THE CENTRAL BANK OF THE RUSSIAN FEDERATION

Banking Supervision
Report 2004

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Foreword

The Russian banking sector, which is the principal financial intermediary in this country, has developed dynamically during the past few years. Despite some of the problems it faced in the summer of 2004, it continued to make progress in the year under review. As bank lending expanded rapidly in 2004, credit institutions registered a significant rise in profits and their return on assets and capital increased.

The current state of the Russian economy and banking business augurs well for the banking sector's future and its increasing role in the country's economy. The implementation of the Banking Sector Development Strategy until 2008 will be a major condition of success in this area.

The Banking Supervision Report 2004 deals with the principal aspects of the functioning of credit institutions last year, the risk profile in the banking sector and the current state and prospects for the improvement of banking supervision in Russia. It contains a more comprehensive analysis of the general economic conditions of banking sector development as it scrutinises, among other things, the state of the non-financial sector of the economy, financial markets and the payment system. More attention has been accorded to the evaluation of the banking sector's stability by stress testing.

The Report also focuses on the measures that have been taken to build the deposit insurance system, which exert a great influence on the banking sector and banking supervision.

Sergei M. Ignatyev,
Bank of Russia Chairman

I

The state of the Russian banking sector

I.1. General economic conditions

I.1.1. Macroeconomic developments

Russia continued to enjoy economic stability in 2004. The economic situation in this country was characterised by the continued growth in the output of goods and services, household real money income and fixed capital investment. Russia continued to demonstrate a strong balance of payments and had a federal budget surplus. Although the inflation target set for 2004 was surpassed, consumer price growth last year was smaller than in 2003.

GDP expanded 7.1% year on year as against 7.3% in 2003. There were both external and internal factors behind the economic growth.

The favourable price situation and the expansion of export volumes last year caused exports to grow to the highest level since 1994. Energy prices were 23% higher on average in 2004 than in 2003. The average price of Urals crude oil went up 26.8% in 2004, to $34.6 per barrel. Year on year, exports of goods increased 35.0% to $183.5 billion and imports rose 26.6% to $96.3 billion. Russia's trade surplus reached an all-time high of $87.1 billion, whereas in 2003 it stood at $59.9 billion.

The current account surplus rose 70% year on year, to $60.1 billion, or 10.3% of GDP, whereas in 2003 it stood at $35.4 billion, or 8.2% of GDP. As Russia liberalised its foreign exchange legislation and interest rates soared on international financial markets, net capital outflow by the private sector of the economy increased from $1.9 billion in 2003 to $9.4 billion in 2004.

Russia's international reserves grew 1.6 times, and as of January 1, 2005, aggregated $124.5 billion, contributing to the country's financial stability. In December 2004, the real effective rate of the ruble was 4.7% higher than in December 2003.

Domestic demand, a major factor of production growth, increased rapidly in 2004. Last year's tendency of fixed capital investment growing faster than real consumer spending has changed. Fixed capital investment expanded 10.9% in 2004 as against 12.5% in 2003. A 9.9% growth in real money income led to an increase in real consumer spending, which rose by an estimated 11.5% in 2004 as against 8.2% in 2003.

Unlike the previous year, 2004 saw the number of employed in the economy rise and unemployment drop. Last year, the unemployment rate[1] dropped to 8.2% as against 8.6% in 2003 amid rapid growth in labour productivity.

The favourable external economic situation, the improvement of the financial standing of enterprises, household income growth and the government's moderate spending policy brought about a rise in the federal budget surplus to 4.4% of GDP as against 1.7% in 2003.

In 2004, the Russian government formed a stabilisation fund within the federal budget, accumulating additional revenues from high oil prices on the world market. By the end of 2004, the stabilisation fund aggregated 522.3 billion rubles. It became a major factor of lessening inflationary pressure on the economy.

Consumer price inflation slowed to 11.7% last year as against 12% in 2003. Price formation was subject to volatile factors unrelated to the monetary policy in the short term, such as the sharp rise in world energy prices and the instability of some food products supply on the domestic and world markets. In December 2004, core inflation stood at 10.5% as against 11.2% a year earlier.

The improvements in the Russian economy, sustained economic growth and political stability did not pass unnoticed by international rating agencies and in November 2004 Fitch Ratings raised Russia's sovereign rating to investment grade.

I.1.2. The non-financial sector of the economy

The situation in the Russian economy was largely determined by the development of its non-financial sector.

Production growth rates in different branches of the non-financial sector differed significantly. Industrial output increased 6.1% in 2004. At the same time, the most rapid rate of output growth was registered in the glass, porcelain and faience industry (16.3% compared to 2003) and machine-building and metalworking (11.7%). The chemical and petrochemical industry increased its output by 7.4%. Output grew 5.3% in the building materials industry, 5% in the food industry, 4% in the ferrous metallurgy industry and 3% in the timber, woodworking and pulp-and-paper industry. Year-on-year production growth in the fuel industry stood at 7.1% and at 0.3% in the electric-power industry.

Profit net of loss of the key branches of the non-financial sector of the economy in 2004 increased more than 50% year on year to 2,083.9 billion rubles.

The proportion of loss-making companies in 2004 dropped by 5.5 percentage points to 35.8%. According to official statistics, the biggest number of loss-making enterprises in 2004 was registered in the production and distribution of electricity, gas and water (56.7% of the total

[1] The unemployment ratio calculated according to ILO methodology to the economically active population.

number of enterprises in this sector) and woodworking and the output of timber products (51.7%).

Enterprises' activity in 2004 resulted in profit from sales, profit before tax and net profit, all of which increased as compared with the same period in 2003. However, in 2004 only profit from sales increased more than in 2003 (40.6% as against 39.4% in 2003). Although pretax profit rose 57.0% in 2004 as against 68.8% in 2003, it accounted for 86.4% of the profit from sales as against 80.6% in 2003. Net profit, which enterprises retained after tax and extraordinary incomes and expenses, increased 62.0% and accounted for 9.6% of earnings. In 2003, it rose 110% but accounted for just 8.2% of earnings.

Most of the growth in profit was due to the increased profit of export-oriented industries, especially the oil and metallurgy sectors, which was largely the result of an increase in the world market prices and the price policy they pursued on the domestic market.

The return on enterprises' sales[2] and capital[3] also increased in 2004. The return on sales stood at 17.4% in the period under review as against 15.9% in 2003 and the return on capital rose from 8.3% to 10.7%.

The velocity of enterprises' capital turnover stood at 0.71 of the over-the-period turnover in 2004. This means that the earnings received in 2004 compensated 71% of the funds placed in assets (this compares with 65% in 2003). The duration of one turnover, or the period during which the cost of the capital invested in assets at the 2004 velocity of capital turnover could be offset by earnings, was 1.4 years as against 1.5 years in 2003.

Labour productivity[4] at enterprises stood at 973,200 rubles per person employed as against 729,800 rubles per person in 2003.

The financial conditions of enterprises with different sizes of capital differed significantly. The financial standing of the largest enterprises was relatively good, while other enterprises, especially those with assets smaller than 100 million rubles, continued to face serious problems.

Unlike larger enterprises, enterprises with assets smaller than 100 million rubles registered a contraction in both fixed and equity capital. The reduction of fixed capital at enterprises with assets smaller than 100 million rubles was largely due to the contraction of fixed assets (by 6.0%). The equity capital of enterprises with assets smaller than 100 million rubles decreased in its balance sheet value by 7.1% and by 6.2% in net assets.

The level of self-financing of enterprises fell slightly and the ratio of equity capital in enterprises' balance sheet total for 2004 fell from 63.7% to 62.8%.

The analysis of the investment activity of 12,500 enterprises monitored by the Bank of Russia in the fourth quarter of 2004 showed that the main incentives for the investment activity of non-financial enterprises were ensuring the utilisation of production capacity, intensifying and modernising production, expanding output, turning out new products, borrowing funds and getting a return from financial investment.

As for the major sources of investment, the enterprises surveyed by the Bank of Russia indicated in order of priority profit, depreciation, bank and other loans, leasing, budget funds, federal target programmes, foreign investments and share issue.

The raising of long-term funds enabled enterprises to use their own funds not only for growth in investment assets, but also the financing of current activities. Enterprises had their own floating funds and had broader opportunities to use them for working capital formation. The value of enterprises' own floating funds increased 61.9% in 2004, whereas in 2003 it decreased 11.2%.

The ratio of equity capital invested by enterprises in working capital in 2004 expanded from 13.2% to 19.0% of the total equity capital. Accordingly, the ratio of working capital created from enterprises' own funds increased from 25.2% to 32.4% of the working capital.

The state of payments and settlements continued to improve. Specifically, the ratio of non-payments in total receivables of large and medium-sized enterprises dropped by 5 percentage points to 16.2% and by 5.8 percentage points to 18.9% in total payables.

As the financial performance of non-financial enterprises improved, their demand for banking services increased. According to a special poll conducted by the Bank of Russia in the fourth quarter of 2004, which involved more than 10,000 enterprises based in 79 Russian regions, the non-financial enterprise sector was characterised by a relatively high level of demand for banking services.

In the period under review, 47.2% of the enterprises polled applied for new or additional services and 93.1% of enterprises had their demand for banking services met; 20.8% of enterprises had their demand met to a full extent.

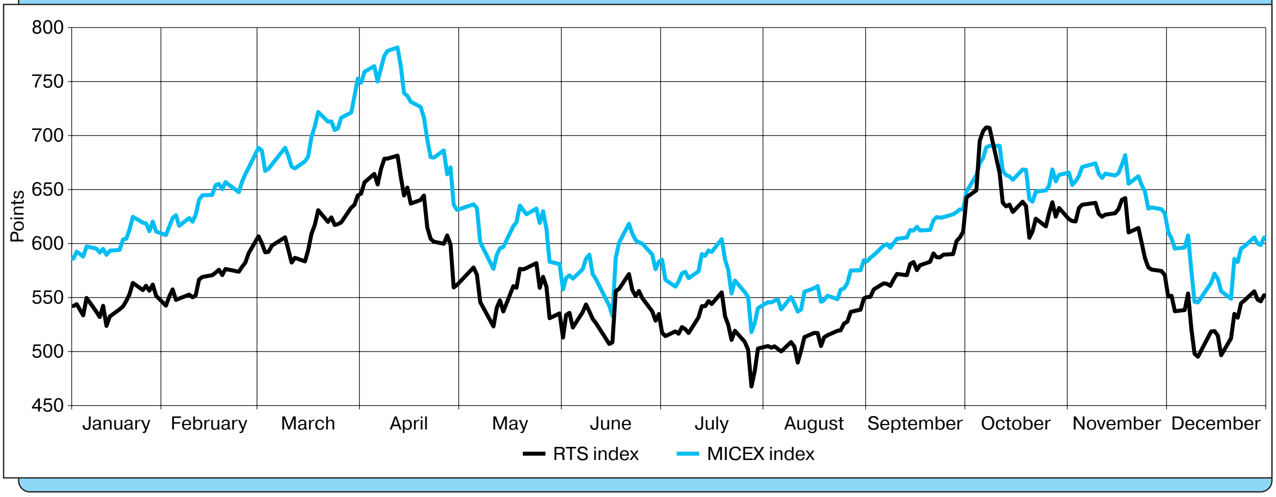
I.1.3. Financial markets and non-bank financial institutions[5]

There was a slight slowdown in the development of financial markets in 2004, but overall they grew faster than GDP. The financial markets came to play a more important role in accumulating savings and transforming them into investments. The value of investments attracted by Russian enterprises on the domestic securities markets (corporate bond and stock markets) in 2004 aggregated 153 billion rubles.

[2] Calculated as the ratio of profit from sales to earnings regarded as volume of sales.
[3] Calculated as the ratio of profit before tax to average assets.
[4] Labour productivity is measured using the indicator employed for this purpose by the European Central Bank. It is calculated as the ratio of earnings from sales of goods and services to the number of persons employed.
[5] Materials prepared by the Federal Financial Market Service ("Russian Financial Market Development Strategy"), Economic Research Foundation "Development Centre" and data compiled by RTS, MICEX, National Association of Stock Market Participants and the National Managers' League are used in this sub-section.

RTS and MICEX Index Dynamics in 2004

CHART 1.1



Despite progress in the development of the financial markets, Russia's top companies do not regard the national financial market as a major source of investments, while many medium-sized companies do not have access to it. The principal sources of investments for Russian companies are, as before, their own funds, loans and primary offerings on foreign markets. In 2004, Russian enterprises raised $10.2 billion in investments on foreign securities markets through participation and debt financing.

Corporate securities market

The stock market. The favourable macroeconomic situation and the improvement of the financial standing of enterprises in the real sector in 2004 had a benign effect on the Russian stock market. The favourable external factor of growth of the Russian stock market was the improved price situation on world raw material markets, which allowed Russia to maintain a foreign trade surplus and receive considerable federal budget revenues.

At the same time, the end of 2004 was not good for the stock market due to the instability of major issuers. The stock market indices gained less in 2004 than they did in 2003[6]. The MICEX index gained 7% as against 61% in 2003 and stood at 552.22 points as of December 30, 2004 and the RTS index rose 8% as against 58% in 2003 and reached 614.11 points as of December 31, 2004 *(see Chart 1.1)*. At the same time, both trading floors registered an increase in stock price volatility in 2004.

The average daily volume of stock trade on MICEX stood at 11.1 billion rubles in 2004, an increase of 29% on 2003, whereas in the RTS, it remained virtually unchanged at $22 million. The aggregate secondary stock trade turnover on the two trading floors expanded 27% in 2004 year on year. At the end of the period under review, the capitalisation of the RTS stock market stood at $168 billion, representing an increase of 6% on the same period a year earlier.

Investors' interests differed considerably by instrument and depended on the issuer's financial standing and potential. The shares of electricity companies continued to predominate in MICEX and the RTS aggregate exchange trade turnovers in 2004, accounting for 52% as against 64% in 2003 on MICEX and 29% as against 34% in the RTS.

The fact that stock trade volumes increase faster than market capitalisation testifies to the increased liquidity of the stock market. However, in terms of liquidity, the Russian stock market is inferior not only to most of the developed markets, but also some emerging markets. Russian outstanding corporate stocks account for no more than 5—25%.

It should be noted that a large portion of Russian stocks is traded on international financial markets (London and New York) in the form of American depositary receipts (ADR) and global depositary receipts (GDR).

Banks still maintain a low presence on the stock market: their share of the market is estimated at 8—9%, and it declined slowly in 2003 and 2004.

The corporate bond market. As the needs of the real economy for investment increased, the corporate bond market continued to grow dynamically. The fastest growing segment of the financial market, the corporate bond market expanded by two-thirds in 2004. At the same time, in the middle of last year the corporate bond market demonstrated its stability despite rumours of overheating. It had survived defaults on several bank bond issues almost unscathed.

Companies were active in issuing bonds in 2004: more than 80 new corporate bond issues with a nominal value of 140.4 billion rubles were placed on MICEX, an increase of 79% on 2003. The average value of a corporate bond issue in 2004 topped 1.5 billion rubles as against 1 billion rubles in 2003.

The structure of corporate bonds by maturity did not change much in 2004 as compared with 2003: new is-

[6] The annual rates of growth of Russian stock indices in 2004 were comparable with those of the major stock indices of the developed markets: Tokio's Nikkei rose 8%, London's FTSE 8%, Frankfurt's DAX 7% and the Dow Jones Industrial Average 3%.

sues with 2- and 3-year maturity periods predominated. At the same time, corporate bond issues with maturity periods of 5 years and more were placed.

In 2004, the corporate bond market was characterised by an increase in secondary trade. The average daily volume of secondary corporate bond trade on MICEX[7] expanded 67% in 2004 year on year to 1.7 billion rubles. Secondary trade volumes and growth rates on the corporate bond market exceeded those of the ruble-denominated government securities market.

Organised borrowings on the bond market are beginning to compete with bank lending. By the beginning of 2005, rates on primary offerings were within 10—12% p.a. and for the largest companies 7—9% p.a., that is, they were quite competitive with interest rates on long-term ruble loans (10—14% p.a.) regardless of the expenses involved in conducting and servicing bond issues (these account for about 1.5% of the value of the issue).

At the same time, ruble borrowings made on the bond market largely go to finance current needs rather than investments. According to Rosstat data, bank loans accounted for 6.3% of the financing of fixed capital investment in 2004, whereas corporate bond issues accounted for a lowly 0.2%.

Unlike the stock market, the corporate bond market has banks as its main participants. Banks have always accounted for a large share of this market: in the middle of last year it was over 40% and by the beginning of 2005 it exceeded 50%. At the same time, there is no indisputable leader, as none of the banks controls more than 3% of the market.

The domestic foreign exchange market. The situation on the domestic foreign exchange market in 2004 was affected by the dynamics of export earnings, Russian companies' borrowings abroad, Bank of Russia operations conducted in line with its monetary and exchange rate policy and dollar fluctuations against the euro on the world currency market. Banks' demand for foreign exchange was largely determined by such factors as import payments and large corporate foreign debt payments.

From January to the middle of April, the situation on the domestic foreign exchange market was characterised by growth in the supply of foreign exchange, caused by the flow of vast amounts of currency export earnings to the economy, and the active opening of short currency positions by credit institutions.

In the middle of April, the dollar's rally encouraged credit institutions to build up their long positions in this currency. In the second half of April, a rise in the dollar rate against the ruble ended and the exchange rate stabilised at 29.0—29.3 rubles to the dollar. In the meantime, the situation on the world currency market changed and some Russian banks experienced a shortage of liquidity. The ruble resumed its rally in nominal terms in late October when the inflow of export earnings grew and the dollar weakened on the world currency market.

The average daily ruble/dollar spot trade turnover on the interbank market increased 32% in 2004 year on year, to $16.4 billion. The average daily dollar/euro spot trade turnover expanded 37% to $4.1 billion.

The aggregate ruble/dollar exchange trade turnover more than doubled in 2004 as compared with 2003 and stood at $347.5 billion; STS turnover of "today" trades aggregated $84.7 billion and STS turnover of "tomorrow" trades reached $119.1 billion. The aggregate volume of ruble/euro exchange operations contracted 10% in 2004 to 2 billion euros.

The GKO—OFZ market. The situation on the government securities market in 2004 was affected by the domestic debt management policy pursued by the Finance Ministry, the situation on the domestic foreign exchange market and banking sector liquidity dynamics. During the year, the effective yield on government bonds calculated by MICEX declined by 0.51 percentage points from 7.46% to 6.95%. The average daily trade turnover expanded 31% year on year to 1.2 billion rubles[8].

The high level of banking sector liquidity in the first quarter of 2004 allowed the Finance Ministry to place government bonds without offering any premium to the market yield.

As the situation on the domestic foreign exchange market changed in April 2004, government securities became less attractive to investors. The liquidity shortage in the banking sector, caused by problems faced by some banks, led to the further reduction of activity of government securities market participants. In the second quarter of 2004, the GKO—OFZ trade volume dropped by more than half compared to the previous quarter.

