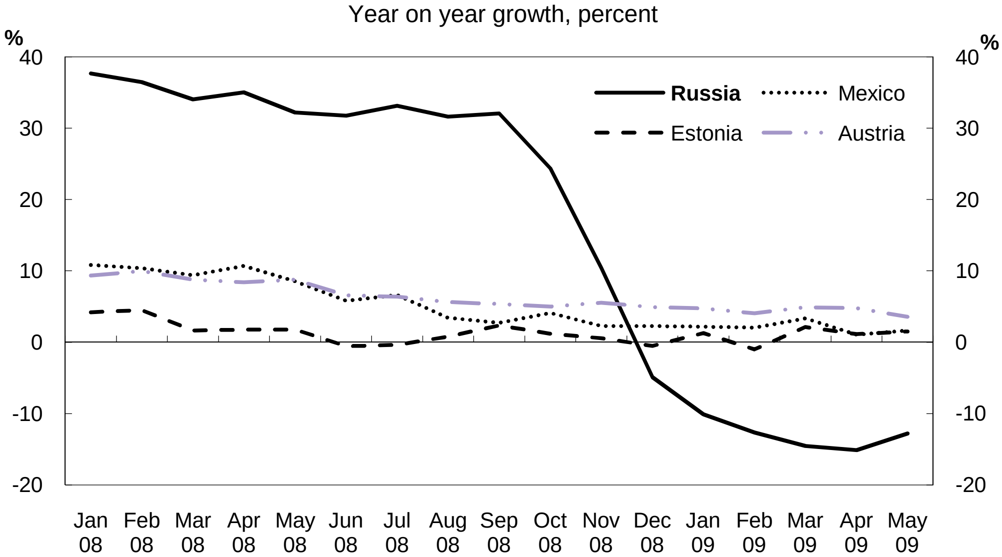
Figure 10. **Banking system liquidity**

Source: OECD calculations based on Central bank of Russia.

The current crisis

17. The initial effect on the banking sector of the adverse shift in global financial conditions came *via* the securities markets. The global crisis intensified sharply in September 2008 with the failure of Lehman Brothers, but large falls in Russian share prices had already got underway before then, given net sales by foreign institutions from emerging markets in general beginning in May 2008, the rapid fall in commodity prices after their peak in July 2008, and some negative Russia-specific factors such as the conflict with Georgia in August 2008 and the TNK-BP saga. A number of banks, exposed to securities markets (especially *via* the use of multiple repos – see Box 3), quickly found themselves in difficulty, and began to default on obligations in the interbank market. These banks were swiftly either acquired *via* state action/support or closed, and their obligations to other banks were honoured. Even though these stricken banks did not include any of systemic importance, the impact on sentiment among depositors and other banks was marked. This in turn was in part on account of the legacy of crises, which makes sentiment of the Russian population fragile, leading to bigger deposit withdrawals than elsewhere (Figure 11). The net deposit withdrawals in late-2008 were especially marked for private second-tier banks, but affected even state- and foreign-owned banks.

Figure 11**. Real bank deposits**
Year on year growth, percent



Source: OECD calculations based on IMF IFS.

Box 3. **Gaming the system – selected schemes for circumventing prudential and tax regulations**

Inflating authorised capital. Banks often used loan schemes to increase equity capital and align it with risk-weighted assets according to CBR requirements. A CBR regulation N215-P of March 2003 on the method for determining the capital of banks introduced the concept of "improper assets", which aimed at ruling out the use of loan schemes to form capital. Improper assets include cash assets and other assets originating directly or indirectly from assets provided by the bank or other individuals, if the bank directly or indirectly assumed risks arising through the provision of these assets. In identifying instances or symptoms that capital was formed using improper assets the CBR can demand banks to provide documented proof that improper assets were not used in forming capital or make the appropriate changes to capital within a specified period. This measure in principle addresses the problem, but in practice is hard to implement effectively

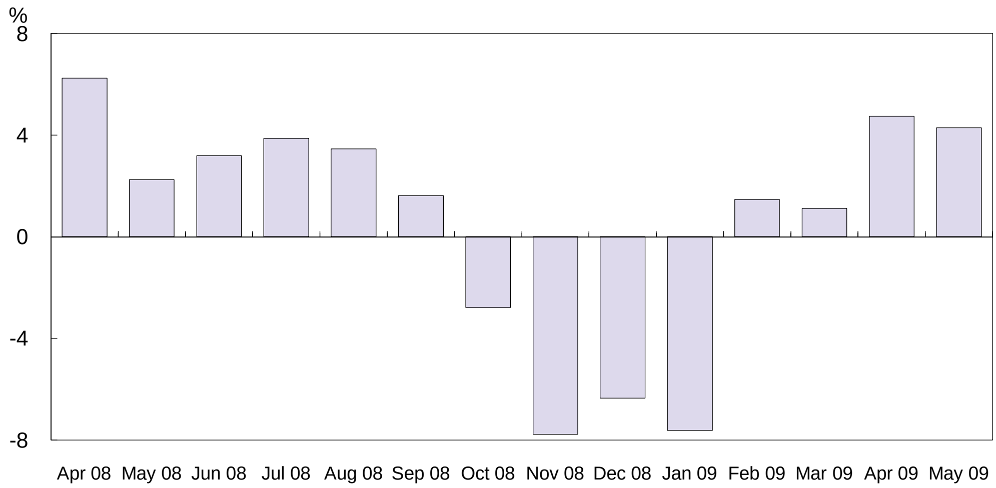
Multiple repos. Under this scheme, a bank holding bonds (yielding, say, 8%) pledges them at a discount for a loan at a lower interest rate (*e.g.* 6%), using the proceeds to buy the same bonds. The newly acquired bonds are likewise pledged and so on. It emerged at the onset of the 2008 crisis that some banks and financial companies had used such a scheme 5-6 times to leverage returns. Such iteration could roughly double the initial 8% bond return, but at the cost of greatly increased market risk. When the markets fell in August-September 2008, some market players suffered heavy losses and were not able to meet their payment obligations to other participants in the market, which resulted in a chain reaction through the system. The sharp rise in counterparty risk provoked the seizing up of the interbank market, other than for the largest banks.