The GKO—OFZ market in 2004 was characterised by a small volume of operations conducted to regulate the current liquidity level. Banks preferred to cover the shortage of funds by concluding repo deals with the Bank of Russia. The main reason for the reduction of the GKO—OFZ market's role in regulating commercial banks' free funds is the low level of liquidity of government securities, which is largely the result of the negative real yields on many government securities and the high concentration of bond issues placed with passive investors.

Banking sector liquidity started to grow again in September 2004, causing the demand for government securities to rise. At the same time, the principal GKO—OFZ market participants were, as before, the biggest investors, such as Sberbank and the Pension Fund[9], which bought government securities for the long-term investment of free funds.

[7] Taking into account over-the-counter transactions registered on MICEX.
[8] This figure does not take into account the Finance Ministry and Bank of Russia auctions. In 2004, the Finance Ministry held 27 primary GKO—OFZ bond auctions, raising 94.5 billion rubles, excluding secondary trade operations. During the year, the nominal value of the domestic government debt market rose 77% to 557.6 billion rubles and its duration increased from 2.7 years to 4.8 years.
[9] According to the Federal Financial Market Service, in 2002 and 2003 the Pension Fund accumulated and invested 99 billion rubles of pension savings in government bonds. In 2004, the Pension Fund invested 15 billion rubles in these instruments.

The role of non-bank financial institutions in the Russian financial system and their interrelationship with credit institutions. The principal types of non-bank financial institutions on the Russian market today are insurance companies, investment intermediaries and collective investment institutions. In addition, there are the necessary elements of the market infrastructure, such as trading floors, clearing systems and discount houses, but since they perform purely auxiliary functions and make no investments on their own behalf, their activities are not considered in this Report.

The role of the non-bank financial institutions increased on the Russian market in 2004 mainly owing to ***insurance companies.***

Three factors affected the insurance market in 2004. First, amendments to the Federal Insurance Law came into effect at the beginning of 2004, which set new requirements for the minimum paid-up authorised capital of insurance companies and established the procedure for conducting specialisation. Second, the proportion of financial optimisation schemes, especially in life insurance, contracted in the insurance business structure. Third, the dynamics of the insurance market and its financial stability in 2004 were significantly affected by compulsory third party liability auto insurance introduced in the middle of 2003.

The total value of insurance premiums increased 9% in 2004 to 471.6 billion rubles and insurance indemnities aggregated 307.6 billion rubles, a rise of 8.1% on 2003. However, despite significant growth in the total value of insurance premiums collected by insurance companies, they accounted for a meagre 2.8% of GDP in 2004.

Insurance companies mainly invest in corporate stocks and debt instruments, which, according to experts' estimates, accounted for nearly 60% of insurance companies' total investments in the first nine months of 2004.

Although insurance companies are the most developed non-bank financial institutions, the volume of their operations is considerably smaller than that of banks. As of the beginning of 2005, insurance companies' assets accounted for about 9% of bank assets and insurance companies' capital accounted for nearly 12% of aggregate banking sector capital.

Most of Russia's largest insurance companies are a part of financial holding companies or have been created by large industrial companies. Such holding companies comprise banks, as a rule, which are only connected with insurance companies by having the same owner rather than directly participating in capital.

Financial intermediaries play an increasingly important role on the Russian stock market each year. At the same time, a tendency towards concentration of services has been registered in this sector since 2002. The number of professional securities market participants has been declining, while the ratio of universal companies that have the right to conduct all types of activities permissible for the professional securities market participant has been expanding. According to the Federal Financial Market Service (FFMS), more than half of the 1,664 companies of this kind were engaged in broker and dealer activities and securities management since the beginning of 2005 as against 37% as of the beginning of 2003 and 16% as of the beginning of 2000.

As of the beginning of 2005, Russian investment intermediaries managed more than 311 billion rubles, or 4.4% of banking sector assets. Management companies set up by banks play a minor role, accounting for 3.5% of trust assets.

Most of the resources managed by investment intermediaries are those accumulated by ***collective investment institutions.*** These institutions are represented by unit investment funds (PIF) and non-government pension funds (NPF) on the Russian financial market.

According to the National Managers' League, assets of ***unit investment funds*** increased almost 14% during 2004 to 106 billion rubles. However, they account for just 1.5% of aggregate banking sector assets. The number of registered unit investment funds rose by 125 to 286 last year.

The investment structure of PIFs is dominated by stock funds, which account for three quarters of all assets. The less risky bond unit investment funds account for a lowly 3% of assets, while the remainder are mixed investments, most of which are also shares, and riskier venture funds and real estate funds.

Hence, the management companies of the unit investment funds are largely oriented to the stock market where banks are not particularly active. The investment declarations of unit funds usually do not provide for investments in bank deposits. Therefore, banks and unit investment funds have little bearing upon each other.

At the same time, unit investment funds are the immediate rivals of general bank management funds (OFBU), although the funds attracted by the latter accounted for just 2% of the funds attracted by PIFs (2.3 billion rubles) as of the beginning of 2005, according to the National Managers' League.

The total value of pension reserves of ***non-government pension funds*** (NPFs) stood at 175 billion rubles as of the beginning of 2005, according to the FFMS. This represents 2.5% of banking sector assets. The major NPFs have been established and are maintained by the largest Russian enterprises.

The investment strategy of the biggest funds is to invest in stocks and bonds, especially those issued by the parent company. Bank deposits usually account for 7—8% of investment assets and are placed with a bank affiliated with the parent structure. Hence, the interrelationship between banks and non-government pension funds is confined to the aforementioned deposits and only exists for a small number of banks.

Overall, the analysis of the interconnection between the Russian banking sector and non-bank financial institutions shows that if problems arise in the non-bank financial sector, they will have little effect on the banking sector. First, banks are incomparable in scale with other institutions (banking sector assets exceed by almost 10 times the assets of the major non-bank financial institutions, although last year's dynamics indicate that non-banking institutions have been growing faster). Second, the direct participation of non-bank financial institutions in banks' capital is negligent. Banking assets currently owned by non-bank financial institutions account for a meagre 0.2—0.3% of banking sector assets.

Banks dominate all domestic debt markets. They account for more than a half of the domestic government debt market, mainly owing to Sberbank, two-thirds of the volume of the regional and local government debt market and more than 43% of the corporate bond market.

On the one hand, the key role played by banks is due to their resource potential; on the other hand, banks actively work as regional and corporate loan underwriters and consultants.

Owing to client relations, the non-bank financial sector is more dependent on the banking sector than banks depend on non-bank intermediaries. Non-bank financial institutions have a small but stable share of banking sector liabilities (5—6%). The share of bank deposits in non-bank institutions' assets is several times bigger. Consequently, should problems arise in the banking sector, the non-bank financial sector's stability will be seriously affected.

I.1.4. Payment system

The state of the Russian payment system was a major factor of stability of the financial sector and the economy as a whole in 2004.

During the year under review, the Russian payment system effected 992.0 million payments to the amount of 223.9 trillion rubles. At the same time, the rate of growth in the number of payments remained unchanged from 2003 at 116%. In the meantime, the rate of growth in the value of payments slowed down by 17.1 percentage points year on year to 122.9%.

Electronic settlements become increasingly used in the Russian payment system. They accounted for 80.4% of the total number of payments and 89.6% of the total value of payments as against 77.5% and 86.8%, respectively, in 2003. The use of electronic technologies in the Russian payment system, based on the advanced methods of data processing and transmission, increased the efficiency and security of the services provided to all participants in settlement.

The Bank of Russia payment system, which the joint IMF-World Bank mission characterised as systemically important within the framework of the Financial Sector Assessment Programme for Russia, leads in terms of both the number and value of payments effected. In 2004, the payments effected by the Bank of Russia payment system accounted for 47.6% of the total number of payments effected by the Russian payment system and 60.5% of the total value of payments.

The Bank of Russia continues to attach great importance to the creation of a real-time gross settlement system and in 2004 it made some progress towards reaching this goal.

The provision of settlement services by the Bank of Russia is regulated by Russian legislation, which requires the Bank of Russia to conduct free of charge operations with regional government accounts and the accounts of the bodies that provide cash services for the regional budgets. In accordance with the decision of the Bank of Russia, no fee is charged for the settlement services provided when funds are reserved in foreign exchange operations. Free payments accounted for 56.1% of the total number of payments in 2004. Operations conducted by the Bank of Russia for pay accounted for 43.9%. The charge was unchanged from the previous year.

One of the Bank of Russia's major areas of activity is setting rules for the use of non-cash settlement instruments, which should broaden the range of affordable payment services, match international regulation standards and take into account the current trends in the development of new technologies.

In 2004, the Bank of Russia began to elaborate new principles of regulating non-cash settlements and payment systems in order to standardise non-cash settlement rules and establish uniform requirements for the management and operation of the payment systems and set a procedure for monitoring compliance with these requirements.

Changes were made in non-cash settlement rules in Russia last year (with regard to the letter of credit settlements), which took into account the international practice of conducting documentary operations.

The Bank of Russia upgraded the standards regulating the procedure for issuing bank cards in Russia and conducting payment card operations by credit institutions. The new regulations are designed to encourage non-cash settlements using common settlement and credit cards and create conditions for the introduction of new payment instruments such as prepaid bank cards.

I.1.5. Banking sector performance indicators relative to key macroindicators

Despite sustained economic growth and the favourable price situation on world raw material markets, the rates of growth in the major banking sector performance indicators slowed down in 2004. Banking sector assets increased 27.4% during 2004 as against 35.1% in 2003. Capital growth slowed to 16.2% from 40.2% in 2003. Loans to the non-financial sector expanded 39.0% as against 42.4% in 2003 and household sector deposits grew 29.7% as against 47.1% in 2003.

As a result, the ratio of these indicators to GDP changed in 2004. The ratio of banking sector assets to GDP (42.5%) was virtually unchanged from the previous year (42.4%), the ratio of household sector deposits to GDP did not change much either (11.7% as against 11.5% in 2003), whereas banking sector capital to GDP contracted from 6.2% to 5.6%.

At the same time, the expansion of banks' operations with the real sector was the principal factor of growth in banking sector assets in 2004. Loans and other funds provided to the non-financial enterprise sector increased from 17.2% of GDP to 18.8% of GDP and their share in banking sector assets expanded from 40.5% to 44.1%.

The chief source of resources for credit institutions in 2004 was funds attracted from enterprises and organisations, which increased 43.4% during the year as against 26.9% in 2003. Relative to GDP, they grew from 10.5% to 11.8% and their share in banking sector liabilities expanded from 24.7% to 27.8%.

In real terms, aggregate banking sector assets increased 19.7% in 2004, capital 4.0%, loans to the non-financial sector 29.5%, household deposits 21.8% and funds attracted from enterprises and organisations 35.2%.

The dynamics of the ratio of the key banking sector performance indicators to GDP indicate that the banking sector's role in the country's economy constantly grows.

I.2. Institutional aspects of the banking sector development

I.2.1. Banking sector quantitative characteristics

The number of operating credit institutions decreased from 1,329 to 1,299 in 2004. Thirty-three credit institutions had their banking licences revoked last year. These included eight of the top 200 banks in terms of assets: Dialog-Optim (ranked 56th as of January 1, 2004), Kredittrast (63rd), Neftegazbank (106th), Sodbiznesbank (113th), Imperial (135th), Paveletsky (167th), Legprombank (170th) and Meritbank (200th). Three credit institutions were reorganised through mergers and acquisitions and five new ones were registered.

There was a slight drop in the number of operating banks in all federal districts, except the North-Western Federal District. The biggest reduction in the number of credit institutions was registered in the Central Federal District from 752 to 742.

The reorganisation of the branch network of credit institutions continued in the year under review. There was a slight rise in the number of branches of operating credit institutions last year: from 3,219 as of January 1, 2004, to 3,238 as of January 1, 2005, an increase of 0.6%. (In the previous three years, the number of branches of operating credit institutions had declined by 574, or 15.1%). There were 1,011 Sberbank branches as of January 1, 2005, 34 fewer than a year earlier *(see Chart 1.2)*.

Credit institutions and their branches continued to increase the number of their internal divisions such as additional offices and cash and credit offices in 2004. At the same time, there was a fall from 19,060 to 18,491 in the total number of cash points. The total number of internal divisions of credit institutions and their branches increased by 1,202 to 27,670 as of January 1, 2005, as against 26,468 as of January 1, 2004.

In five federal districts (the North-Western, Volga, Southern, Siberian and the Far Eastern districts) the number of branches of banks based in other regions exceeded the number of local credit institutions and their branches as of January 1, 2005.

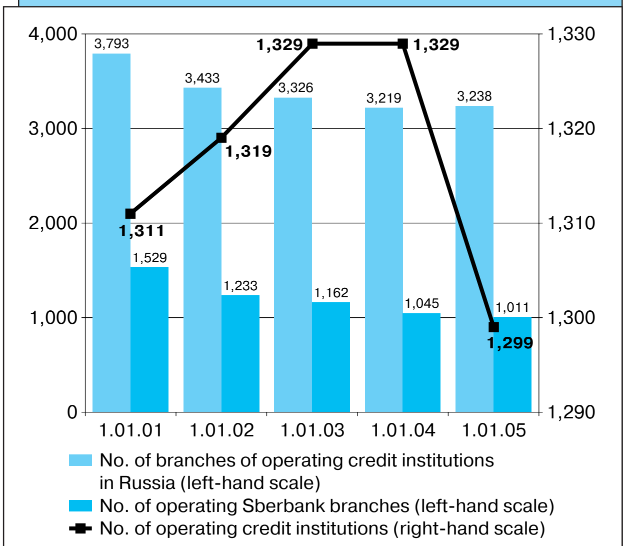
I.2.2. Concentration of banking activities

The share of the top 200 credit institutions in terms of assets was virtually unchanged in 2004 and as of January 1, 2005, it stood at 89.0% of total bank assets as against 88.0% as of January 1, 2004. The share of the largest five banks expanded from 42.9% to 45.1%, mainly due to the expansion of Sberbank's share from 27.6% to 28.6%.

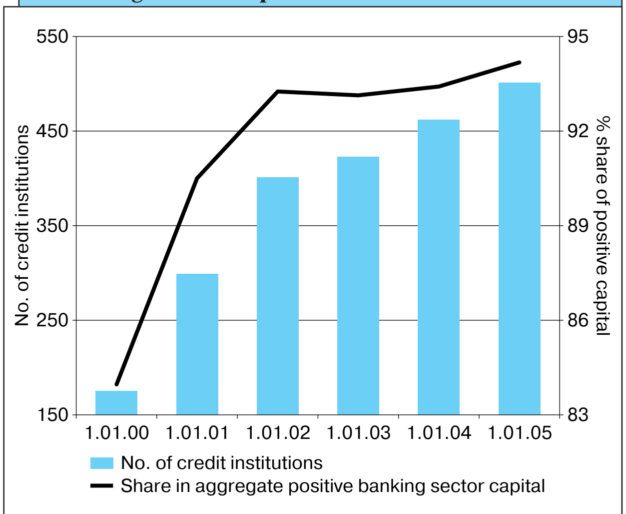
The top 200 banks in terms of capital accounted for 82.9% of aggregate banking sector capital as of January 1, 2005, as against 82.7% as of January 1, 2004, and the largest five banks accounted for 34% as against 35% as of January 1, 2004.

The number of credit institutions with a capital of more than 5 million euros increased during 2004 from 462 to 501, or by 8.4% (the aggregate capital of this group of

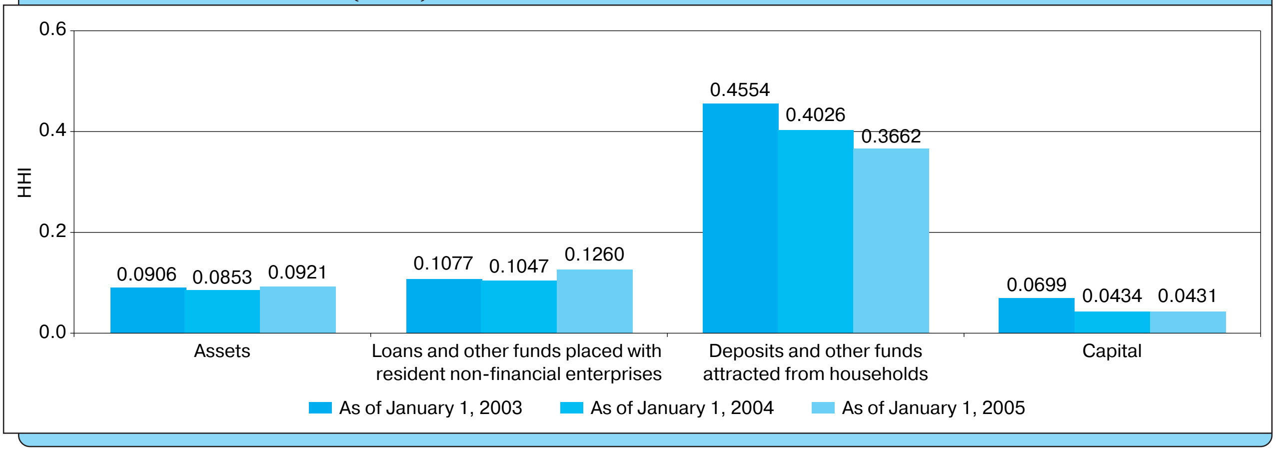
Number of credit institutions and their branches CHART 1.2



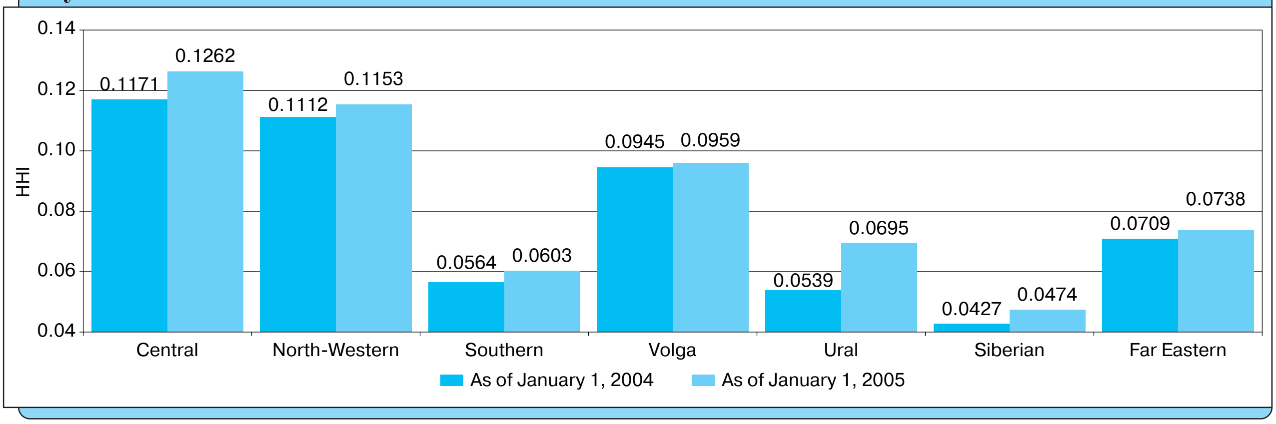
Number of banks with a capital of more than 5 million euros and their share in aggregate banking sector capital CHART 1.3



Russian banking sector concentration indicators (HHI) CHART 1.4



Banking sector asset concentration by federal district CHART 1.5



banks grew 17.1%) and their share in aggregate banking sector capital expanded from 93% to 94% *(see Chart 1.3).* As of the beginning of 2005, 38.6% of all credit institutions had a capital in excess of 5 million euros as against 34.8% a year earlier.