Tax optimisation. Banks often have associated companies located in regions with favourable tax regimes. An associated company located in such a region that owns a bank building or other property can save on property tax. Lease payments for the use of the building, although they have no impact on profit under IFRS, reduce it under RAS, which is what counts for tax purposes. The associated company in a holding company often serves as the profit centre, and manages the bank's securities portfolio. The bank receives a low level of interest income on a loan to this company and most profit on securities operations remains on the balance sheet of the associated company. Another option is for the associated company to receive a loan from the bank and place the money on deposit in the bank. Interest on the loan is lower than the deposit rate, which reduces pretax profit according to Russian accounting standards. Claims on associated companies can be shown in correspondent accounts in banks, loans to banks and companies, or notes, and liabilities can be shown in deposits, notes, correspondent accounts, and loans of other banks. Several companies, including offshore companies and Russian banks, can be involved in this scheme.

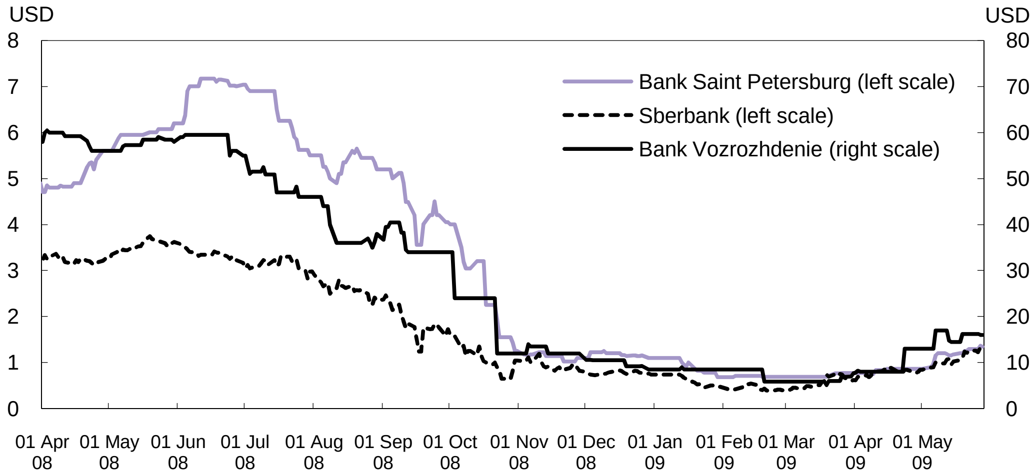
18. Thus, when the global crisis suddenly intensified in September 2008, problems were already emerging, which contributed to the weakening of the population's already shaky confidence in Russian banks. If Lehman Brothers could fail, how many of Russia's 1 100 banks could be considered safe? Given also pressure on the rouble arising in large part from the fall in the oil price, rouble deposits reversed their strong growth trend of the past ten years (Figure 12, Panel A), and the shares of quoted banks fell by nearly 90% from their peaks (Figure 12, Panel B).

Figure 12. **Crisis impact on banks**

A. Rouble deposits[1]



B. Share prices



1. Total deposits of individuals + organisations + credit institutions + individual enterpreneurs.

Source: Datastream and OECD calculations based on Central Bank of Russia.

19. Indeed, in some respects Russia's banking system was more severely affected by the onset of the global economic crisis than those of most other countries, which is on the face of it surprising since Russia appeared to be relatively well placed to resist such developments. Russian banks had low direct exposure to troubled US assets such as mortgage bonds and derivatives, and had not engaged in complex lending practices with structured products, a practice which proved so dangerous in a number of advanced countries. Also, the US-style "sub-prime" mortgage market was virtually non-existent in Russia.

20. Another factor favouring resilience to a global financial crisis was that, despite the big increase in 2006-07, the share of foreign liabilities remained relatively low by comparison with other emerging markets. There were a few banks with much greater than average resort to foreign borrowing which were forced to find other funding or shrink their balance sheets quickly to survive when the crisis struck. But this is not true for most of the major banks, and for the largest of all, Sberbank, the share of foreign liabilities was in the low single digits.

21. In addition, although the pre-crisis picture for individual banks varies widely, the banking sector as a whole had a fairly balanced exposure to different sectors, with none accounting for more than 20% of total lending. The energy and metals sectors have been underrepresented in the loan portfolios of Russian banks, as the largest companies have been able to attract cheaper and longer-term resources from international banks and capital markets. Total lending to real estate and the construction sector had grown very rapidly in the years prior to the crisis and, at around 11% of bank assets, was the 3rd largest sectoral exposure, after trade and finance. This level remains fairly modest in international comparison, however.

22. Moreover, at the onset of the current crisis the Russian banking system was relatively well capitalised, bank profitability was relatively high and rising, and Russian banks were increasingly efficient: as shown in Figure 7, cost-to-income ratios were on a declining trend through early-2008. In addition, almost all of the largest banks are either state-owned or are subsidiaries of foreign banks (Table 1). In both cases, stability is in principle bolstered by the existence of owners capable of supporting the banks in the event of difficulties, although the scale of upheaval in advanced country banking systems has underlined the risk that foreign banks may not be able or willing to support their Russian subsidiaries. Indeed, it has become clear that they may even seek to use them as a source of liquidity. The presumed existence of back-up resources for state- and foreign-owned banks is reflected in the fact that their capital adequacy ratios are lower than for domestic private banks on average, since the latter may require more of a capital buffer.

Table 1. **Top ten banks by ownership type**

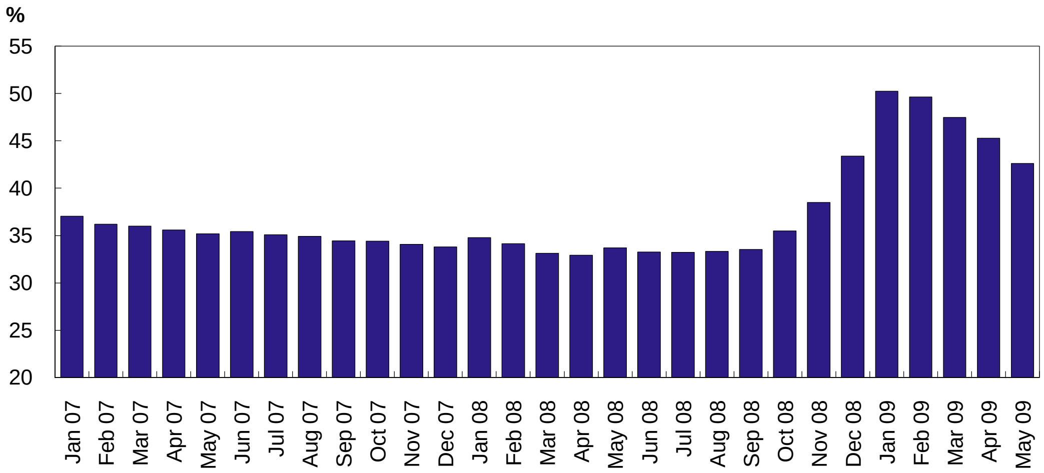
Bank	% of total banking assets	Ownership
Sberbank	23.7	State
VTB	8.0	State
Gazprombank	4.7	State
Rosselhozbank	2.9	State
Bank of Moscow	2.8	State
Alfa-bank	2.5	Private domestic
UniCredit Bank	2.1	Foreign
Raiffeisenbank	2.1	Foreign
VTB-24	2.0	State
Rosbank	1.7	Foreign

Source: Central Bank of Russia and OECD calculations.

23. So although most systemic indicators of banking system health did not suggest major difficulties for Russia in the face of an adverse shock to the international financial system, as it turned out a combination of actual problems in a few banks with a low level of public confidence in the system served to produce a degree of panic and a sudden switch from robust deposit growth to net withdrawals when the global crisis intensified in September 2008. At the same time, although the banks were very much in the forefront of sectors immediately affected by the global financial crisis, part of the reason for the heavy

impact of the crisis on the Russian banking system is that it quickly became much more than just a financial crisis. In Russia's case, the 75% fall in the oil price over a matter of 5 months in the second half of 2008 radically undermined the macroeconomic health of the country. It meant, among other things, a dramatic worsening of the position of Russian corporates, which exposes banks to higher loan losses (and which may also mean that apparently balanced foreign exchange positions of banks wind up being unbalanced as and when foreign currency loan defaults come through). Lower economic growth reduces the creditworthiness of borrowers, cutting lending growth and impacting on non-performing loan rates. Fears of rapid depreciation of the rouble became a significant factor in deposit withdrawals and shifts to foreign currency deposits by both households and firms (Figure 13).

Figure 13. Share of foreign currency deposits in total[1]



1. Total deposits of individuals + organisations + credit institutions + individual enterpreneurs.

Source: Central Bank of Russia.