The dynamics of the internationally-accepted Herfindahl-Hirschman Index (HHI)[10] testify to the low level of asset concentration in the Russian banking sector *(see Chart 1.4).* However, after its fall in 2003, this index rose in 2004. After a three-year decline, the level of concentration of loans to the non-financial enterprise sector also rose in 2004 and registered 0.126. Hence, the level of concentration of loans to the non-financial enterprise sector in 2004 may be rated as medium.

Only the personal deposit market had a high level of concentration, despite its persistent decline. As of January 1, 2005, the HHI of this segment of the market registered 0.37. The significant reduction of the index during the past few years was largely due to the contraction of Sberbank's share of the personal deposit market and it testifies to the intensification of competition on the retail banking market.

The capital concentration level (0.043) was the lowest banking sector performance indicators and during the past few years had the tendency to decline.

Banking sector concentration levels continued to differ significantly by region in 2004 *(see Chart 1.5).*

The second highest level of banking sector asset concentration after the Central Federal District is registered in the North-Western Federal District, where it is given a medium rating (HHI = 11.5). Other federal districts have low asset concentration levels and the Siberian Federal District has the lowest. However, all federal districts registered a rise in asset concentration levels in 2004.

I.2.3. Banking sector development at the regional level

The number of regional banks[11] fell slightly in 2004, decreasing from 650 as of January 1, 2004, to 628 as of

[10] The Herfindahl-Hirschman Index is recommended by the Compilation Guide on Financial Soundness Indicators, which is currently being drafted by the IMF, as a measure of concentration in the banking sector. It is calculated as a sum of squared unit weights of credit institutions in the total volume of the banking sector indicator. The index shows the extent of the indicator's concentration on the scale of values from 0 to 1. The value 0 signifies the lowest level of concentration, less than 0.10 a low level of concentration, 0.10 to 0.18 a medium level of concentration and more than 0.18 a high level of concentration.
[11] Regional banks are the banks registered outside Moscow and the Moscow Region.

January 1, 2005. At the same time, the rates of growth in regional bank assets[12] (31.5%) were faster than the rates of growth in aggregate banking sector assets (27.4%) in 2004. As a result, regional banks accounted for 37.3% of aggregate banking sector assets as of January 1, 2005, as against 35.5% as of January 1, 2004.

The aggregate capital of regional banks increased by 30.0 billion rubles, or 22.9%, and these banks account for 17.0% of aggregate banking sector capital as of January 1, 2005, as against 16.1% as of January 1, 2004.

As in the previous two years, regional banks profited in 2004, aggregating 26.4 billion rubles, an increase of 34% on 2003. The ratio of profit-making regional banks was virtually unchanged at 98.3% of the total number of regional banks as of January 1, 2005, and 99.95% of aggregate regional bank assets.

The North-Western Federal District had the highest rate of provision with banking services in 2004: it was 27% higher than the national average[13]. At the same time, the ratio of assets and loans to gross regional product exceeded the national average by 41% and 27% respectively. The ratio of personal deposits to income was also the highest in Russia. Another region where the rate of provision with banking services was higher than the national average was the Volga Federal District.

The lowest rate of provision with banking services was, as before, in the Siberian Federal District, although growth in this rate reduced the gap between it and the Southern, Ural and Far Eastern Federal Districts to a minimum (however, the Ural and Far Eastern Federal Districts are far ahead in terms of *institutional* saturation with banking services, the number of credit institutions and their branches per capita). The lowest rates of provision with banking services were registered in the Republics of Ingushetia and Daghestan.

At the beginning of 2005, as in the previous year, there were no more than two locally-based operating credit institutions in 13 Russian regions[14] (the Bryansk, Kursk, Lipetsk, Orel, Tambov, Novgorod, Penza and Chita Regions and the Republics of Buryatiya, Kalmykia, Ingushetia, Karelia and Marii-El)[15]. There were no credit institutions in the Jewish Autonomous Area and the Chukchee Autonomous Area as of January 1, 2005, as in the previous years.

Consequently, the provision of the Russian regions with banking services has not changed much in recent years, while the persisting differentiation between regions in this respect largely results from different levels of their economic development.

I.2.4. State participation in the banking sector

According to estimates[16], the group of state banks (credit institutions in which the state[17] controls more than 50% of authorised capital) comprised 21 credit institutions as of January 1, 2005, as against 20 credit institutions as of January 1, 2004.

As of January 1, 2005, state banks accounted for 28.0% of aggregate banking sector equity capital (as against 28.4% as of January 1, 2004), 38.1% of assets (as against 36.0% as of January 1, 2004), 42.2% of loans to the real economy (as against 38.2% as of January 1, 2004), 65.7% of household deposits (as against 67.7% as of January 1, 2004) and 76.6% of investments in Russian government debt obligations (as against 80.0% as of January 1, 2004).

Sberbank plays a special role on the Russian banking services market. In 2004, its share in aggregate banking sector assets expanded from 27.6% to 28.6% and in aggregate banking sector capital from 18.2% to 18.3%. Sberbank continues to dominate the household sector deposit market. Despite its gradual decline, Sberbank's share in the total value of deposits and other household sector funds attracted by banks remained large at 60.3% as of January 1, 2005 (a year earlier, it was 63.3%).

Sberbank also plays the leading role on the financial market. As of January 1, 2005, it accounted for 71.3% of investments in Russian government debt obligations as against 71.9% as of January 1, 2004. It has retained its major role in lending to the real sector and its share of total loans extended by the banking sector to the non-financial enterprise sector has expanded significantly during the year (from 29.3% as of January 1, 2004, to 32.6% as of January 1, 2005). The scale of Sberbank's operations on the interbank market also expanded significantly in 2004. Sberbank's share in total interbank loans, deposits and other placements increased from 2.4% to 6.4%.

Vneshtorgbank, Russia's second largest state bank, also expanded its activities significantly in 2004. During the year, its assets increased almost 1.5 times and, as a result, Vneshtorgbank's share in banking sector assets rose from 5.2% to 6.0%. The value of household deposits almost doubled during the year and Vneshtorgbank's share of the household deposit market expanded from 1.8% to 2.6%. The bank's share of lending to the non-financial enterprise sector also increased from 4.8% as of January 1, 2004, to 5.7% as of January 1, 2005. At the

[12] Assets of the banks registered in the region, including their branch network inside the region, and assets of the branches of banks registered in other regions.
[13] The average rate of provision with banking services by region was calculated without taking into account credit institutions based in Moscow and the Moscow Region.
[14] Excluding the autonomous areas inside other constituent territories of the Russian Federation.
[15] As of January 1, 2004, these constituent territories included the Leningrad Region, where the number of locally-based operating credit institutions increased to three in 2004, and did not include the Republic of Kalmykia, where the number of such credit institutions decreased from three to two.
[16] There are no accurate figures because the Bank of Russia has no codes in its database allowing it to precisely identify state participation in the authorised capital of credit institutions (applicable legislation does not require the Bank of Russia to have such codes).
[17] Among the organisations that represent the state are the executive bodies of power, federal and regional state unitary enterprises, the Federal Property Fund and the Bank of Russia, which is not an executive body of power.

same time, Vneshtorgbank's investments in Russian government debt obligations decreased almost four times and the bank's share in total investments in government debt instruments contracted from 6.3% to 1.7% during the year. Vneshtorgbank's share in aggregate banking sector capital also decreased (from 6.5% to 6.0%) as the bank's capital grew more slowly (7.3%) than banking sector capital as a whole.

Looking at the Russian banking sector without Sberbank and Vneshtorgbank, the state banks play a far more modest role in it. They account for 4.9% of total banking sector equity capital (as against 4.9% as of January 1, 2004), 5.3% of aggregate assets (as against 4.9% as of January 1, 2004), 6.3% of loans to the non-financial enterprise sector (as against 6.2% as of January 1, 2004), 7.3% of household deposits (as against 7.6% as of January 1, 2004) and 13.5% of investment in Russian government debt obligations (as against 7.9% as of January 1, 2004).

The group of Russian overseas banks is composed of the Moscow Narodny Bank (London), Banque Commerciale pour l'Europe du Nord-Eurobank (Paris), Ost-West Handelsbank (Frankfurt-am-Main), Donau-Bank (Vienna) and East-West United Bank (Luxembourg). These banks operate in compliance with host country legislation and are supervised by local supervisory authorities, while the Bank of Russia participates in managing these banks through its representatives on their supervisory boards.

The Bank of Russia holds a 15% stake in the Donau-Bank (Vienna) and East-West United Bank (Luxembourg). It has retained its blocks of shares in these banks at the recommendation of the local supervisory authorities. The Bank of Russia holds a 88.89% stake in the Moscow Narodny Bank (London), a 87.04% stake in Eurobank (Paris) and a 51.62% stake in Ost-West Handelsbank (Frankfurt-am-Main).

Pursuant to Article 8 of the Federal Law on the Central Bank of the Russian Federation (Bank of Russia), the Bank of Russia disposes of its stakes in these banks in agreement with the Russian government. Article 13 of the Federal Law places decision-making concerning the participation of the Bank of Russia in the capital of credit institutions within the competence of the National Banking Board.

Implementing the decisions of the National Banking Board, in 2004, the Bank of Russia continued to create conditions for a withdrawal from the capital of Russian overseas banks. Specifically, it took steps to make them more independent financially from the Bank of Russia, held meetings and consultations with host country supervisory authorities and studied possible ways of alienating shares. Work continued in the period under review to transfer to the Bank of Russia the rights to the shares of Russian overseas banks historically registered with "nominal shareholders."

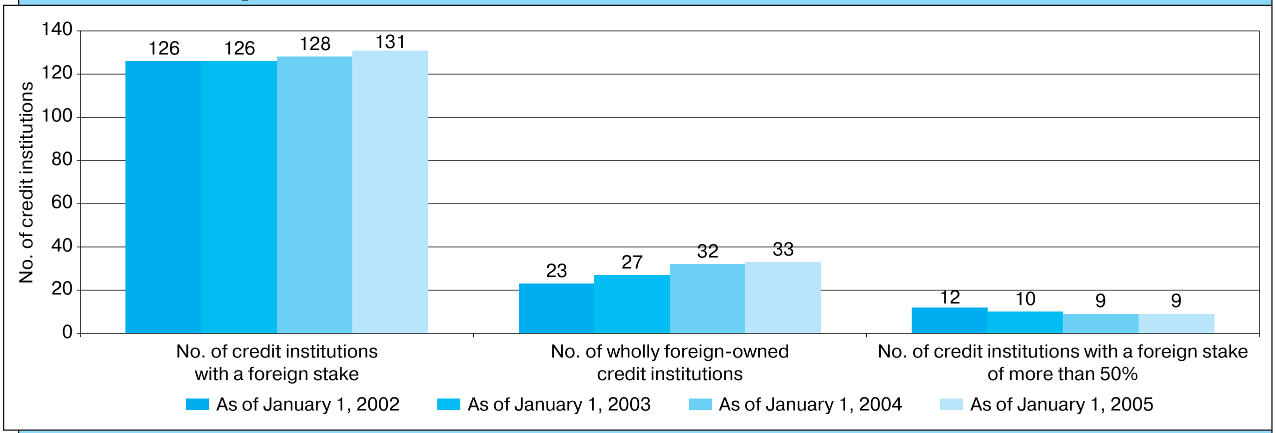
The financial standing of the Russian overseas banks is considered stable. All of them profited in 2004.

The Russian Banking Sector Development Strategy until 2008[18] envisages the withdrawal of the Bank of Russia from the capital of Russian overseas banks. At the same time, the Bank of Russia and its collegiate body, the National Banking Board, believe that the Bank of Russia stakes in these banks should be sold without harming the interests of the state.

I.2.5. Foreign capital in the Russian banking sector

Foreign capital participation in the Russian banking system expanded in the year under review. Non-resident participation in the aggregate authorised capital of operating credit institutions increased from 18.9 billion rubles to 23.6 billion rubles, or 24.9%, in 2004 (in 2003, it increased from 15.9 billion rubles to 18.9 billion rubles, or 19.0%). The non-resident share of aggregate banking sector authorised capital expanded from 5.2% to 6.2% (in 2003, it shrank slightly from 5.3% to 5.2%). As the number of operating credit institutions with foreign interest rose from 128 to 131 (in 2003, it increased from 126

Dynamics of the number of operating credit institutions with a foreign stake in authorised capital CHART 1.6



[18] Passed by a joint statement by the Russian government and the Bank,of Russia on April 5, 2005.

to 128), the number of credit institutions with a non-resident stake of more than 50% increased from 41 to 42 (in 2003, it rose from 37 to 41), while foreign investment in the authorised capital of operating banks grew by 4.65 billion rubles *(see Chart 1.6)*.

There are credit institutions with foreign interest located in 29 Russian regions, 87 of which, or 66.4% of the total, are based in Moscow and the Moscow Region, eight in St Petersburg and four in the Tyumen Region.

Eighty-four credit institutions with foreign interest, or 64.1% of the total) have a general banking licence, 45 credit institutions, or 34.4%, have a licence to conduct banking operations in rubles and foreign currency and two credit institutions, or 1.5%, are licensed to conduct operations in rubles only. Of the total number of credit institutions with foreign interest, 122 credit institutions, or 93.1%, have a licence to take household funds on deposit and 38 credit institutions, or 29.0%, are licensed to take on deposit and place precious metals.

Thirty-three credit institutions, or 25.2%, are wholly foreign-owned. The number of such banks increased by one during the year (Moscow-based Ziraat Bank).

The policy of foreign-controlled banks in 2004 was mainly expanding the provision of settlement services to clients and operations on the Russian retail banking and securities markets.

The assets of foreign-controlled banks increased 29.9% during 2004 to 539.9 billion rubles and their equity capital expanded 36.7% to 73.8 billion rubles. However, foreign capital continues to play a very modest role in the Russian banking sector: as of January 1, 2005, this group of banks accounted for 7.6% of banking sector assets and 7.8% of equity capital (as against 7.4% and 6.6%, respectively, as of January 1, 2004).

The main sources of funds for foreign-controlled banks in 2004 remained the funds in their customer accounts and loans, deposits and other funds raised on the interbank market. These sources accounted for nearly 77% of the banks' liabilities.

The balances in customer accounts increased 1.5 times in 2004 and stood at 246.9 billion rubles, while their ratio in these banks' liabilities expanded from 39.4% as of January 1, 2004, to 45.7% as of January 1, 2005. In the meantime, the balances of corporate customer settlement, current and other accounts increased 29.2%, whereas their ratio in liabilities was virtually unchanged at 17.3%. Corporate deposits grew 43.7% to 73.6 billion rubles, while their ratio in liabilities expanded from 12.3% to 13.6%.

Foreign-controlled banks rapidly expanded their operations on the retail banking services market in 2004. The value of deposits and other funds attracted from households increased from 34.0 billion rubles to 55.2 billion rubles, or 62.7% — more than the banking sector's 29.7% average. This source of funds accounted for 10.2% of the liabilities of this group of banks as against 8.2% a year earlier. At the same time, the foreign-controlled banks' share of the household deposit market expanded from 2.2% as of January 1, 2004, to 2.8% as of January 1, 2005.

The balances of funds raised by foreign-controlled credit institutions on the interbank market rose 15.8% in 2004 to 169.9 billion rubles, while their share in liabilities contracted from 35.3% to 31.5%. Most of the funds were attracted from non-resident banks — 140.6 billion rubles (82.7%), of which nearly 45% of the funds had a maturity of over one year.

Foreign-controlled banks are beginning to play a more significant part in the redistribution of resources between the international and Russian financial markets. As of the beginning of 2004, the funds attracted by the banks to the Russian financial market exceeded the funds placed with non-residents by 109.9 billion rubles, whereas as of January 1, 2005, the excess amounted to 153.8 billion rubles. Credit institutions controlled by non-residents accounted for 51.1% of the net inflow of funds from the international financial market to the Russian banking sector as of January 1, 2005, as against 64.4% as of January 1, 2004.

Lending operations are a major activity of the banks controlled by non-residents. Loans and other funds provided by the banks to the non-financial enterprise sector increased from 146.1 billion rubles to 202.1 billion rubles, or 38.3%, in 2004, while their share in the assets of the banks expanded from 35.2% to 37.4%. Loans extended in foreign currency accounted for 74% of the banks' credit investments. However, the share of foreign-controlled banks in the total value of loans extended by the banking sector to non-financial enterprises remained virtually unchanged in 2004 at 6.2%.

There was a marked rise in the foreign-controlled bank activity on the consumer credit market. Consumer credit increased 2.7 times in 2004 (2.1 times in the banking sector) to 46.6 billion rubles, accounting for 14.5% of the loan portfolio of the banks as against 7.6% as of January 1, 2004.

As foreign-controlled banks expanded their operations on the securities market in 2004, their investments in securities increased 52.3% to 84.6 billion rubles. Investments made in securities accounted for 15.7% of assets of this group of banks as against 13.4% a year earlier. As banks preferred to invest in debt obligations, these investments grew 57.6% to almost 95.6% of the total value of securities bought by the banks. At the same time, there was a significant rise in investments in the debt obligations of Russian banks (from 1.4 billion rubles to 10.2 billion rubles) and corporations (from 9.4 billion rubles to 20.9 billion rubles) and their share in total debt obligations expanded to 38.5% as of January 1, 2005, as against 21% as of January 1, 2004. The share of investments in Russian government debt obligations decreased from 56.2% to 35.0%.

The 2004 results proved further improvement of foreign-controlled banks' financial standing. Current profits increased 7.5% (from 16.5 billion rubles as of January 1, 2004, to 17.8 billion rubles as of January 1, 2005). The number of profit-making banks rose slightly (from 34 to 38), while their profits increased from 16.7 billion rubles to 18.0 billion rubles. At the same time, the number of loss-making banks fell from six to four, with their losses increasing marginally (from 218 million rubles to 239 million rubles).

Growth in bank profits allowed an improvement in their financial results in 2004, taking into account their performance in the previous years. As of January 1, 2005, profits aggregated 29.7 billion rubles as against 19.7 billion rubles as of January 1, 2004, taking into account the financial results of past years.

At the same time, profits in 2004 grew slower than those in 2003 due to some extent to the increase in the costs involved in the expansion of the branch network and retail banking business. Profit growth was also slower than that in assets and capital. As a result, the return on both assets and capital of the credit institutions controlled by non-residents decreased in 2004 to 3.8% and 29.0% respectively (as against 4.7% and 35.8% in 2003). These rates, however, are higher than the banking sector's averages.

I.3. Banking operations

I.3.1. The dynamics and structure of borrowed funds

The resource base of credit institutions continued to expand during the year under review and its growth was accompanied by structural changes in banking sector liabilities *(see Chart 1.7)*. However, the rates of resource growth slowed down largely due to the “crisis of confidence” that led to the stagnation of the interbank market in the summer of 2004, the run on some banks and the reduction of demand for bank securities *(see Annex IV.1)*.

Growth in banking sector liabilities was largely due to the funds attracted from the enterprise and household sectors.

The funds attracted from the enterprise sector last year were the principal source of the expansion of the resource base of credit institutions, accounting for 27.8% of aggregate banking sector liabilities as against 24.7% as of January 1, 2004. At the same time, these funds accounted for almost 40% of overall growth in banking sector liabilities. The funds attracted from the enterprise sector increased 43.4% during the year to 1,986.1 billion rubles *(see Chart 1.8)*. Faster growth in funds attracted from the corporate sector to some extent compensated the slowing of growth in household deposits and funds raised by issuing debt obligations.

Funds attracted from resident enterprises and organisations were the principal source of resources attracted from the enterprise sector. As of January 1, 2005, they accounted for 25.0% of banking sector liabilities as against 22.4% as of January 1, 2004. The funds attracted from resident enterprises and organisations increased by 527.0 billion rubles, or 41.9%, during 2004, ensuring about one-third of growth in banking sector liabilities, and aggregated 1,784.1 billion rubles as of January 1, 2005.

The balances in settlement and current accounts account for 64% of total funds attracted from the enterprise sector.

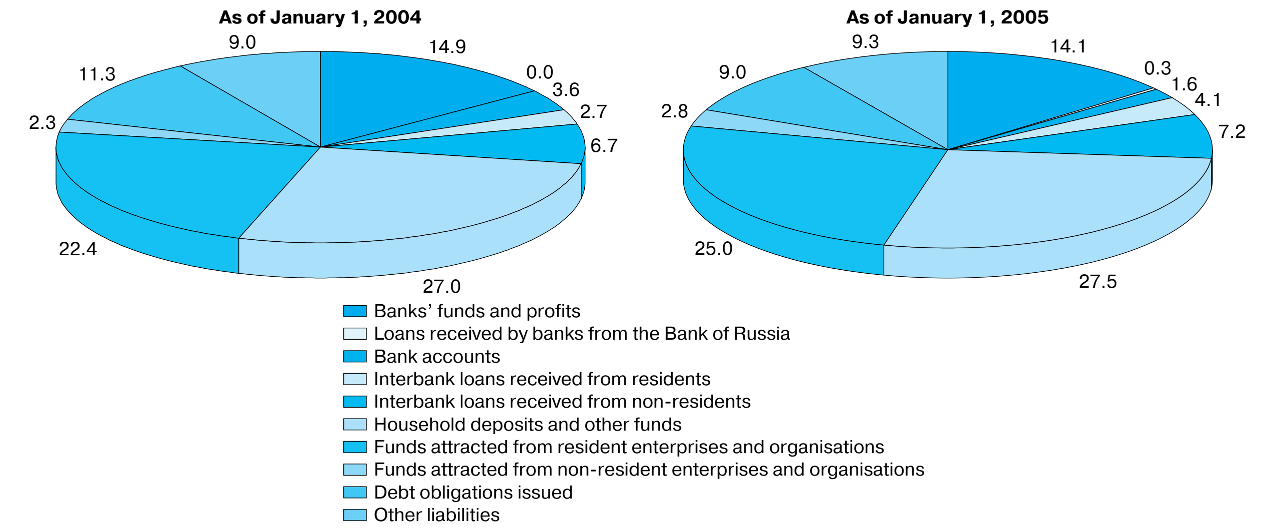
Corporate deposits grew 80.5% in 2004 as against 12.9% in 2003 and their share in aggregate banking sector liabilities expanded from 5.6% as of January 1, 2004, to 7.9% as of January 1, 2005.

Demand deposits and deposits with terms of up to 30 days increased 2.1 times and accounted for 12.2% of total corporate deposits. Deposits with terms from 31 days to 1 year rose 68.5% and deposits with terms longer than 1 year increased 93.1% (as of January 1, 2005, they accounted for 54.2% and 33.6% of total deposits respectively).

Household deposits were another major source of growth in banking sector resources. As of January 1, 2005, they accounted for 27.5% of banking sector liabilities as against 27.0% as of January 1, 2004. Household deposits accounted for 29.3% of growth in aggregate banking sector liabilities. They increased 29.7% and as of January 1, 2005, aggregated 1,964.0 billion rubles. It is clear that the rates of growth in household deposits were adversely impacted by last summer’s “confidence crisis.” They slowed down significantly from 47.1% in 2003 and from 51.9% in 2002. However, there are objec-

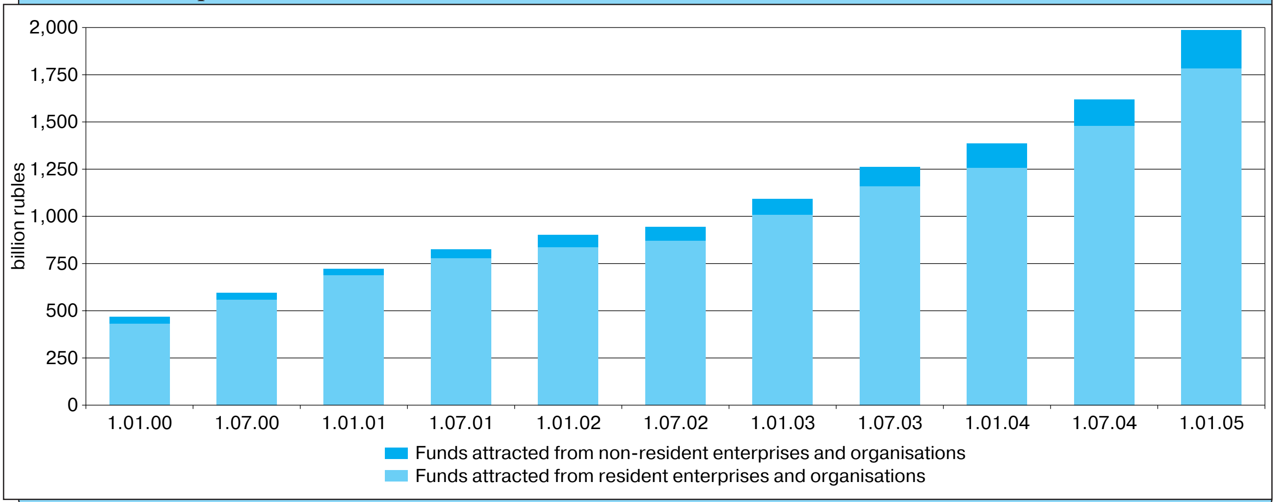
Structure of banking sector liabilities (%)

CHART 1.7



Dynamics of funds attracted from the corporate sector

CHART 1.8



tive reasons for the slowing of growth in household deposits in the future.

In 2004, as in 2003, household deposits in rubles grew faster than those in foreign currency, whereas the opposite trend was registered in 1999—2002 *(see Chart 1.9).* As a result, the ratio of the ruble-denominated bank deposits expanded from 69.4% to 73.6% in total household deposits in 2004. This trend was typical of Sberbank, which leads the ruble deposit market, and, to a far greater extent, other banks.

The ratio of household deposits with terms longer than 1 year expanded from 43.7% of total deposits as of January 1, 2004, to 57.6% as of January 1, 2005 and from 11.8% of total banking sector liabilities to 15.8% respectively.

Competition on the household deposit market continued to increase. Household deposits with banks excluding Sberbank grew 40.2%, whereas household deposits with Sberbank increased 23.6% as against 29.7% in the banking sector as a whole.

Sberbank's share of the household deposit market continued to contract in 2004, although Sberbank still dominates this market: as of January 1, 2005, it accounted for 60.3% of total household deposits as against 63.3% as of January 1, 2004 *(see Chart 1.10).*

The value of debt obligations issued by banks in 2004 increased slightly by 1.5%, standing at 644.2 billion rubles as of January 1, 2005. Such slow growth rates were largely due to the fall in demand for bank certificates of deposit. Last year also saw a drop in demand for promissory notes. In the second half of May and throughout June, demand sagged due to the turbulent state of the banking sector. Demand also lagged in August and September as a result of the decreased yield on operations with promissory notes.

As of January 1, 2005, the debt obligations issued by banks accounted for 9.0% of banking sector liabilities. The ratio of debt obligations with maturities over one year increased 18.4% and at the beginning of 2005 they accounted for 37.5% of total banking sector debt obligations as against 32.1% a year earlier.

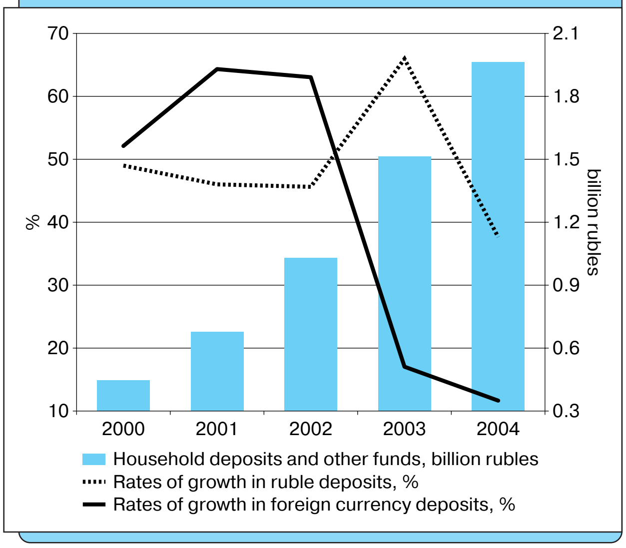
The ratio of promissory notes in banking sector debt obligations increased to 78.6% as of January 1, 2005, as against 73.4% as of January 1, 2004. The total value of promissory notes issued by banks rose 8.6% to 506.2 billion rubles, although in 2004 their ratio in banking sector liabilities fell to 7.1% as against 8.3% as of January 1, 2004.

The total value of bonds, certificates of deposit and savings certificates issued by banks declined by 18.5% to 1.9% of banking sector liabilities as of January 1, 2005, as against 2.9% as of January 1, 2004. Last year's fall in the value of certificates of deposit, which have always been an alternative to bank promissory notes (whenever banks exceeded the N13 required ratio, which placed a limit on promissory note issuing), was due to the coming into force of Bank of Russia Instruction No. 110-I, dated January 16, 2004 "On Banks' Required Ratios," which cancelled the N13 ratio.

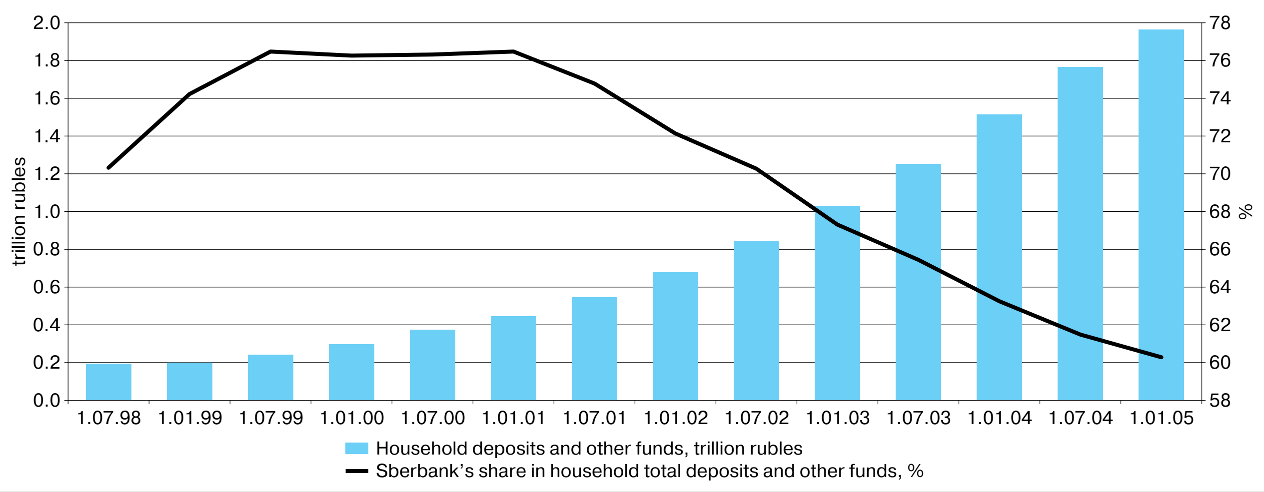
The value of obligations on loans, deposits and other funds from other banks increased 40.3% to 737.1 billion rubles in 2004 and the ratio of this source of funds in bank-

Household deposits and other funds

CHART 1.9



Dynamics of funds attracted from households — CHART 1.10



ing sector liabilities expanded from 9.4% as of January 1, 2004, to 10.3% as of January 1, 2005 *(see Chart 1.11)*. At the same time, there was a significant slowdown in fund-raising operations on the interbank market (from 66.5% in 2003 to 40.3% in 2004) due to the "confidence crisis," which led to stagnation of the interbank market early in the summer of last year.

Loans taken from resident banks grew at a particularly rapid rate in 2004 (49.8% as against 36.6% on loans taken on the international interbank market). However, loans taken from non-resident banks accounted for almost 70% of total interbank loans as of January 1, 2005. Foreign currency loans accounted for 98.1% of total loans taken on the international interbank market as against 94.0% as of January 1, 2004, whereas their balances increased 42.5% during 2004 as against 88.3% in 2003. Loans taken from non-resident banks in foreign currency accounted for 68.4% of total interbank loans as against 67.4% a year earlier. The ratio of foreign currency loans raised on the international interbank market with a maturity of over one year expanded from 53% as of January 1, 2004, to 58% as of January 1, 2005.

Medium- and long-term loans raised on international financial markets in 2004 grew against the background of positive assessments of the economic situation in Russia by leading ratings agencies. After Moody's gave Russia an investment grade rating in 2003, Fitch did the same in November 2004.

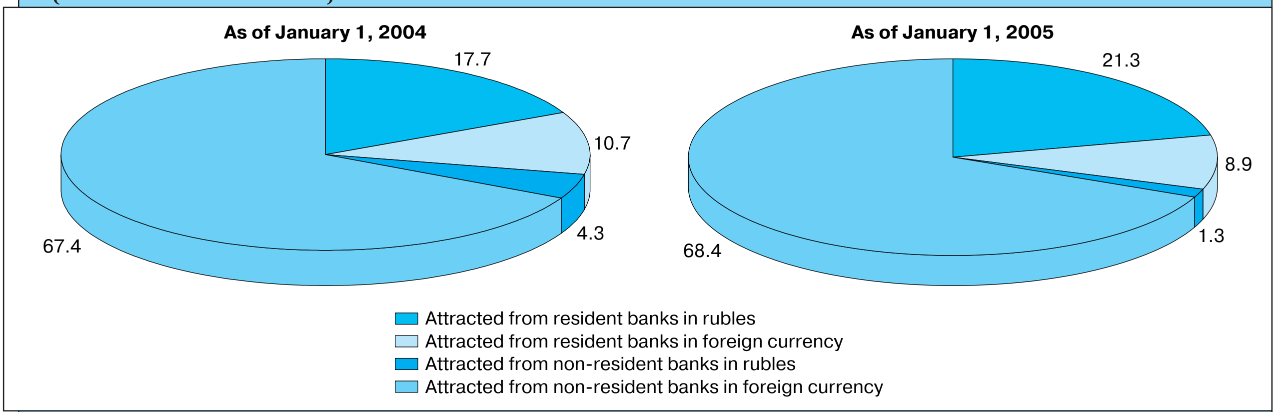
I.3.2. Asset dynamics and structure

In 2004, the Russian banking sector managed to preserve momentum and strengthen its positions as a financial intermediary. Banking sector assets increased 27.4% in 2004 to more than 7.1 trillion rubles. *Chart 1.12* illustrates the changes in the structure of banking sector assets.

The expansion of bank lending to the non-financial sector was the major factor of growth in banking sector assets in 2004 *(see Chart 1.13)*.