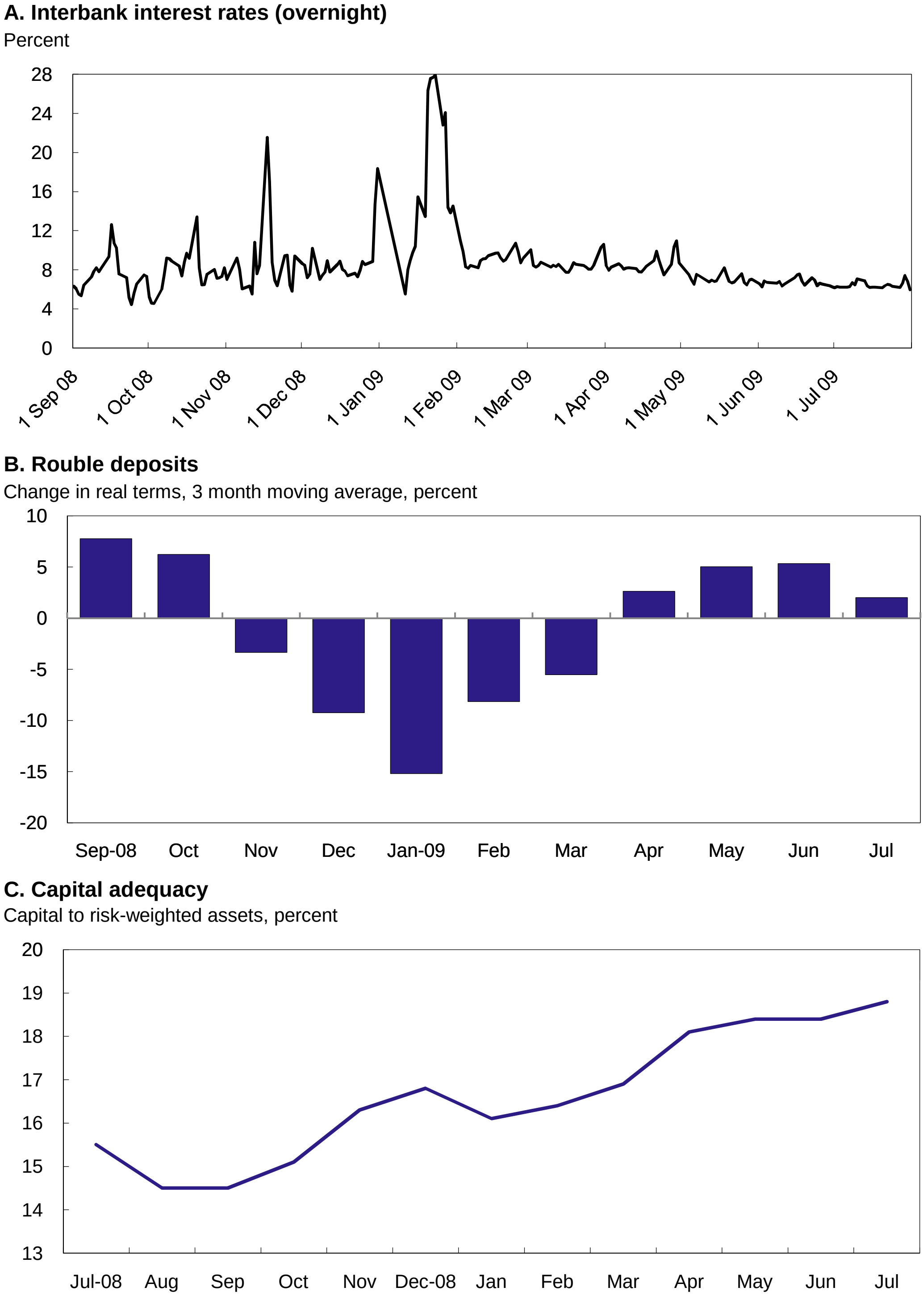
24. Also, significant as it has been, the impact of the global crisis on the Russian banking system may also appear to have been greater than it really was. The authorities' keenness to be seen to be taking decisive action (see Box 4 for a listing of actions taken in response to the crisis to shore up the banking system) may have meant that some measures were taken before they were needed. For example, subordinated loans were made available to banks in large amounts to support capital positions, but as of July 2009 no major Russian bank had fallen below the 10% capital adequacy requirement. Likewise, the facility to provide foreign currency for external debt repayments seems mostly to have been accessed by enterprises and banks which had not exhausted their own capacity to make such repayments.

25. Many of the actions taken since the onset of the crisis are sensible from the point of view of bolstering the banking system and maintaining confidence, and the latest signs are on the whole reasonably encouraging, notwithstanding the scale of the shock. Rouble deposits and broad money did decline in the last quarter of 2008, when pressures on the exchange rate eventually led first to a gradual and then a virtually unchecked depreciation against the dollar-euro basket. Moreover, non-performing loans began to turn upward, and bank profit growth fell sharply. This first wave of the crisis, with flight from Russian banks and from the rouble and a resultant credit crunch, lasted until about January 2009. From that time, however, some measures of banking system health have improved or stabilised. At least in terms of Russian accounting standards, the overall banking system continued to record positive profits in the first half of 2009, and liquidity conditions improved considerably, with a sharp reduction in interbank rates (Figure 14, Panel A) and a much reduced dependence on official support. Deposit growth has resumed (Figure 14, Panel B), and the average capital adequacy ratio for the system has continued to increase (Figure 14, Panel C).

Box 4. **Anti-crisis measures to support the banking system**

- Reduction of reserve requirements 18 September and 18 October, boosting bank liquidity by approximately RUB 400 billion.
- Auction of government deposits to banks. Originally RUB 1.1 trillion, later expanded 30 to RUB 1.5 trillion.
- Increased CBR repo transactions, beginning in September 2008. Average amounts increased roughly five-fold after early September, peaking in late-January 2009.
- Permission for CBR to extend uncollateralised credit to banks with designated credit ratings. Amount extended rose to RUB 1.9 trillion in February 2009.
- Amendment to 2008-10 Budget to allow government to deposit money from National Welfare Fund with Vnesheconombank (VEB), which is to buy back shares of enterprises controlled but not wholly-owned by the state, up to RUB 75 billion in 2008 and RUB 175 billion in 2009.
- Set-aside of USD50 billion to help companies (*via* VEB) refinance foreign loans falling due. USD12 billion used by end-2008.
- Permission for CBR to compensate banks for losses on interbank loans through end-2009.
- VEB authorised to provide subordinated loans of RUB 450 billion to banks other than Sberbank, with CBR authorised to provide up to RUB 500 billion to Sberbank.
- Acquisition (*via* VEB and state-owned enterprises) of failing private banks (Globex, Kit, Sobinbank, Svyaz).
- Raising of deposit insurance limits to RUB 200 000 from RUB 100 000, and at 90% up to RUB 700 000 from RUB 400 000.
- Raising of interest rates paid to banks by CBR on deposits.
- Restarting of CBR 90-day repos, after earlier being discontinued for lack of demand.
- Amendment of 2008 Budget to provide for capital injections of RUB 200 billion to the Deposit Insurance Agency (in order to allow it to restructure or liquidate failed banks) and RUB 60 billion to the State Mortgage Agency.
- Guarantee by State Mortgage Agency of mortgage bonds and lending, up to RUB 500 billion.
- Recapitalisation of RosSelkhozbank (agriculture bank) and RosAgroLeasing.
- Government guarantee of bank loans to corporates, up to 70% of loans; amount available RUB 300 billion.
- Announcement of further possible injections of capital into banks, up to RUB 1.4 trillion.