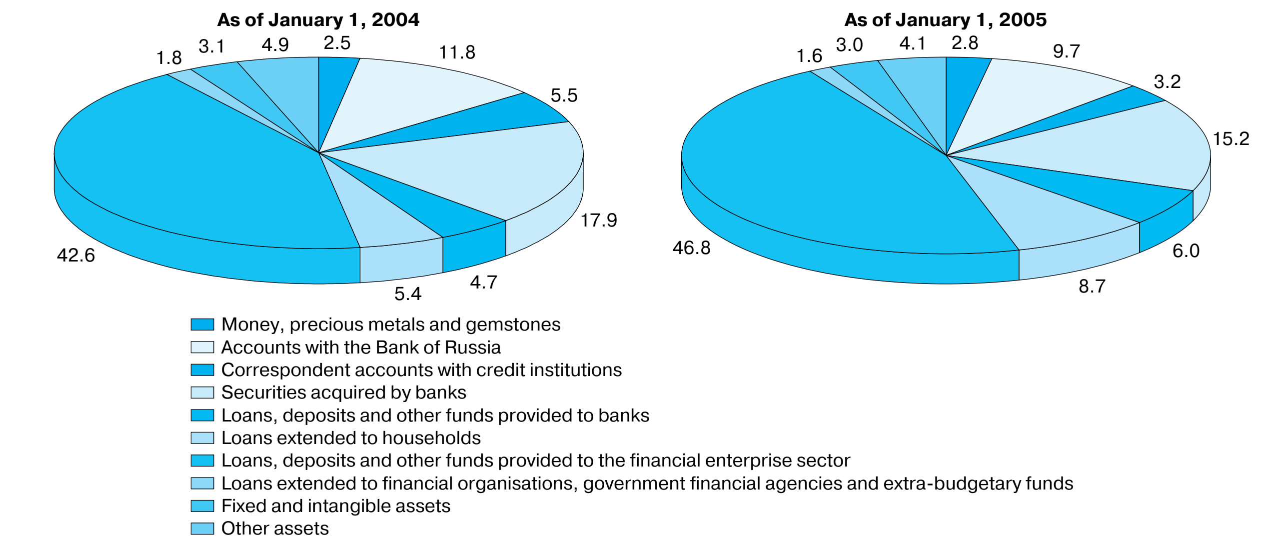
Loans extended by banks to the non-financial enterprise sector increased 39.0% in 2004 as against 42.4% in 2003 and aggregated 3,149.9 billion rubles as of January 1, 2005. However, the ratio of the loans in aggregate banking sector assets expanded from 40.5% to 44.1% *(see Chart 1.12)*. Last year, 70.1% of operating credit institutions expanded lending to the non-financial enterprise sector. Of the total value of loans to the non-

Loans, deposits and other funds raised on interbank markets (% share of total value) — CHART 1.11



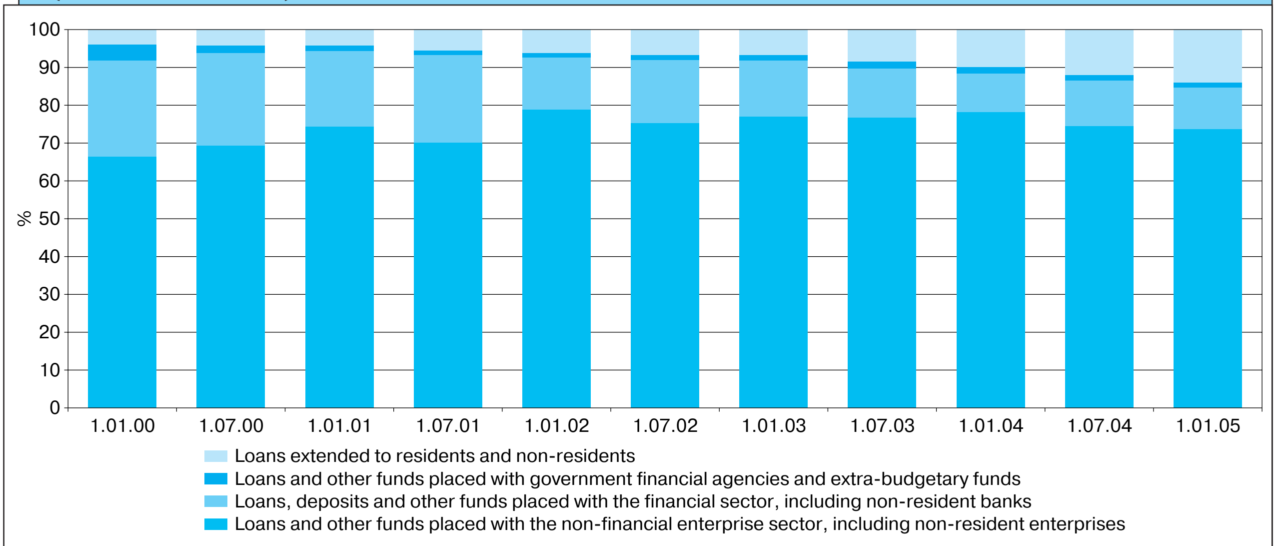
Banking sector asset structure (%)

CHART 1.12



Structure of banking sector lending operations (as % of total loans)

CHART 1.13



financial enterprise sector, 72.4% were extended in rubles and their value increased 50.3% during the year under review.

Loans with maturities over one 1 year increased 44.7% to 39.5% of total loans to the non-financial enterprise sector as against 37.9% as of the beginning of 2004.

The structure of credit investments[19] by sector has changed. Growth in debt on loans extended to the farm and construction sectors rose slightly faster in 2004 than in 2003 (65.5% as against 62.6% and 50.0% as against 49.2% respectively). Despite their significant decline, the rates of growth in credit to the transport and communications sector remained high (38.3% as against 62.8% in 2003) and lending to the trade and pubic catering sector increased 34.1% as against 40.5% in 2003. The debt on loans extended to industrial enterprises grew 23.6% (of this, the debt on loans to chemical industry enterprises rose 27.5% as against 41.6% in 2003 and those to light industry enterprises 32.1% as against 31.6%). The majority of loans were extended to industry, trade and public catering and other sectors. The debt on loans to enterprises in the industries accounted for respectively 33.5%, 22.4% and 29.7% of enterprises total debt as of January 1, 2005 as against 37.6%, 23.2% and 25.7% as of January 1, 2004. The ratio of debt on loans to the farm sector rose from 2.7% to 3.3%, construction sector from 5.0% to 5.4% and transport and communications remained at 5.7%.

The value of loans and other funds provided to non-resident corporate borrowers[20] was nearly unchanged in

[19] Sectoral data are based on bank statements (form 0409302 code).
[20] Excluding loans extended to non-resident banks.

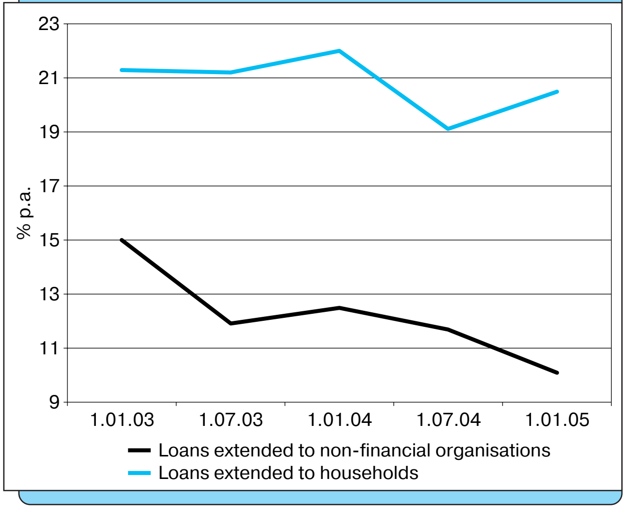
2004 at 118.8 billion rubles, of which 84.2% of funds were provided in foreign currency. Loans extended to non-resident corporate borrowers accounted for a lowly 1.7% of banking sector assets as of January 1, 2005.

The main factors that determined the favourable dynamics of lending to the non-financial sector in the previous years remained the same in 2004. One reason is the enterprise sector's persistently high demand for loans. Another is the growth in the supply of loans from banks due to the increase in the value of funds attracted by credit institutions for a specific term, including maturities over one year.

As the Bank of Russia repeatedly cut its refinancing rate in 2004 (from 16% to 13%) and reduced the reserves credit institutions are required to deposit with it[21], the price of resources attracted by banks decreased and this allowed banks to cut the cost of credit. As a result, bank loans became affordable for a broader range of borrowers. The average weighted interest rate on ruble loans extended to non-financial organisations for all maturities fell from 12.4% in January 2004 to 10.1% in December and the interest rate on loans with maturities from 1 year to 3 years declined from 15.3% to 10.8% respectively *(see Chart 1.14).*

Dynamics of average weighted interest rates on loans to non-financial organisations and households in 2003—2004 (% p.a.)

CHART 1.14



At the same time, the demand for loans has yet to be met in full. The largest Russian companies, whose shares are known as blue chips, actively raise funds on international financial markets by selling securities (eurobonds) issued by non-residents in the interest of specific Russian companies. There are several reasons why this mechanism is used: the Russian banking sector lacks the resources that are adequate in volume, maturity and cost to the needs of large companies and the cost of resources on international financial markets is lower. Another important factor is that corporate relations between Russian credit institutions are underdeveloped and this represents an obstacle to syndicated lending (only a handful of Russian banks can meet borrowers' demand for large-sum loans).

Lending to resident individuals continued to increase at rapid rates in 2004. As in 2003, the value of the loans rose by 2.1 times last year. The value of loans extended to Russian residents increased from 298.4 billion rubles as of January 1, 2004, to 616.5 billion rubles as of January 1, 2005, of which 535.8 billion rubles, or 87%, were provided as consumer credit. Banks extended most of the loans to households in rubles (85.2% of the total value of the loans). Loans to the household sector accounted for 8.6% of banking sector assets as of January 1, 2005, as against 5.3% as of January 1, 2004, and 13.8% of banking sector loans as against 9.8% respectively.

At the same time, rapid growth in lending to households makes these operations riskier: overdue debt on this kind of loans in the banking sector as a whole increased 2.5 times and accounted for 1.4% of their total value as of January 1, 2005, as against 1.1% as of January 1, 2004.

Further growth in consumer lending is hindered by the lack of necessary legal conditions, like an effective mortgage system and legal protection of consumers' interests and the high cost of credit, which does not correspond to the income level of the majority of the population. Another brake on consumer credit was the absence of credit bureaus[22], which help credit institutions reduce risks and cut costs.

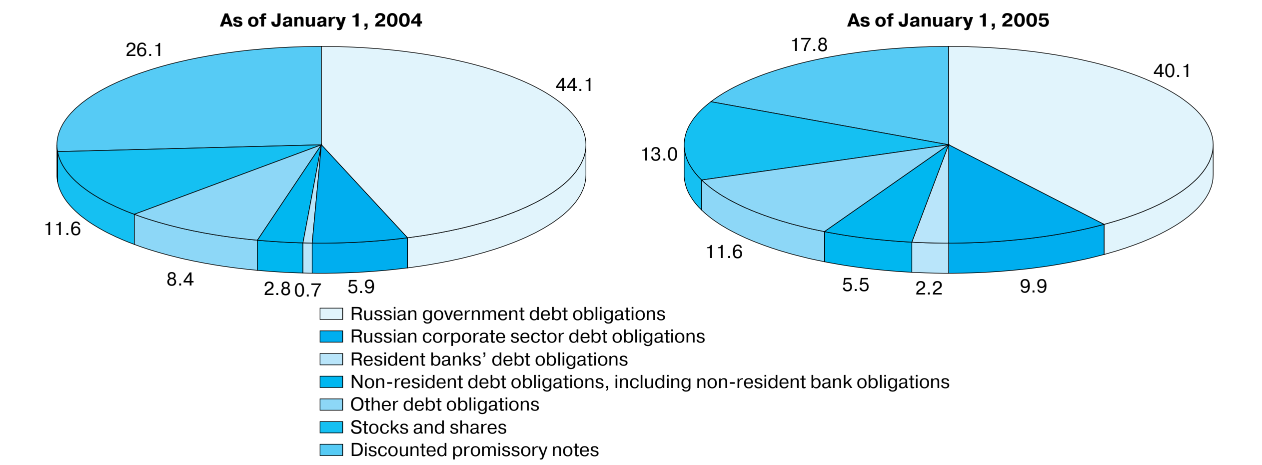
Banks' investments in securities increased 8.4% in 2004 and as of January 1, 2005, aggregated 1,086.9 billion rubles. As a result of more rapid growth in operations on the asset side, especially lending, the ratio of securities in banking sector assets contracted from 17.9% to 15.2%. The ratio of debt obligations in credit institutions' securities portfolios increased from 62.4% to 69.2% in 2004, while slightly contracting in banking sector assets from 11.2% to 10.5%. Russian government debt obligations predominate in the structure of bank investments in debt obligations (57.9% as of January 1, 2005, as against 71.5% as of January 1, 2004). The value of Russian government debt obligations fell by 2.6% in 2004 to 435.6 billion rubles and their ratio in banking sector assets dropped from 8.0% to 6.1% *(see Chart 1.15).* Banks scaled down their activity on the government securities market in 2004 after the policy pursued by the Finance Ministry had changed the bonded debt structure in favour of longer-term instruments (the share of the debt depreciation federal loan bonds, or OFZ-AD, expanded from 38.9% to 63.6% during the year, while the short-term GKO bonds were withdrawn from circulation). The low liquidity level of the government securities market and smaller returns the government securities offered as compared with other

[21] According to the decision of the Bank of Russia Board of Directors, since July 8, 2004, the required reserves for obligations to households were lowered from 7% to 3.5% and for other obligations of credit institutions in rubles and in foreign currency from 7% to 3.5%.

[22] Federal Law No. 218-FZ, dated December 30, 2004, "On Credit Histories," is to come into force on June 1, 2005.

Structure of investment in securities (including discounted promissory notes), %

CHART 1.15



investments made by credit institutions led to a contraction in investments in government bonds *(see I.1.3. Financial markets and non-bank financial institutions).*

Bank investments in resident corporate debt obligations increased 83% in 2004 to 108.0 billion rubles and they accounted for 1.5% of banking sector assets, up from 1.1% a year earlier.

Bank investments in stocks expanded 21.7% to 140.9 billion rubles in 2004, but their share in banking sector assets remained small at 2.0% as of January 1, 2005 (2.1% as of January 1, 2004). At the same time, bank investments in Russian non-financial enterprise sector's shares accounted for 68.0% of their total value, investments in non-resident bank shares accounted for 9.2% and investments in resident bank shares accounted for 4.0%.

Banks invest in stocks and shares not only to profit, but also to diversify their investments in order to increase returns. Specifically, they would buy shares of big issuers such as Unified Energy System or LUKoil to resell them on the secondary market.

Bank investments in promissory notes dropped significantly in 2004. As of January 1, 2005, they accounted for 2.7% of banking sector assets as against 4.7% as of January 1, 2004. The value of promissory notes discounted by banks in 2004 decreased 26.0% in 2004 to 193.4 billion rubles. Promissory notes issued by Russian enterprises account for 46.8% of the notes discounted by banks, notes issued by Russian banks account for 49.2% and promissory notes issued by non-residents, excluding banks, account for 3.2%. At the same time, investments in promissory notes issued by Russian enterprises declined significantly in 2004 (by 44%), mainly as a result of the fall in returns from these operations in the third quarter of last year. In that period, the average weighted interest rate on ruble-denominated discounted notes with maturities up to 30 days fell to 1.5% as against 11.6% in the second quarter and 15.1% in the fourth and there was also a drop, although not as sharp, in interest rates on promissory notes with maturities from 1 year to 3 years.

In the summer of 2004, the Russian interbank market was stagnant, but fully recovered in the fourth quarter. The value of claims on interbank loans, deposits and other placements increased 61.5% in the banking sector as a whole in 2004 and their share in banking sector assets expanded from 4.7% to 6.0%. The value of loans placed on the domestic interbank market rose 60.7% and their share in banking sector assets increased to 3.2% as of January 1, 2005, as against 2.6% as of the beginning of 2004. The value of loans placed with non-resident banks grew 62.4% and their share in banking sector assets expanded from 2.2% to 2.7%.

I.4. Financial performance of credit institutions

I.4.1. Financial results

The overall financial standing of credit institutions remained stable in 2004. Although growth in banking sector assets slowed down slightly, this had no negative effect on credit institutions' returns.

Banking sector profits continued to increase rapidly in 2004. During the year, they grew 38.6% as against 38.1% in 2003. As of January 1, 2005, operating credit institutions profited 177.9 billion rubles as against 128.4 billion rubles a year earlier *(see Chart 1.16),* while their profits, including the financial result of the past years, aggregated 199.4 billion rubles as against 114.7 billion rubles as of January 1, 2004. For the first time since the 1998 crisis, credit institutions' profits, including the financial result of the past years, exceeded current profit as credit institutions covered the losses they incurred as a result of the crisis.

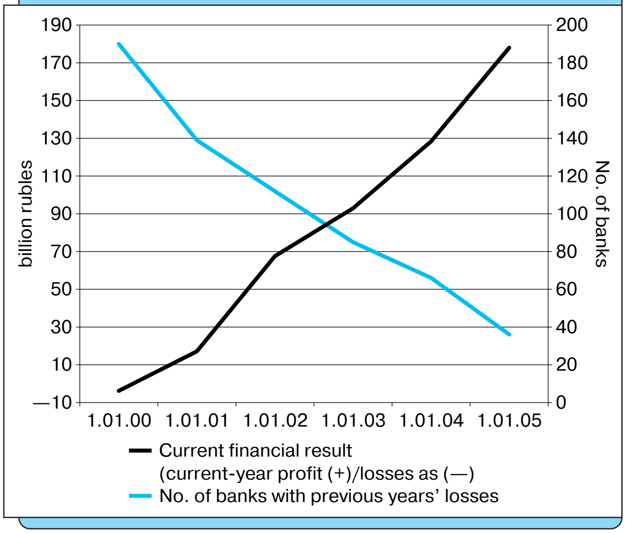
The ratio of profit-making credit institutions increased from 96.6% to 98.2% of the total number of credit institutions. The number of loss-incurring institutions fell from 41 to 22 over the year and their ratio shrank from 3.1% to 1.7% of the total operating credit institutions *(see Chart 1.17).* Credit institutions' losses decreased to 551.3 million rubles in 2004, while as of January 1, 2004, they amounted to 5.0 billion rubles.

Banking sector profitability has remained at a fairly high level during the past four years, while the return on capital in the banking sector continues to exceed the return on capital in the economy as a whole. The return on bank assets increased from 2.6% in 2003 to 2.9% in 2004, while the return on capital rose from 17.8% to 20.3%[23]. During the past year, 800 banks, or 62% of operating credit institutions, have increased their return on assets and capital. The selection of banks for participation in the deposit insurance system, which began in 2004 and in the course of which the Bank of Russia paid attention to their profitability indicators, provided an impetus for the improvement of the financial performance of banks.

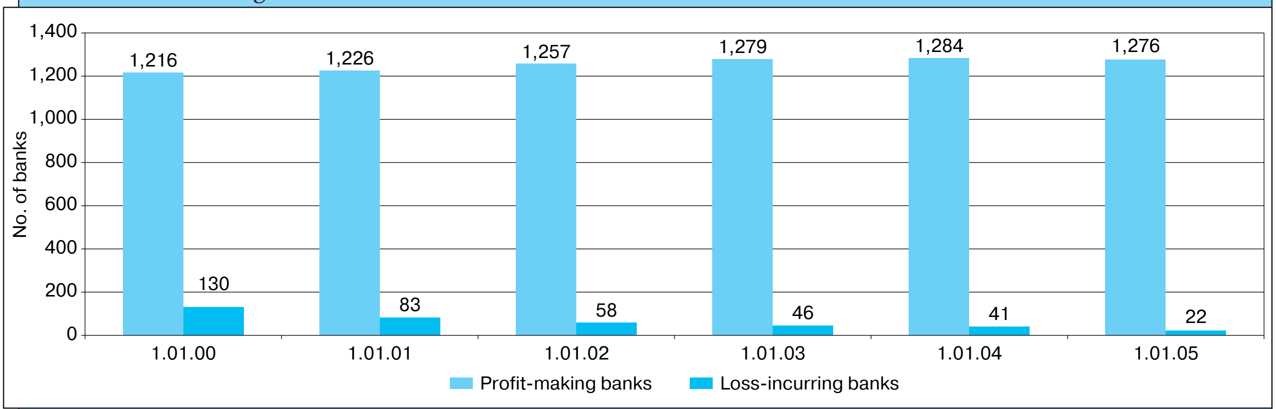
I.4.2. Income and expense structure

In 2004, as before, the structure of gross incomes of credit institutions was dominated by incomes from foreign exchange operations (37.3% as against 39.2% as of January 1, 2004) and incomes from the recovery of sums from fund and reserve accounts (34.0% as against

Banking sector financial result CHART 1.16



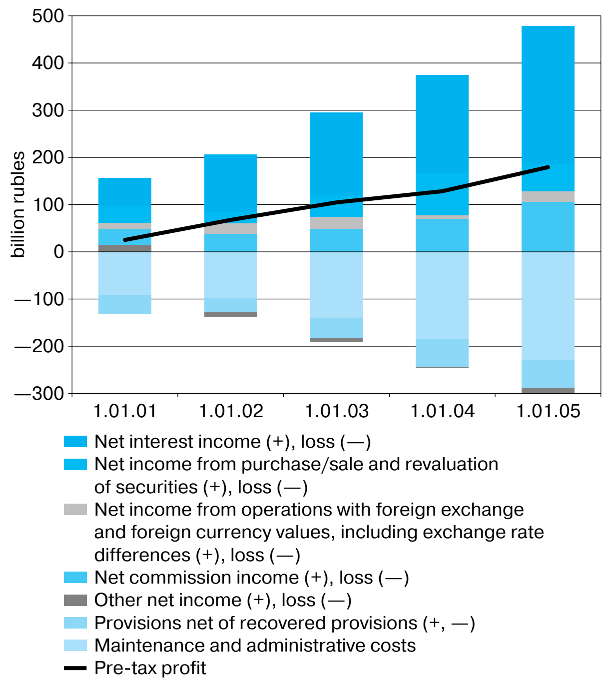
Dynamics of profit-making and loss-incurring banks CHART 1.17



[23] Return on assets is calculated as the ratio of the full-year financial result before tax to bank assets, while the return on capital is calculated as the ratio of the full-year financial result before tax to capital. Assets and capital have been calculated as annual (chronological) averages for the accounting period.

Structure of credit institutions' current financial result (gross net income and profit)

CHART 1.18



28.5%). At the end of 2004, interest incomes received accounted for 13.3% as against 12.8% at the end of 2003, while the share of incomes from operations with securities continued to decline (from 11.5% as of January 1, 2004, to 7.8% as of January 1, 2005).

Similar changes occurred in the structure of expenses in 2004. Expenses on foreign exchange operations and deductions to funds and reserves predominated, accounting for 38.7% and 37.7% respectively. The increase by 5.25 percentage points of expenses on the replenishment of funds and reserves in 2004 reduced the proportions of other expenses. The most significant decrease was registered in expenses on interest payments on borrowings (from 6.21% as of January 1, 2004, to 5.87% as of January 1, 2005) and expenses on operations with securities (from 7.14% to 5.39%). Administrative costs and expenses on penalties and fines remained relatively unchanged in 2004.

Banking sector net current income[24] aggregated 467 billion rubles in 2004, an increase of 25.6% year on year. The net income structure was largely determined by the further expansion of credit investments, the increased attractiveness of foreign exchange operations and the reduction of the yield on securities market instruments *(see Chart 1.18).* Net interest income makes up the largest part of banks' net current income and in 2004 it increased to 62.3% of net income as against 55.6% in 2003.

The dollar's rally against the ruble in the spring and summer of 2004 and the expansion of import volumes stimulated growth in credit institutions' operations with foreign exchange and foreign currency values and income from these operations increased accordingly. As a result, the ratio of banks' net income from operations with foreign exchange and foreign currency values, including exchange rate differences, rose during the year from 1.8% to 4.9%.

Net commission income continued to grow in 2004 and its ratio expanded from 19.0% of net income as of January 1, 2004, to 22.6% as of January 1, 2005.

At the same time, there was a sharp fall in net income from the sale and purchase of securities and their revaluation in 2004. This was largely due to the reduction of bank investments in Russian government debt obligations. Income from securities trading was also affected by the significant decline in securities prices in the second quarter of 2004 and the corresponding negative revaluation of Russian stock prices after a long period of their growth. As a result, the ratio of net income from operations with securities, which rose to 34.6% as of April 1, 2004, fell to 16.0% as of July 1, 2004, and eventually decreased to 12.5% as of January 1, 2005.

Credit institutions' maintenance and administrative costs accounted for 49.2% of net current income in 2004 as against 49.8% in 2003. During the year, they grew 24.1% as against 32.2% in 2003.

Bank reserves were nearly unchanged in 2004 and aggregated 58.1 billion rubles as against 58.3 billion rubles in 2003. The size and structure of loan loss provisions were largely affected by the reclassification of bank loans, the cancellation of standard loan provisions and the possibility of making minimum deductions to reserves on other quality categories of loans due to the introduction of the new loan classification and provisioning procedure on August 1, 2004[25]. The reduction of the ratio between reserves and net income from 15.7% to 12.4% made it possible to raise the ratio of pre-tax profit to 38.4% as against 34.5% at the end of 2003.

The analysis of credit institutions' key financial soundness indicators in 2004 testifies to the overall stability of the Russian banking sector. During the year, the number of credit institutions without any shortcomings (Group 1) increased from 297 to 352, while the number of credit institutions with few shortcomings (Group 2) decreased from 982 to 904. As a result, financially sound credit institutions (Group 1 and Group 2 banks) accounted for 96.7% of all banks. The ratio of problem banks (Group 3 and Group 4) decreased to 3.2% during the year as against 3.5% as of January 1, 2004.

Financially sound credit institutions continued to account for the largest possible proportion (99.3%) of aggregate banking sector assets in 2004. Almost all funds raised by the banking sector were placed with financially sound banks.

[24] Net income is the financial result prior to the creation (recovery) of reserves net of maintenance and administrative expenses. Calculated in accordance with the Profit and Loss Account of Credit Institutions (form 0409102 code).

[25] Before August 1, 2004, loan loss reserves were calculated for four credit risk groups and a fixed percentage of deductions was set for each group (Bank of Russia Instruction No. 62a, dated June 30, 1997, "On the Procedure for Making and Using Loan Loss Provisions"). After August 1, 2004, calculations have been made for five loan categories. Provisions have been cancelled for (the highest) Category I loans and minimum and maximum provisions have been established for Category II, III and IV loans, depending on the collateral of Category I and II quality (Bank of Russia Regulation No. 254-P, dated March 26, 2004, "On the Procedure for Making by Credit Institutions Loan Loss Provisions and Provisions for Loan Debts and Similar Debts").

II

Banking sector risks

II.1. Credit risk

II.1.1. Banking sector loan portfolio quality

Overdue debt on loans rose 28.9% in 2004 and as of January 1, 2005, aggregated 61.9 billion rubles. At the same time, its ratio of total debt on loans contracted from 1.6% to 1.4%.

Overdue debt accounted for 1.5% of loans to the non-financial enterprise sector as of January 1, 2005, as against 1.6% a year earlier. Overdue debt on ruble loans was down to 1.6% from 1.7%, whereas overdue debt on foreign currency loans expanded from 1.3% to 1.4%. As in the previous years, the highest overdue debt ratio on ruble loans was registered in agriculture (2.9%) and on foreign currency loans in the construction sector (6.5% in 2004 as against 0.3% in 2003) *(see Chart 2.1)*. On the whole, overdue debt ratios differ little by sector, even taking into account the currency of credit.

During 2004, the number of credit institutions with an overdue debt of less than 2% of their loan portfolio declined from 609 as of January 1, 2004, to 605 as of January 1, 2005, and such banks accounted for 78.0% of banking sector assets as against 81.5% a year earlier.

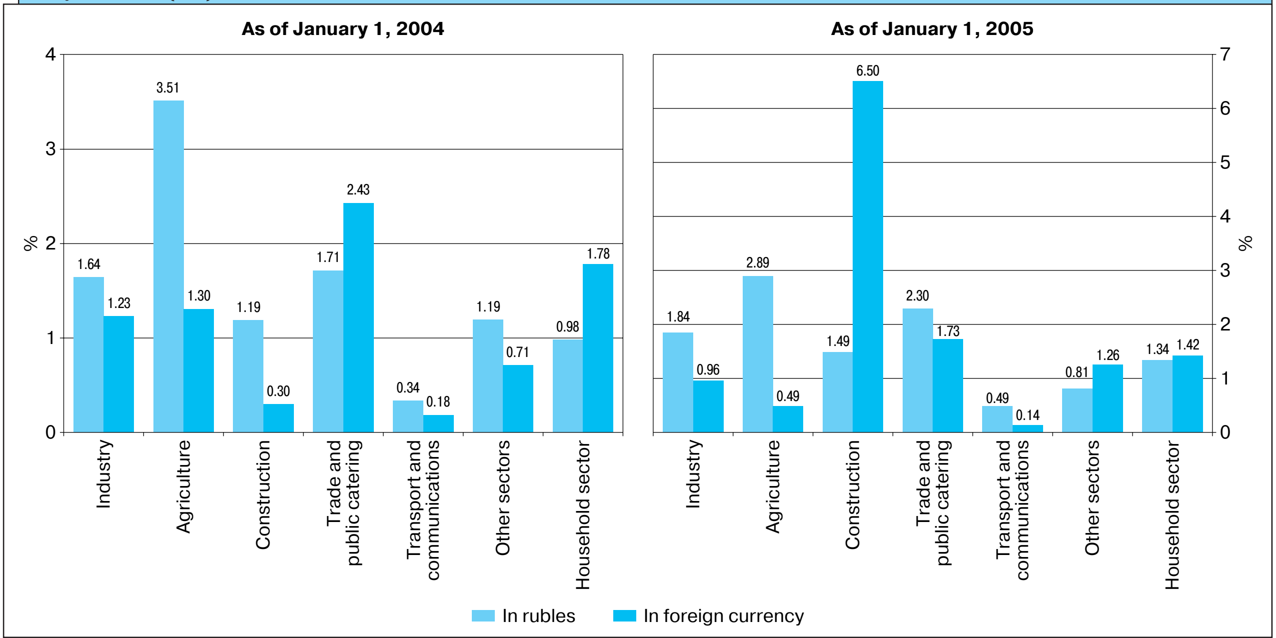
On the other hand, the number of credit institutions with an overdue debt of more than 10% of their loan portfolios fell from 69 to 38 and as of January 1, 2005, such banks accounted for 0.2% of banking sector assets.

Standard loans accounted for 46.9% of the total loan debt as of January 1, 2005, and non-performing (problem and bad) loans amounted to 3.8%. This means that the banking sector has a medium-level credit risk and it is much too low to provoke a bad debt crisis[26] (for the record[27]: as of September 1, 2004, 43.3% and 3.1% respectively) *(see Chart 2.2)*. The number of credit institutions with more than 50% of standard loans in their loan portfolios stood at 460 in 2004 and they accounted for 55.8% of aggregate banking sector assets.

II.1.2. Credit risk concentration

As in the previous year, only one credit institution violated the large loan risk ratio[28] in 2004.

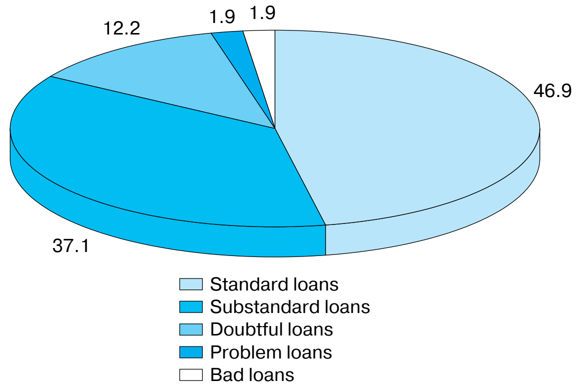
Overdue debt in total loan debt by sector (%) *CHART 2.1*



[26] According to international banking supervision standards, non-performing loans accounting for more than 10% of the loan portfolio signify a high credit risk.
[27] Comparisons are only possible beginning from September 1, 2004, due to the enforcement of Bank of Russia Regulation No. 254-P, dated March 26, 2004, “On the Procedure for Making by Credit Institutions Loan Loss Provisions and Provisions for Loan Debts and Similar Debts,” which changed the methodology of determining the quality of loans. In reports prior to September 1, 2004, loans were classified in accordance with Bank of Russia Instruction No. 62a, dated June 30, 1997, “On the Procedure for Making and Using Loan Loss Provisions.”
[28] Under Article 65 of the Federal Law on the Central Bank of the Russian Federation (Bank of Russia), a large loan risk is the sum of loans, guarantees and sureties issued to one customer exceeding 5% of the equity capital of a bank.

Banking sector loan portfolio quality as of January 1, 2005 (%)

CHART 2.2



The value of large loan claims (credit risks) in the banking sector as a whole increased from 1,964.4 billion rubles to 2,298.2 billion rubles, or 17.0%, in 2004. This means that it grew considerably more slowly than overall loan debt. As a result, large loans accounted for 32.2% of banking sector assets as of January 1, 2005, as against 35.1% a year ago.

The number of credit institutions that violated the N6 ratio (maximum risk per borrower or group of related borrowers) fell from 24 to 23 and they accounted for 5.9% of aggregate banking sector assets as against 6.7% a year earlier.

II.1.3. Credit risks on operations with shareholders and insiders

As of January 1, 2005, the N9.1 ratio (the maximum amount of loans, bank guarantees and sureties provided by a credit institution or banking group to its members or shareholders) was calculated by 500 credit institutions as against 504 as of January 1, 2004. At the same time, none of the credit institutions was found guilty of violating this ratio as of the end of 2004, whereas as of the beginning of 2004 three credit institutions were.

The N10.1 ratio, which sets a limit on total loans extended by a credit institution to insiders and guarantees and sureties issued to them, was calculated by 932 credit institutions as of January 1, 2005, as against 879 credit institutions as of January 1, 2004. As of the end of 2004, two banks failed to comply with this ratio (they accounted for a negligent part of assets of the banks that calculate this ratio), whereas as of the beginning of 2004 only one credit institution was found guilty of violating this ratio.

II.1.4. Loan loss provision

Throughout 2004, credit institutions demonstrated high loan loss provision (LLP) levels. On nearly all accounting dates the actual LLP level of the overwhelming majority of banks matched the required minimum[29]. As of January 1, 2005, the number of banks with LLP of at least 100% of the imputed reserve adjusted for the collateral factor stood at 1,203 against 1,238 as of January 1, 2004, and accounted for 95.4% of banking sector assets as against 93.6% a year earlier.

The total LLP created as of January 1, 2005, covered 5.3% of the actual loan debt. At the same time, it covered 68% of non-performing (problem and bad) loans.

II.1.5. Financial soundness of borrowers

The quality of banks' loan portfolios is immediately dependent upon the financial standing of borrowing enterprises. The Bank of Russia's enterprise-monitoring results have shown that the financial condition of borrowing enterprises was satisfactory in 2004 and better than in 2003. However, it is mostly the industrial enterprises that have improved their financial standing. Transport and construction companies were in poor financial condition. Communications, trade and public catering enterprises faced serious financial problems.

The actual level of the self-financing of enterprises[30], which is a measure of enterprises' equity capital, dropped slightly in 2004 and by the end of the period under review it stood at 67.2%.

The debt load on enterprises' equity capital[31] was moderate at 0.49, but it rose slightly in 2004. However, the debt load on industrial and communications enterprises was moderate, whereas the already heavy debt load on construction and transport enterprises further increased and by the end of the period it had surpassed their equity capital by 1.6 times and 2.4 times respectively. In the meantime, the debt load on the equity capital of trade and public catering enterprises, which had declined slightly, registered 2.9.

The raising of mostly long-term resources, including bank loans, allowed enterprises to use their own funds not only for expanding investment assets, but also financing current activities. The value of enterprises' own working assets increased 43.7% in 2004 and as a result, the ratio of working assets created from their own funds grew from 41.4% to 48.2% (in 2003 it expanded from 35.1% to 40.2%).

The state of enterprises' settlements deteriorated slightly in 2004. As short-term payables and receivables grew, the short-term net receivables position[32] of enterprises, which reflects the deflection of funds from production, increased. At the same time, the ratio of overdue receivables remained high at 15.8%.

Enterprises' earnings from the sale of goods, work and services in 2004 increased 42.0% year on year. At the same time, enterprises' net inflow of money account-

[29] Beginning from reports as of September 1, 2004, the minimum loan loss reserve has been determined by adjusting the imputed reserve for the collateral factor in compliance with Bank of Russia Regulation No. 254-P, dated March 26, 2004, "On the Procedure for Making by Credit Institutions Loan Loss Provisions and Provisions for Loan Debts and Similar Debts."
[30] The ratio of net assets in enterprises' balance sheet total.
[31] The ratio of total debt obligations to equity capital of enterprises.
[32] The excess of receivables over payables of enterprises.

ed for 1.5% of their earnings and this led to the 58.3% expansion of the money stock.

The coverage of enterprises' current (short-term) obligations improved on the whole. The cash coverage of obligations rose to 13.6% by the end of the period. It was the highest (15.3%) in industry and lowest (2.4%) in trade and public catering.

The coverage of enterprises' current (short-term) obligations with working assets increased from 159.3% to 181.1% in 2004. At the same time, it deteriorated in the communications and construction sectors where at the end of the period it stood at 60.6% and 96.7% respectively. Despite growth, the coverage of short-term obligations of transport enterprises also remained inadequate at 83.5%.

The financial result of the activities of enterprises in all sectors was pre-tax profit, which in 2004 increased 50.1% year on year.

The enterprise sector return on assets rose to 11.5% in 2004 as against 9.1% in 2003 and the enterprise sector return on equity capital increased to 17.0% as against 13.7%.

Overall, the analysis of the borrowing enterprises' financial soundness indicators in 2004 did not reveal any factors that might lead to a significant deterioration in the quality of banks' loan portfolios.

II.2. Market risk

II.2.1. General characteristics of market risk

The number of credit institutions calculating market risk decreased from 824 to 790 in 2004 and they accounted for 90.2% of banking sector assets as against 93.1% in 2003.

Banking sector market risk increased 15% in the period under review and as of January 1, 2005, it stood at 262.3 billion rubles. Its ratio to the capital of the market risk-calculating banks also rose (from 30.7% to 31.7%). However, the ratio of market risks to aggregate banking sector risks is still small and as of January 1, 2005, it stood at 5% *(see Chart 2.3).*

The structure of market risk changed dramatically in 2004. In January—November 2004, stock market risk accounted for the largest part of market risk, whereas in December the situation changed and as of January 1, 2005, interest risk prevailed for the first time in aggregate market risks (during 2004, its ratio increased from 32.3% to 41.8%). The ratio of stock market risk dropped from 40.3% to 39.8% and currency risk from 27.4% to 18.3%.