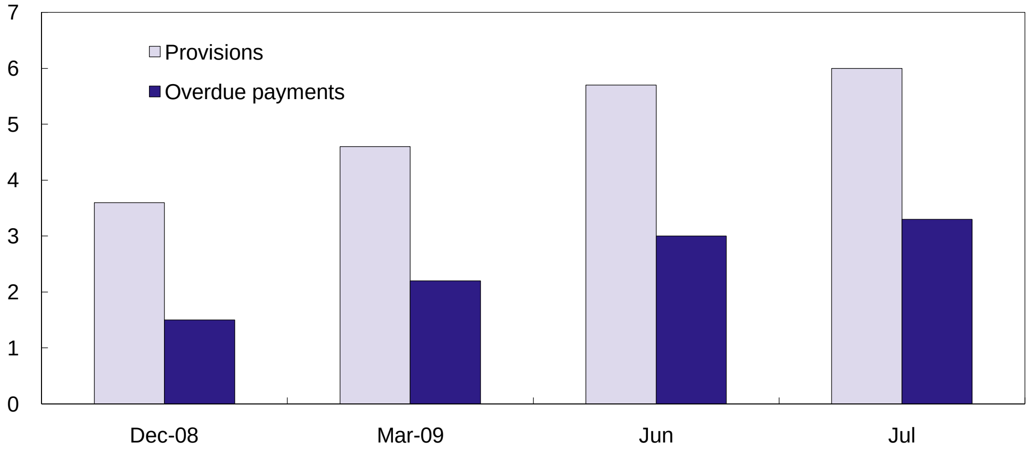
Figure 14. **Signs of stabilisation**



Source: OECD calculations based on Central Bank of Russia data.

26. Lending has continued to contract, but at decreasing rates in recent months. The main concern since the spring of 2009 has been the possibility of a major upsurge in non-performing loans as the downturn hit the profitability of the real sector. Overdue payments did increase rapidly in the first seven months of 2009, but this was more than matched by an increase in provisions (Figure 15), and most banks appear to be well placed to cope with a further rise in NPL rates.

Figure 15. **Provisions and overdue loans**
In percent of total assets



Source: Central Bank of Russia.

27. Notwithstanding the improved dynamics in the banking system, Russia is still in the crisis phase, and the outcome is uncertain. More bad news, such as an acceleration in the rate of increase of non-performing loans, the failure of one or more of the larger banks, or renewed rouble weakness, perhaps driven by another sharp decline in oil prices, could result in further bank runs. Although, unlike some other crisis-hit countries, pre-crisis leverage levels were not obviously excessive, further deleveraging therefore remains possible.

Dealing with the current crisis…

28. In the short term, the authorities are faced with the challenge of preserving stability of the financial system in the face of unfavourable economic conditions while minimising adverse effects on long-run efficiency. Avoiding a collapse of the banking system has rightly been a high priority of the authorities. As Russia's own past experience and that of many OECD and emerging market economies confirm, financial crises are often costly. At least among advanced economies, there is also evidence that such crises aggravate and prolong cyclical slowdowns (Reinhart and Rogoff, 2009; Mourougane and Furceri, 2009; IMF, 2008).[5] The deleveraging that occurs as banks try to repair their balance sheets in the face of rising non-performing loans and/or securities losses can aggravate other recessionary forces, and bank bailouts or restructurings can entail massive budgetary costs,

29. The relative pre-crisis solidity of the banking system, the fact that only a few banks are of systemic importance, and the reasonably favourable outcomes to date (given the scale of the global crisis) suggest that one near-term danger is overloading the crisis response with potentially harmful measures. In Russia's case, these would include excessive aggravation of moral hazard and further expansion of the state's already heavy involvement in banking. Clearly, as in other countries, there is a case for the judicious use of government guarantees of some assets, capital injections, and even perhaps nationalisations if necessary to preserve the functioning of the system. With state banks already holding half of banking system assets and no private bank accounting for more than 2½ per cent, however, there are few if any private banks which would have to be saved to keep the system functioning. Costly support

5. For developing economies it is less clear-cut that financial crises prolong downturns. For such economies recessions accompanied by financial crises are typically deep but are not found to be longer on average than those not featuring such crises.

for or acquisition of such banks should be avoided. If more banks do fail in coming months, the presumption should be in favour of speedy liquidation and a pay-out of depositors. More consolidation of the banking sector is likely to improve competition and banking efficiency and reduce the burden of supervision borne by the CBR.

30. One aspect of a creeping expansion of the role of the state in banking is the increased capitalisation of and delegation of additional tasks to VEB. VEB is one of the half dozen recently-created special-status state corporations whose governance falls short of OECD standards, and as such its growing importance as a lender, investor, and vehicle for rescuing banks and corporations is a potentially worrying development. The government should either provide for VEB to be licensed and regulated like other financial institutions or reduce its role.

31. While the state's control of the largest banks is in some ways an advantage in a crisis situation, since it is easier to maintain lending levels, it also carries dangers. In particular, there is a temptation to direct lending to favoured large (and often state-owned) enterprises, thus weakening competition. Care should be taken to maximise the extent to which loans are allocated on a commercial basis, even if pressure is exerted to maintain overall lending levels. In Russia, it is above all small and medium-sized enterprises which are credit-deprived and which should benefit from any favourable treatment.

…and reducing the probability of future ones

32. Russia faces two broad challenges as regards making the banking system more resistant to crises in the future. The first is to converge on existing best practice as regards the implementation of prudential supervision. The second, which faces not only Russia but many other countries, including the most advanced, is to address defects in bank regulation which amplify economic cycles and give insufficient weight to liquidity considerations.[6]

33. Notwithstanding the many improvements made over the past decade or so, there are significant remaining weaknesses in prudential supervision. Banks continue to report that inspectors have insufficient understanding of banking and banking risks, and that supervision is still largely form-over-substance. This may reflect insufficient resources and/or training for bank supervisors. Meanwhile, although the authorities have consistently affirmed their aim to implement Basel II, there has never been a formal objective for the date by which this would be achieved, and the informal timetable has already slipped by several years. It is currently hoped that implementation will be achieved in 2011, but progress in preparing for that shift appears to be slow. In addition, as in other countries, the arrival of the current economic and financial crisis suggests that there are weaknesses in the existing approaches to banking supervision (both as regards Basel I and Basel II), with in particular excessive pro-cyclicality and insufficient weight put on liquidity as against capital adequacy.

34. Better implementation of the existing supervision framework could involve a number of elements. To begin with, more and better-trained supervisors would be helpful. Consolidation of the sector would help in this respect, as scarce resources could be spread over a smaller number of banks. Also, it

6 There are also, of course, policy actions not directly related to the banking system which can have a bearing on the probability of banking crises. For example, in the environment of strong domestic growth and abundant international liquidity and strong appetite for risk which prevailed in the years preceding the crisis, Russia's quasi-fixed exchange rate regime encouraged borrowing from abroad, creating additional vulnerability to a sudden stop of capital inflows and/or adverse interest rate or exchange rate shocks. These vulnerabilities contributed to the loss of public confidence in Russian banks when such shocks struck in 2008. Avoiding procylical macroeconomic policies can be as important for the stability of the banking system as avoiding procyclical bank regulation.

may be useful to explicitly divide the Russian banking sector into tiers subject to different levels of supervision, to allow resources to be more focussed on the larger banks. In addition, there is scope for further streamlining of formal requirements on banks, while increasing substantive assessment of risks. In the longer term, Russia might benefit from moving away from supervision by legal form of the regulated entity to supervision by objectives. Currently, the CBR is responsible for banking supervision and the Federal Financial Markets Service oversees financial markets, while the Ministry of Finance supervises insurance. Some OECD countries have adopted regulation by objectives (Netherlands, Australia), while others (*e.g*. Sweden and the United Kingdom) have adopted a unified framework with a single financial services regulator. There is as yet no consensus on the optimal approach to the institutional set-up for financial regulation, and it is likely to depend in part on the institutional history of each country. The current crisis has, however, provided a reminder that banks generally receive public support when the system comes under stress, which suggests the need for more robust regulation to prevent excessive risk-taking and protect the public purse.

35. As regards moving toward a more countercyclical framework for bank supervision, it is widely acknowledged that there is a global need for a more macro-prudential approach, one which takes more account of systemic risks while continuing to consider bank-specific ones (*e.g.* Borio and White, 2004; Borio and Shim, 2007; Turner, 2009; G30, 2009). This is certainly true for Russia. Difficult issues arise with efforts to make banking regulation more countercyclical, for example the problem of ascertaining where the economy is in the cycle at any given moment, but the dangers of inaction are more obvious than ever. Capital requirements and/or provisioning rules should be made counter-cyclical and capital requirements should be allowed to vary across banks to reflect each bank’s contribution to systemic risk. In addition, stress tests should include assessments of shocks which hit the financial system as a whole, so that counterparty and market risk deteriorate along with credit risk. The global crisis has given impetus to efforts to reform international rules to strengthen existing supervision approaches. Russia should play an active role in these discussions, but whether an international consensus approach emerges quickly or not, it need not wait to implement its own reforms to make bank regulation less procyclical.

36. Another important aspect of international efforts to improve prudential supervision of banks is the need for more regulation of liquidity to put it on a more equal footing with capital adequacy. One possible reform would be to require banks to prepare periodic liquidity assessments for review by the CBR, with the CBR to give liquidity guidance to banks on an individual basis.

37. Certain actions beyond bank supervision would be useful in furthering greater resilience of the system. While the repeated crises in the Russian banking sector do not have a single cause, one common thread is the low confidence of the population in banks (and the rouble) and the low levels of trust between banks. This suggests the need for more transparency and more confidence in the strength of regulation and the rule of law. Notwithstanding the improvements that have been made, the Russian banking system continues to suffer from a relative lack of transparency. It remains the case that not all links between banks and related parties are revealed, which obscures the extent to which such parties may be afforded favourable treatment in the event of difficulties, leaving other creditors and/or shareholders bearing the burden of losses. Although this problem is well known, the reality is hard to pin down. The authorities remain reliant on the willingness of shareholders to disclose. This problem is not unique to Russia, but it does seem to be particularly pronounced there. A culture of transparency remains to be entrenched.