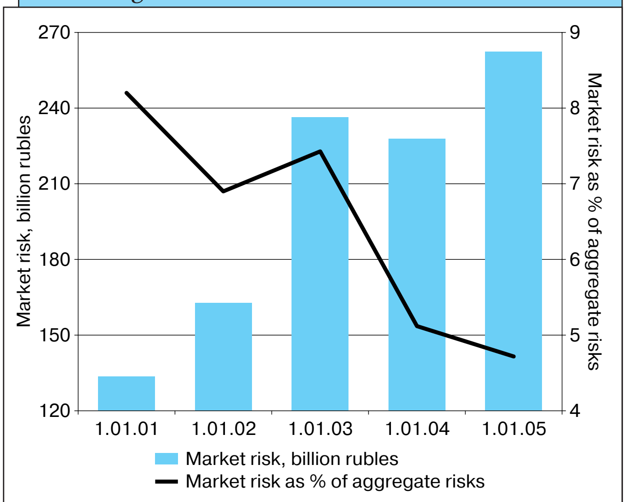
One of the factors of growth in interest risk in December was the contraction of trade investments in Russian government debt obligations (by 21.7 billion rubles, or 7.4%, in December) and the continued expansion of investment in resident corporate debt obligations (by 6.1 billion rubles, or 10.8% in December).

There was an expansion of the ratio of currency risk in March—July 2004, which on August 1, reached a year-high of 32.1% due to growth in the aggregate value of the open currency positions caused by the dollar's rally in that period *(see I.1.3. Financial markets and non-bank financial institutions).*

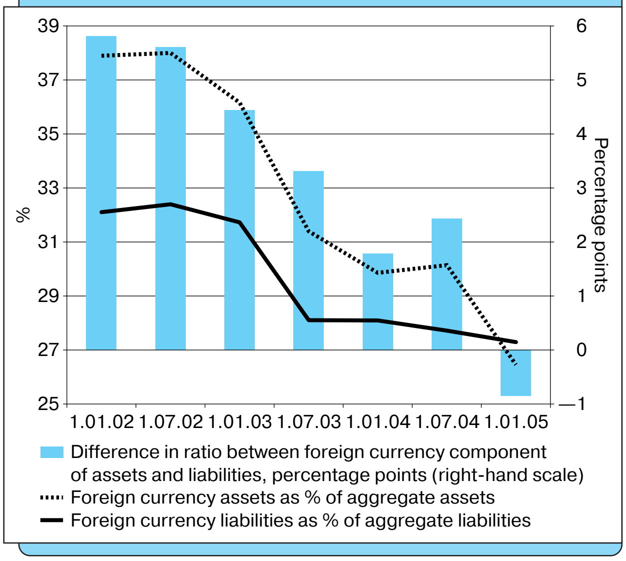
As of January 1, 2005, currency risk was taken into account when calculating capital adequacy by 716 banks, which accounted for 85% of banking sector assets (775 banks accounting for 87% of banking sector assets as of January 1, 2004). In comparison, as of January 1, 2005, stock market risk was included in the calculation by 118 banks accounting for 27% of banking sector assets and interest risk was included in the calculation by 214 banks accounting for 32% of banking sector assets. The number of banks that play an important role in all segments of the financial market and, consequently, must include all the three kinds of market risk in the calculation is relatively small (72 as against 70 as of January 1, 2004) and as of January 1, 2005, they accounted for 22% of banking sector assets as against 20% as of January 1, 2004.

The foreign currency component of credit institutions' assets and liabilities continued to contract in 2004 *(see Chart 2.4).* As of January 1, 2005, foreign currency assets accounted for 26.5% of total assets as against 29.9% a year earlier and foreign currency liabilities accounted for 27.3% of total liabilities as against 28.1%. As a result, the difference between the ratios of the foreign currency assets and liabilities became negative (—0.8 percentage points) as the yield on the ruble-denominated instruments grew due to the rise in the ruble's exchange rate in 2004.

Market risk as a percentage of aggregate banking sector risks CHART 2.3



Foreign currency assets and liabilities as a percentage of aggregate banking sector assets and liabilities CHART 2.4



At the same time, credit institutions have improved compliance with the size of the open currency position (OCP). Eighteen credit institutions on average violated the limits set on the OCP quarterly in 2004 as against 24 in 2003. As of January 1, 2005, the banks that failed to comply with the OCP limits accounted for 6.6% of banking sector assets as against 8.6% as of January 1, 2004.

Credit institutions continued to expand their operations on forward markets in 2004. The value of claims and obligations for the delivery of money, precious metals and securities in forward transactions increased 1.8 times in 2004 to 800.4 billion rubles and 784.9 billion rubles respectively. The ratio of such claims to banking sector capital expanded from 55.0% to 84.6% during 2004 and obligations from 52.6% to 82.9%.

The range of participants on the derivatives market has widened. Fourteen new organisations, including eight banks, have become settlement firms participating in clearing operations. Among them are major financial market participants like Vneshtorgbank and Brunswick UBS, one of the leading investment banks operating on the Russian securities market. Dresdner Bank has announced the beginning of its accreditation on the Russian forward market. According to official exchange data, the ratio of banks participating on the forward exchange market in 2004 remained stable at 29% in the FORTS system and 68% on the St Petersburg Currency Exchange as against 25% and 67% in 2003 respectively. The banks participating on the forward exchange market in 2004 accounted for no more than 4% of the total number of banks.

In 2004, the value of off-balance sheet foreign currency claims and obligations rose 43.4% and 29.4% respectively. The ratio between off-balance sheet and balance sheet operations conducted by banks in foreign currency also increased. At the beginning of 2004, the ratio between off-balance sheet claims and balance sheet assets stood at 37%, whereas by January 1, 2005, it rose to 48%. Similar dynamics were registered in the ratio between off-balance sheet obligations and balance sheet liabilities in foreign currency, which increased from 38% to 40% in the period under review.

II.2.2. Evaluation of banking sector vulnerability to currency risk

To evaluate the Russian banking sector's vulnerability to currency risk, the Bank of Russia conducted stress testing amid the ruble's rally. The initial event in the stressed situation was a sudden 30% rise in the ruble nominal exchange rate against the dollar. To determine the effect of currency risk on the financial state of the Russian banking sector, the Bank of Russia analysed data on credit institutions required to calculate the level of currency risk[33], which had net long open positions on the dollar. The number of such credit institutions stood at 326 as of January 1, 2005, as against 400 as of May 1, 2004[34], and they accounted for 48.5% of aggregate banking sector assets and 41.4% of banking sector capital (as against 63.7% and 57.3% respectively as of May 1, 2004)[35].

The analysis has shown that by the end of 2004, the long open positions on the dollar of the reviewed group of credit institutions decreased 1.9 times as of May 1, 2004, to $378.6 million, and their share in the long open positions on all currencies and precious metals[36] stood at 68.1% on average as of January 1, 2005, as against 69.6% as of May 1, 2004.

The stress testing has shown that a 30% ruble's gain as of January 1, 2005, will not lead to a significant loss of capital. The overwhelming majority of banks will lose no more than 3% of their capital.

By and large, the banking sector's vulnerability to a sharp rise in the ruble is declining and it is currently low. If the said scenario is realised, as of January 1, 2005, the reviewed group of banks may lose 1.1% of their capital as against 1.5% as of May 1, 2004.

II.2.3. Evaluation of banking sector vulnerability to interest risk (trade portfolio)

To assess the banking sector vulnerability to interest risk on the trade portfolio, the Bank of Russia stress tested banks to determine the effect of growth in interest rates on the financial state of the banking sector. It was assumed that as a result of growth in the required yield on corporate debt obligations, their value would fall by 30%[37].

To evaluate the effect of the interest risk of the trade portfolio on the Russian banking sector, the Bank of Russia analysed data reported by credit institutions with resident enterprises' listed debt instruments in their trade portfolios. For the purposes of this analysis, these credit institutions were divided into two groups: banks required to calculate interest risk and, consequently, include market risk in the capital adequacy ratio and banks that did not calculate interest risk[38].

[33] Currency risk is included in market risk calculation when as of the accounting date, the percentage ratio of the total value of the open currency positions to equity capital equals or exceeds 2%.
[34] Due to the extension of the list of credit institutions required to submit reports in form 0409634, comparisons are only possible from reports as of May 1, 2004. Before this date, credit institutions presented the form on a selective basis and this was done mostly by head offices.
[35] There were no form 0409634 reports on 22 banks with open dollar positions as of January 1, 2005, and on 46 banks as of May 1, 2004.
[36] In ruble terms.
[37] The devaluation of investments in government securities was not assessed because Sberbank and the Russian Government's Pension Fund, which buy government bonds as a long-term investment, remain the principal GKO—OFZ market participants.
[38] In accordance with Bank of Russia Regulation No. 89-P, dated September 24, 1999, "On the Procedure for Calculating Market Risks by Credit Institutions," interest and stock market risks are calculated when the total balance sheet value of the trade portfolio

The number of credit institutions in the first group rose by a third to 120 as of January 1, 2005, as against 90 as of January 1, 2004. They accounted for 64% of banking sector investments in resident corporate debt obligations. This group of credit institutions accounted for 27.5% of banking sector assets and 26.6% of banking sector capital (as against 25.6% and 25.2% respectively as of January 1, 2004).

The number of credit institutions in the second group decreased and as of January 1, 2005, it stood at 76 as against 89 year on year. These banks accounted for the remaining part of banking sector investments in resident corporate debt obligations (36%) and their share of banking sector assets stood at 46.0% as of January 1, 2005, and of capital at 35.9% (as against 46.5% and 37.7% respectively as of January 1, 2004).

The stress testing of the credit institutions required to calculate interest risk has shown that their vulnerability to interest risk increased in 2004. As of the beginning of the year, their pontential losses might have accounted for 4.8% of capital (12.0 billion rubles) as against 3.6% (7.4 billion rubles) a year earlier.

Credit institutions that have trade investments in resident enterprises' listed debt instruments, but do not calculate interest risk also became more vulnerable to interest risk in 2004. If the negative scenario is realised, their losses would account for 2.0% of capital (6.8 billion rubles) as of the beginning of the year as against 1.3% (3.9 billion rubles) as of the beginning of last year.

Consequently, in 2004 the banking sector became more vulnerable to interest risk due to expanded trade portfolios of credit institutions. If the considered scenario is realised, some banks may sustain heavy losses.

II.2.4. Evaluation of banking sector vulnerability to stock market risk

To determine the financial stability of the Russian banking sector to stock market risk by stress testing, the Bank of Russia evaluated the possible negative consequences of a fall in the RTS index. The RTS index's fall by 30%[39] is considered the initial event in the stressed situation.

To determine the effect of stock market risk on the capitalisation of the Russian banking sector, the Bank of Russia analysed data reported by credit institutions with investments in listed stocks in their trade portfolios. As in the analysis of interest risk, credit institutions were broken down into two groups. The first comprised banks required to calculate stock market risk and, consequently, include stock market risk in the calculation of the capital adequacy ratio. The second comprised credit institutions that did not calculate stock market risk.

The number of credit institutions in the first group rose to 111 as of January 1, 2005, as against 94 as of January 1, 2004. They accounted for 68.7% of banking sector trade investments in listed stocks. This group of credit institutions accounted for 24.9% of banking sector assets and 24.7% of banking sector capital as of January 1, 2005 (as against 22.9% and 22.4% respectively as of January 1, 2004).

The number of credit institutions in the second group stood at 156 as of January 1, 2005, as against 160 as of January 1, 2004. These banks accounted for the remaining part of the banking sector's trade investments in listed stocks (31.3% as of January 1, 2005) and their share of banking sector assets stood at 47.8% as of January 1, 2005, and of capital at 39.2% (as against 49.9% and 42.1% respectively as of January 1, 2004).

The stress testing of credit institutions calculating stock market risk has shown that the RTS index's fall by 30% will not lead to significant losses. As of January 1, 2005, they may account for 3.8% of capital (8.9 billion rubles) as against 5.2% (9.5 billion rubles) as of the beginning of last year.

The susceptibility to stock market risk of credit institutions that have trade investments in listed stocks, but do not calculate stock market risk increased slightly in 2004. If the negative scenario is realised, their losses would account for 1.1% of capital (4.0 billion rubles) as of the beginning of the year as against 0.7% (2.5 billion rubles) as of the beginning of last year.

The stress testing shows that the banking sector's vulnerability to stock market risk, evaluated as a sharp fall in the RTS index, is relatively low.

equals or exceeds 5% of the value of a credit institution's balance sheet assets as of the accounting date. The total balance sheet value of the trade portfolio is calculated as the sum of the balance sheet values of the financial instruments that have market value and acquired by a credit institution for subsequent resale, including repo-type instruments.

[39] It was assumed that the RTS index's fall by 30% would cause a similar reduction in the value of trade portfolios.

II.3. Liquidity risk

The most liquid banking sector assets (cash, precious metals and gemstones, the balances in nostro correspondent accounts and balances in correspondent and deposit accounts with the Bank of Russia) increased 18.4% in 2004 and as of January 1, 2005, they aggregated 978.8 billion rubles, or 13.8% of the total banking sector assets as against 14.9% as of January 1, 2004) *(see Chart 2.5).*

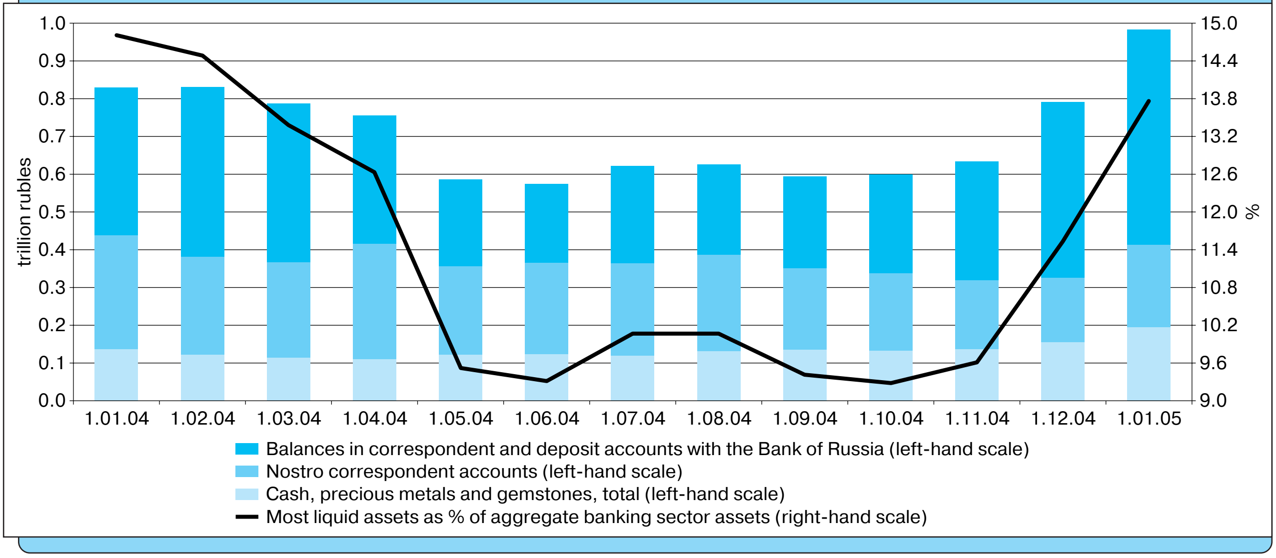
At the same time, the value of cash, precious metals and gemstones remained virtually unchanged in absolute and relative terms in 2004 and as of January 1, 2005, it accounted for 2.8% of aggregate banking sector assets.

The value of nostro correspondent accounts decreased by 1.4 times in 2004. The balances in nostro correspondent accounts with resident banks fell by 1.6 times and in non-resident banks by 1.3 times.

The balances in credit institutions' correspondent and deposit accounts with the Bank of Russia declined in the summer of 2004, but by the end of the year the situation had stabilised and these balances accounted

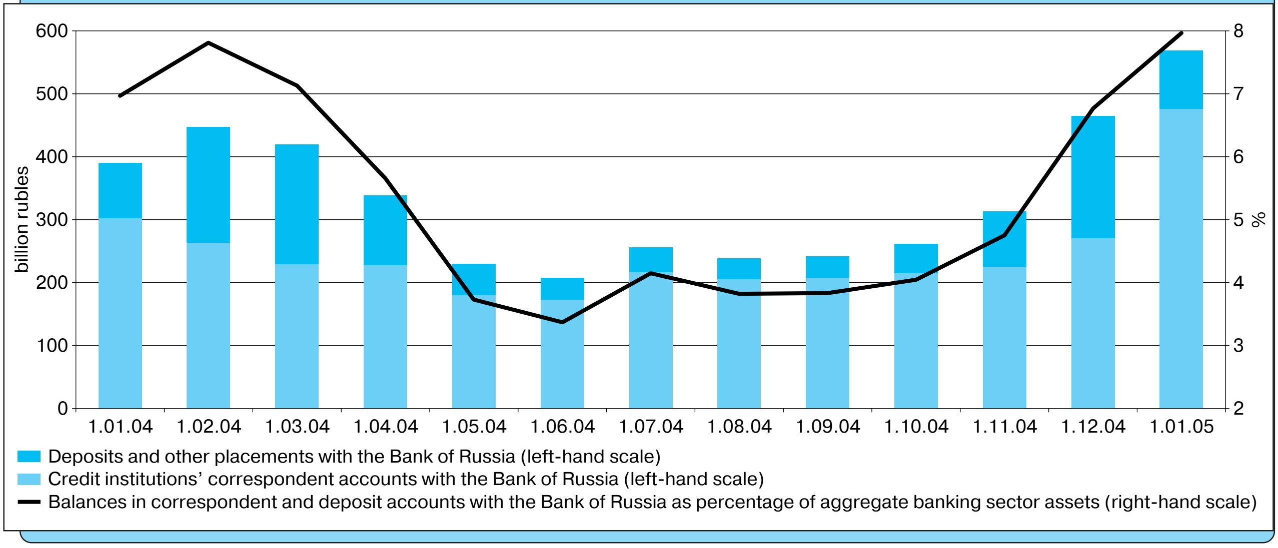
Dynamics of most liquid assets

CHART 2.5



Dynamics of balances in correspondent and deposit accounts with the Bank of Russia

CHART 2.6



for 8.0% of aggregate banking sector assets, an increase of 1 percentage point on the beginning of the year *(see Chart 2.6)*.

II.3.1. Structure of bank assets and liabilities by maturity[40]

Throughout 2004, the value of loans[41] with maturities over one year continued to rise faster (by 53.8%) than total loan debt (by 44.5%). (In 2003, funds provided for terms longer than one year increased 74.4%, while total loan debt grew 49.6%). As a result, the ratio of the medium- and long-term (longer than one year) components of the loan portfolio continued to grow and as of January 1, 2005, it stood at 43.4% of total loan debt as against 40.8% as of January 1, 2004. In the meantime, the ratio of the short-term debt on loans, including loans with a maturity of up to 30 days, decreased from 14.6% as of January 1, 2004, to 7.8% as of January 1, 2005 *(see Chart 2.7)*.