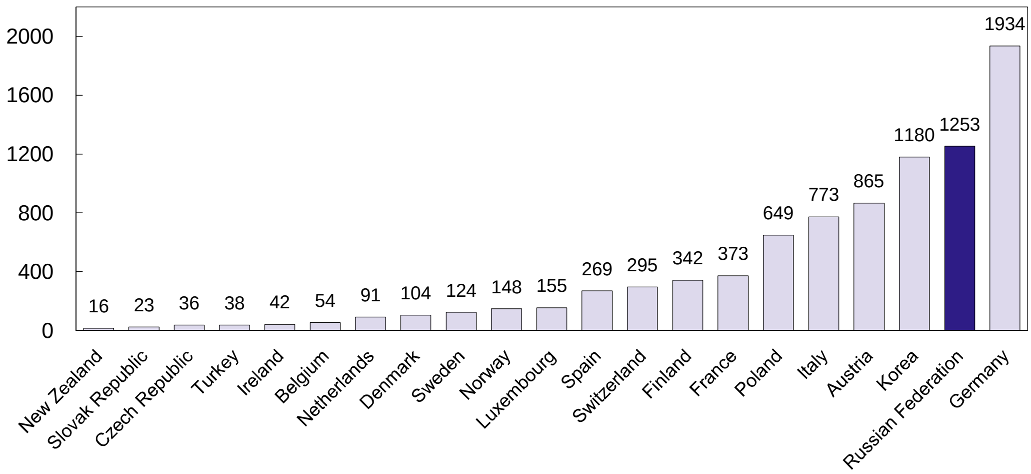
38. Also, while it may still be too early to tell, it is not clear that deposit insurance has had the hoped-for confidence-building effect on depositors. One problem appears to be that the public remain largely unaware of the existence of the system, or of the amount of protection offered. A survey by the Deposit Insurance Agency in 2008 found that only 38% of individuals were aware of the system of deposit insurance. Greater efforts to publicise the deposit insurance scheme and its protections are called for in

current circumstances. It is also important to ensure timely payouts of insured deposits in the event of bank failures as the downturn progresses.

39. Another significant problem is that risk management in Russian banks remains underdeveloped. Only the largest few dozen banks use risk management to manage their businesses. For many other banks, the high reliance on a few customers and the connected nature of many transactions means that risk management considerations are trumped by the perceived need to retain good relations with key borrowers and/or depositors.

40. Russia appears to have too many banks (Figure 16), and in particular too many small banks. The theoretical relationship between bank concentration and banking system fragility is ambiguous. On the one hand, concentration may reduce competition, resulting in higher profits, which makes banks more resistant to adverse shocks. Also, having fewer banks to monitor may facilitate prudential supervision in a concentrated banking system reducing the risk of systemic crisis. In addition, to the extent that banks in a consolidated system are on average larger than those in a diffuse system, they may benefit from greater diversification and/or economies of scale, making them less prone to failure. Moreover, Russia's experience suggests that the vulnerability of smaller banks can spark broader crises of confidence, and so can at times be a drag on the sound part of the system. Banks which are relatively small and weak may be, in part for those reasons, overly aggressive and prone to failure, which can poison trust in the whole system and lead to a seizing up of interbank lending. As against this, it is argued that concentrated banking systems will be more prone to "too big to fail" effects, which aggravates moral hazard and increases banking system fragility (Mishkin, 1999). Beck *et al.* (2006) provide cross-country empirical evidence which supports the consolidation-stability link, and Rati *et al.* (2008), in another cross-country study, find that consolidation is favourable for access to finance.[7]

Figure 16. **Number of banks – international comparison**



Source: OECD Bank Profitability database and Central Bank of Russia.

7. The alternative view on small banks in Russia is that, if they abide by all prudential norms and are not found to be breaking the law, then they are doing no harm, and if they continue to exist then they must be sufficiently efficient. It is also often noted that many small banks are regional, and may be delivering local banking services that would be absent altogether or monopolised in the absence of these banks. As has been seen in many countries in the context of the current economic crisis, however, prudential norms may be procyclical and pay insufficient attention to liquidity sufficiency, while small banks may continue to exist for reasons other than their efficiency: most of the license withdrawals over the past 5 years have been of very small banks found to have been engaged in illegal activities.

41. Interestingly, although Beck *et al.* (2006) find that consolidation is favourable to systemic stability, they find the same for measures of competition, and other research suggest that the two are not necessarily in conflict.[8] Russia appears to have too little of both. Despite the very large number of banks, effective competition in Russian banking is still limited, although it has picked up in recent years. The banking sector is quite concentrated by various measures (*e.g.* shares of top 5 banks in total assets, deposits, and capital) and Sberbank remains the clear market leader in most areas. The relatively high margins enjoyed by Russian banks, albeit positive for building capital and resilience, may be one sign of less-than-vigorous competition.[9] Sberbank, which benefits from cheap funding and favourable access to foreign borrowing on account of its state backing, has not faced a strong challenge in the most profitable market segments.

Achieving a deeper and more efficient banking system

42. Despite the strong growth of lending in the long economic upswing from 1999 through 2008, the Russian banking sector still does relatively little intermediation of savings and investment, especially for small and medium-sized enterprises (SMEs). According to Rosstat, only about 10% of corporate investment is financed by bank loans, up strongly from only 3% in 2000, but still very small in relation to retained earnings and other financing sources. One issue in this respect is financial reporting in the non-financial sector; unlike banks, other enterprises do not have to prepare financial statements according to IFRS, and only a small number (largely those issuing bonds or equity abroad) do so. Russian accounting standards, while useful for some purposes, are less transparent in several respects.

43. Thus, over the longer term, the banking system could do more to contribute to sustained rapid economic growth, especially in conjunction with a liberalisation of product markets, with greater competition throughout the economy. An extensive literature on finance and growth (*e.g.* King and Levine, 1993; Beck *et al*., 2000; Aghion *et al*. 2004, De Serres *et al*. 2006), provides compelling evidence that financial development contributes to faster economic growth. Despite its rapid growth in recent years, Russia's financial system is still relatively underdeveloped, leaving considerable scope for financial deepening to contribute to long-term growth. There can, of course, be trade-offs between financial growth and stability, but Russia appears still to be some way from the efficient frontier where such tradeoffs bind, and there is corresponding scope for Russia both to reinforce the stability of the banking sector and boost potential growth *via* further financial deepening. To begin with, the fragility of the system revealed by successive crises hurts confidence in the system, hindering the growth of deposits, the intermediation of savings, and the efficient allocation of capital – imprudent practices in booms will worsen the busts and provoke more bank crises. In addition, the current structure of the sector leaves unexploited economies of scale and holds back vigorous competition between larger, more equal groups.

44. The general direction of the necessary policy actions – better risk management, more effective regulation, increased transparency, a more level playing field for different categories of bank – is recognised by the Russian authorities, and has been for some time (*e.g.* CBR, 2002; Ministry of Finance, 2007). Progress in these areas underlies much of the banking sector's impressive rebound from the debilitating 1998 crisis.

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8. Claessens and Laeven (2004) find no evidence that increased concentration is associated with anticompetitive activity in the banking sector, and Demirgüc-Kunt *et al.* (2004) find no positive relationship between concentration and net interest rate margins.

9. The high lending margins could also reflect a risk premium, but they seem implausibly large, especially compared to other emerging market economies.

45. One reform which would be likely to boost efficiency in the long run is the reduction of the role of the state from the banking sector. There is no clear long-term rationale for state ownership, while there is substantial evidence from elsewhere for greater efficiency of private banks (*e.g.* La Porta *et al*., 2000). On the other hand, there is no pressing case for privatisation of the large state-owned banks, especially in light of the fragmentary evidence that public banks in Russia are not less efficient than private ones. Moreover, there is clear evidence that state banks have been beneficial for systemic stability in periods of crisis. In the near term, the priority is to work on levelling the playing field and bolstering effective competition. Particularly given the likelihood of a further increase of the share of state-owned banks in total assets as a result of the economic crisis, the authorities should outline a strategy for reducing their dominance. As noted above, the growing role of VEB is particularly problematic, given the shortcomings of its corporate governance.

46. The fact that households are legally able to withdraw their term deposits on demand has long been a much-debated feature of the Russian banking system. This provision of the Civil Code means that regardless of the nominal maturity of a deposit, banks are forced to see it as a demand deposit. This remains a potentially serious source of vulnerability for banks, making it harder to limit maturity mismatches, although to date there is little evidence of it having played a big role in either the underdevelopment of the sector or of financial instability.[10] Whatever the significance of this Civil Code provision, however, there is clearly a relative lack of long-term funding. Amending the Civil Code provision so as to allow for true term deposits for individuals would assist with financial deepening. An effective lengthening of the maturity of liabilities would permit banks to address the shortage of longer-term loans.

47. The use of IFRS financial reporting is beneficial for transparency and should be expanded, including for non-banks. This would help banks make meaningful assessments of credit risk at lower cost than now, and would also improve the transparency of ownership in the corporate sector, which in turn would facilitate the task of identifying related party lending, deposits, and ownership links.

48. As credit to households continue to grow in future as a proportion of total bank lending, it will be increasingly important to develop a system of personal bankruptcy, to facilitate certainty regarding creditor rights.

49. The problem of corruption, recognised at the highest levels of government, may be another factor that impedes the development of the banking sector. Using regional data, Weill (2009) finds that corruption has a depressing effect on lending, and Russia continues to rate poorly on international surveys of perceived corruption. This is course an issue that has much wider implications than just banking (see Conway *et al*., 2009 for a discussion of corruption and product market regulation).

10. There is anecdotal evidence that after the outbreak of the current crisis, some distressed banks defied the Civil Code provision, betting that the time taken to mount a legal challenge would give them enough breathing space to bolster liquidity, and that they would in the end only face manageable fines for breaking the law.

Box 5. **Recommendations for making the banking system more efficient and resilient**

Crisis response measures

- Facilitate and encourage consolidation of the sector, *via* speedy resolution of failing banks, facilitation of mergers, and higher minimum capital requirements.
- Avoid expanding the use of directed lending, especially to large and/or well connected borrowers – to the extent that pressure is put on banks to lend, the opportunity should be taken to expand the share of SMEs in total loans.
- Publicise deposit insurance to raise awareness of its provisions, and ensure speedy and full (*i.e.* in accordance with law) payout of depositors in case of failures during crisis, especially if any larger banks fail, in order to strengthen public confidence in the Russian banking sector.

Strengthening prudential supervision

- Improve the quality of on-site supervision, including *via* increased resources for staffing and training.
- Explicitly divide the Russian banking sector into tiers subject to different levels of supervision, to allow scarce resources to be more focussed on the larger banks.
- Further streamline formal requirements on banks, while strengthening risk assessments.
- Play an active role in international efforts to improve financial regulation.
- In parallel with such efforts, explore ways of making capital adequacy requirements countercyclical, such as via dynamic provisioning rules, higher capital adequacy requirements in cyclical upswings, and capital requirements that vary across banks according to their contribution to systemic risk.
- Expand the use of stress testing, including more testing of system-wide shocks affecting counter-party and market risks.
- Seek improved ways of regulating liquidity and responding to shortages for individual banks. Require banks to prepare periodic liquidity assessments for review by the CBR, with the CBR to give liquidity guidance to banks on an individual basis.
- Consider moving from functional regulation to regulation by objectives.

Improve the regulatory environment for banks

- Amend the Civil Code provision allowing term deposits of households to be withdrawn on demand.
- Expand the use of IFRS financial reporting, including for non-banks.
- Develop a system of personal bankruptcy.

Improve the structure of the banking sector

- Outline a long-term privatisation strategy for the state-owned banks.

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