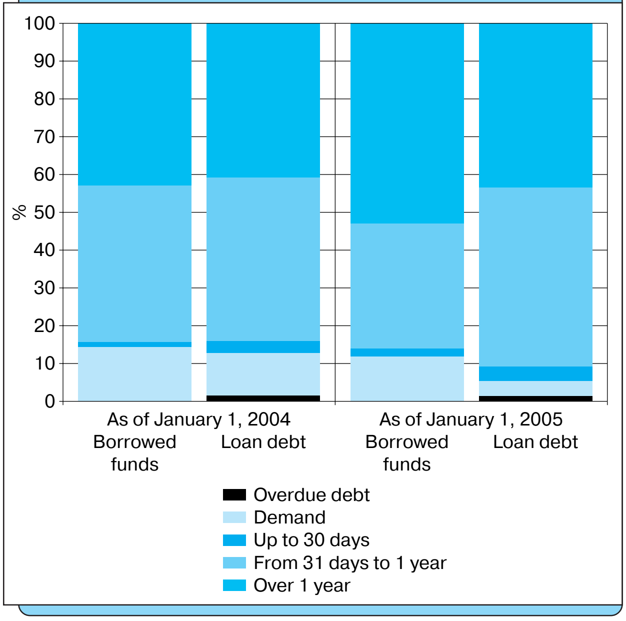
Similar changes were registered in the structure of deposits[42] taken by credit institutions. In 2004, funds attracted for terms longer than one year grew faster than total deposits (71.2% as against 38.4%). Funds attracted for terms longer than one year accounted for 53.0% of total deposits as of January 1, 2005, as against 42.8% as of January 1, 2004. At the same time, the ratio of deposits with a maturity of up to 30 days contracted from 15.8% as of January 1, 2004, to 14.1% as of January 1, 2005.

Customer deposits to loans (cover ratio)[43]

The analysis of the cover ratio (CR) during the last two years reveals the constantly widening gap between customer loans, except interbank loans, and deposits. The ratio of loans financed from other sources, including funds raised on the interbank market and the balances in corporate customer current and settlement accounts, which are mostly short-term, is expanding. As of January 1, 2005, customer deposits covered 64.9% of loans, which represents a decrease by 3 percentage points from January 1, 2004 *(see Chart 2.8)*.

This testifies to the existence of the potential risk of some credit institutions that have problems fulfilling their obligations in the event of unfavourable developments on financial markets.

Structure of loan debt and borrowed funds by maturity *CHART 2.7*



As of January 1, 2005, 443 credit institutions had cover ratios half the size of the banking sector average and they accounted for 17.4% of aggregate banking sector assets. At the same time, 74 credit institutions had no corporate and/or household deposits in their resources, but these credit institutions accounted for a negligent 0.8% of aggregate banking sector assets.

The use of short-term liabilities as a source of medium- and long-term loans[44]

The rate of using short-term liabilities as a source for extending medium- and long-term loans remained virtually unchanged in 2004 and stood at 29.5% as of January 1, 2005, as against 30.3% as of January 1, 2004.

II.3.2. Fulfilment of obligations

The total value of credit institutions' unfulfilled obligations to creditors and depositors decreased by almost 20 times in 2004 and as of January 1, 2005, it stood at

[40] Bank of Russia Ordinance No. 1376-U, dated January 16, 2004, "On the List, Forms and Procedure for Compiling and Presenting Reporting Forms by Credit Institutions to the Central Bank of the Russian Federation," came into force on April 1, 2004, introducing the new version of reporting form No. 0409125 "Information on Assets and Liabilities by Call and Payment Term," which made it impossible to compare data for 2004 and 2005 compiled in this form.

Therefore, the analysis of bank assets and liabilities by maturity was done on the basis of data on the distribution by call and payment term of assets and liabilities accounted for in balance sheet accounts.

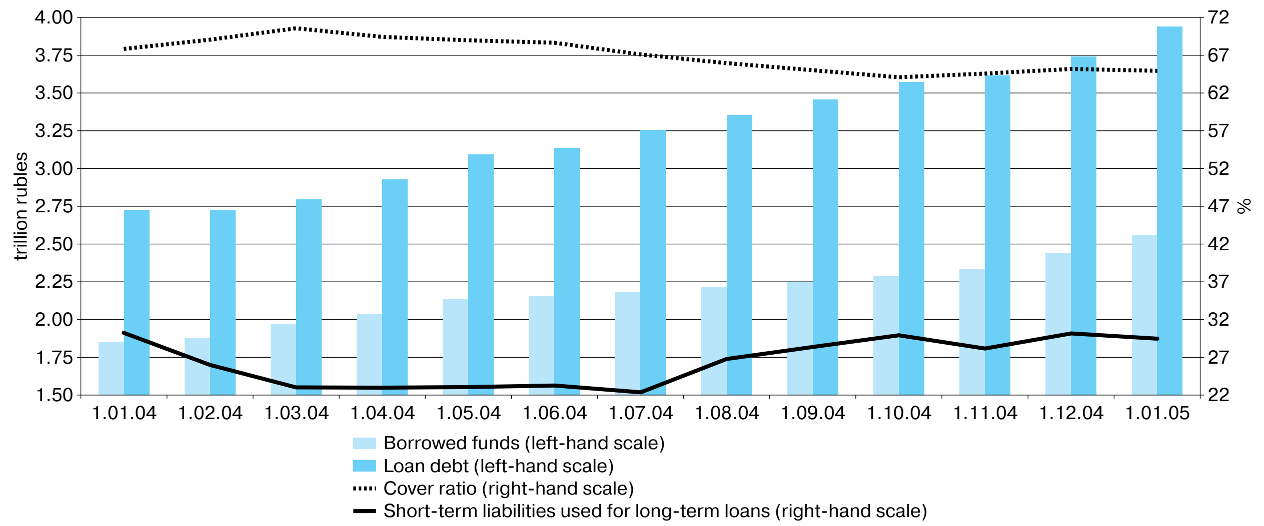
[41] Loan debt includes loans extended by credit institutions to legal entities and households, except resident banks and financial organisations, and other funds provided to these categories of debtors, both resident and non-resident.

[42] Deposits include deposits taken by credit institutions from legal entities and households, except resident banks and financial organisations, and other funds attracted from these categories of resident and non-resident creditors, except the balances in current and settlement accounts of these categories of customers.

[43] Calculation of this indicator is recommended by the IMF ("Customer deposits to total [non-interbank] loans") for the analysis of financial stability in the "Compilation Guide on Financial Soundness Indicators." This indicator allows one to evaluate banking sector liquidity, as it compares the most "traditional" and stable resources with the principal directions of their investment. The reduction of the cover ratio is indicative of the growing dependence of the ability of credit institutions to fulfil the obligations they assumed on their capability to quickly access the money or stock market and, consequently, the increased risk of liquidity loss.

[44] Calculated as the ratio of the excess of medium- and long-term (longer than one year) loans over funds attracted for a similar term to short-term borrowings (up to one year). An increase in this ratio indicates that there is no balance in the structure of the loan portfolio and major resources.

Excess of loan debt over major sources of financing CHART 2.8



2.2 million rubles. At the same time, the number of credit institutions that failed to timely meet their obligations to individual creditors and depositors increased by 14 and as of January 1, 2005, stood at 21.

The growth tendency in the number of credit institutions that had difficulty fulfilling obligations to creditors and depositors emerged last summer *(see Annex IV.1)*.

However, the ratio of unfulfilled obligations and mandatory payments by credit institutions with unmet creditors' claims to their liabilities contracted from 0.4% as of January 1, 2004, to nought as of January 1, 2005.

II.3.3. Compliance with required liquidity ratios

There were few cases in 2004 when some credit institutions failed to comply with required liquidity ratios[45].

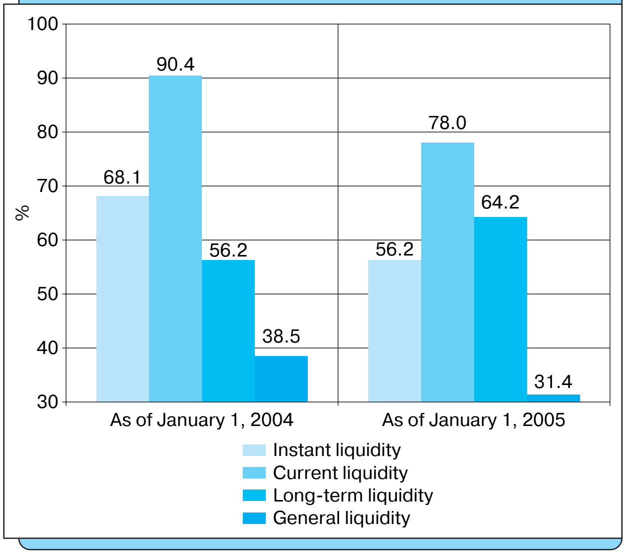
All the top 20 credit institutions in terms of assets complied with the instant (N2) and current (N3) liquidity requirements in 2004.

There was a slight rise in 2004 in the number of credit institutions that failed to comply with the instant liquidity ratio (eight credit institutions as of April 1, 2004, five as of July 1, 2004 and eleven as of October 1, 2004), the current liquidity ratio (five credit institutions as of April 1, 2004, eight as of July 1, 2004 and eight as of October 1, 2004), the long-term liquidity ratio (three credit institutions as of October 1, 2004) and the general liquidity ratio (eight credit institutions as of April 1, 2004, fourteen as of July 1, 2004 and eighteen as of October 1, 2004). Several factors were behind the increase:

— first, in accordance with the new, more conservative method of calculating the required ratios, credit institutions were required to comply with the required rations on a daily basis, whereas previously some of them conducted regulating operations that ensured them formal compliance with the required ratios as of the accounting dates;

— second, there was a slight contraction in credit institutions' liquidity in the spring and summer of 2004.

Banking sector liquidity indicators CHART 2.9



For the same reasons, there was a slight decline in the instant liquidity ratio (from 68.1% as of January 1, 2004, to 56.2% as of January 1, 2005), the current liquidity ratio (from 90.4% to 78.0%) and the general liquidity ratio (from 38.5% to 31.4%) in the banking sector average *(see Chart 2.9)*.

As banks expanded long-term lending in 2004, the banking sector average long-term liquidity ratio[46] in-

[45] Bank of Russia Instruction No. 110-I, dated January 16, 2004, "On the Required Ratios for Banks," which came into effect on April 1, 2004, set new criteria for acknowledging non-compliance with a required ratio. Since data reported as of May 1, 2004, "non-compliance with a required ratio" means the violation of its officially established numerical value for a total of six business days and more during any 30 consecutive business days.

[46] Bank of Russia Instruction No. 110-I, dated January 16, 2004, "On the Required Ratios for Banks," set this ratio at no more than 120%.

creased from 56.2% as of January 1, 2004, to 64.2% as of January 1, 2005. The analysis of the elements involved in the calculation of the long-term liquidity ratio shows that it has risen due to the low rates of growth in aggregate banking sector capital, which has expanded 3.3 times more slowly (16.2% in 2004) than long-term (over one year) lending operations (53.7%). This lagging was not compensated by growth (60.2% during 2004) in banking sector liabilities with maturities longer than one year, which have grown faster than long-term lending.

The growth tendency in the number of credit institutions that failed to comply with required liquidity ratio emerged last summer had reversed by the end of 2004. At the beginning of 2005, as at the begininnig of 2004, the number of credit institutions that failed to comply with required liquidity ratios was negligible.

Four credit institutions (one more than a year earlier) failed to comply with the N2 ratio as of January 1, 2005, four (two more than a year earlier) failed to comply with the N3 ratio and eleven (two more than a year earlier) failed to comply with the N5 ratio. All credit institutions complied with the N4 ratio as of January 1, 2005, whereas a year earlier one credit institution failed to do so. Credit institutions that failed to comply with the above ratios accounted for an extremely small part of aggregate banking sector assets (0.3% as regard the N2 ratio, 0.2% as regard the N3 ratio and 0.4% as regard the N5 ratio).

II.4. Equity capital adequacy

II.4.1. Banking sector capital dynamics and structure

As of January 1, 2005, Russia's operating credit institutions had an equity capital of 946.6 billion rubles. Capital growth rates slowed down significantly in 2004 and stood at 16.2% as against 40.2% in 2003. As a result, the ratio of banking sector capital to GDP declined from 6.2% in 2003 to 5.6% in 2004. The ratio between banking sector capital and assets also changed and stood at 13.3%, whereas in the previous three years it ranged from 14.0% to 14.6% *(see Chart 2.10)*.

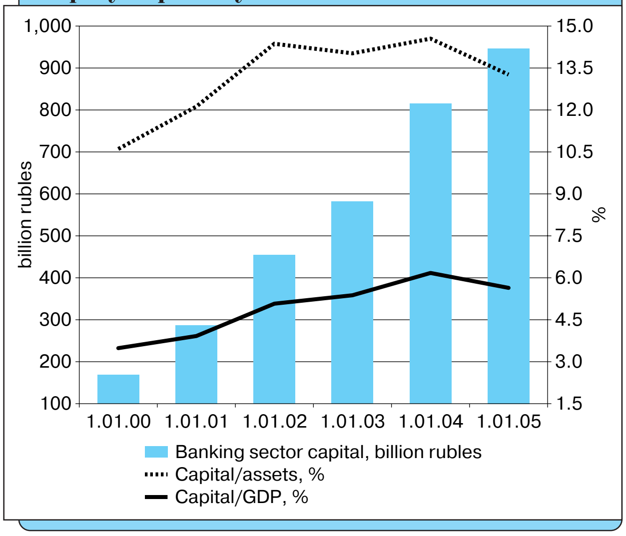
At the same time, banking sector capital formation in 2003 and 2004 was affected by a number of singular, uncharacteristic factors, such as the revocation of banking licence from the SBS-AGRO bank in January 2003, the capitalisation in August—November 2003 of the Rossiiski Kredit bank, which was managed by the state corporation Agency for Restructuring Credit Organisations (ARCO) and the change of the loan loss provisioning and accounting procedure in August 2004. The gap between capital growth rates would have been considerably smaller if these factors had not been taken into account[47].

The reduction of issue income from the sale of bank shares by 9.9 billion rubles, or 8.1%, and the slowing of growth in subordinated loans and the 2004 profits[48] included in the capital calculation were significant factors of the slowdown in capital growth.

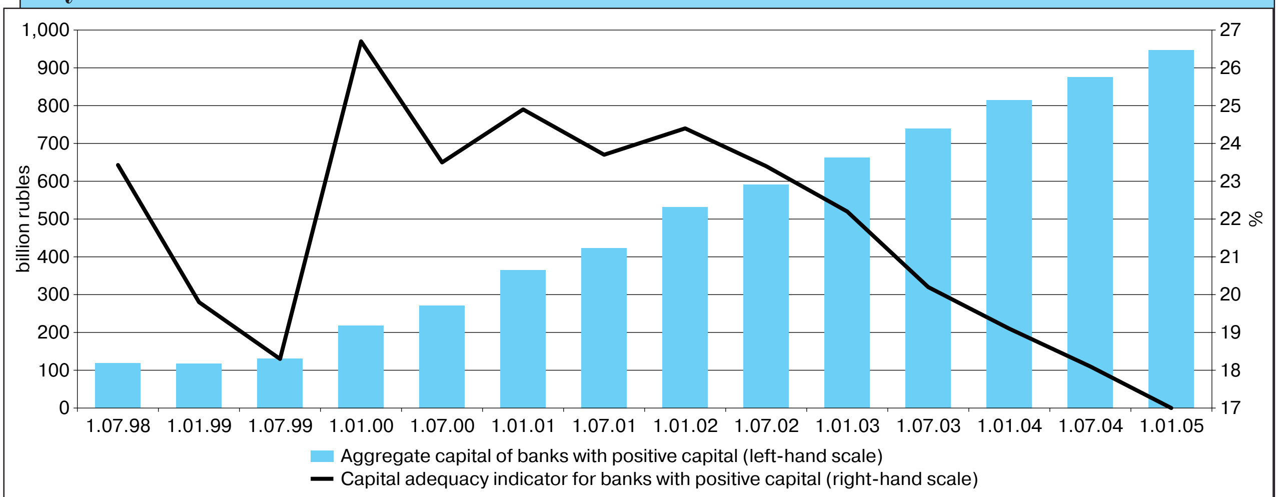
Growth in equity capital was registered by 1,044 banks, or 80.4% of operating credit institutions.

The increase in banking sector equity capital in 2004 was due to a growth by 86.0 billion rubles (65.4% of the total equity capital growth) in profits and funds created from profits and the expansion by 40.7 billion rubles, or 30.9%, of operating credit institutions' paid-up authorised capital included in the equity capital calculation. At the same time, the ratio of authorised capital to equity capital of credit institutions was constantly contracting: in 2004, it fell to 42.2% as against 44.1% in 2003 and 53.4% in 2002.

Banking sector equity capital dynamics *CHART 2.10*



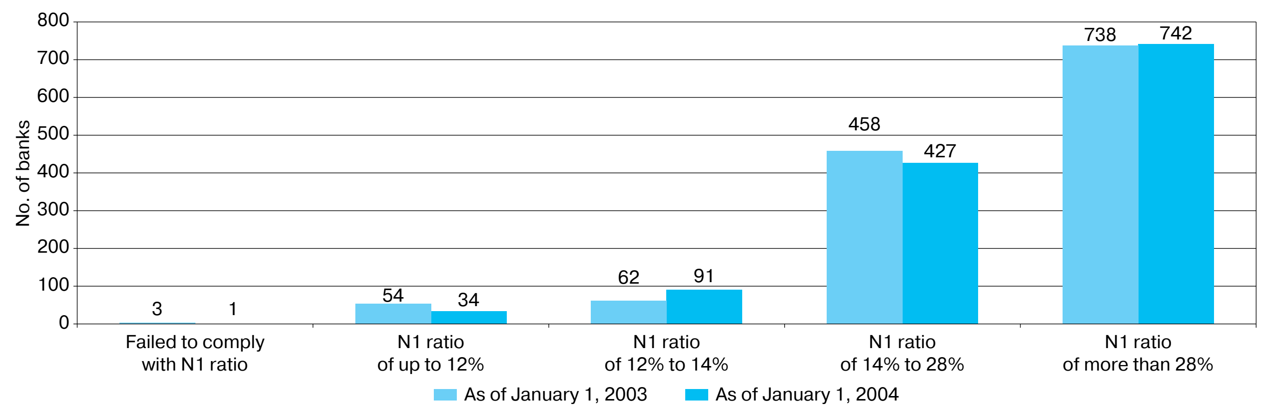
Capital adequacy indicator dynamics *CHART 2.11*



[47] According to Bank of Russia estimates, capital growth rates would have been 22.6% in 2003 without taking into account the SBS-AGRO and Rossiiski Kredit banks and 17.9% in 2004 (including loan reclassification on August 1, 2004).
[48] Current profits included in the capital calculation rose 69.3% in 2003 and 17.5% in 2004.

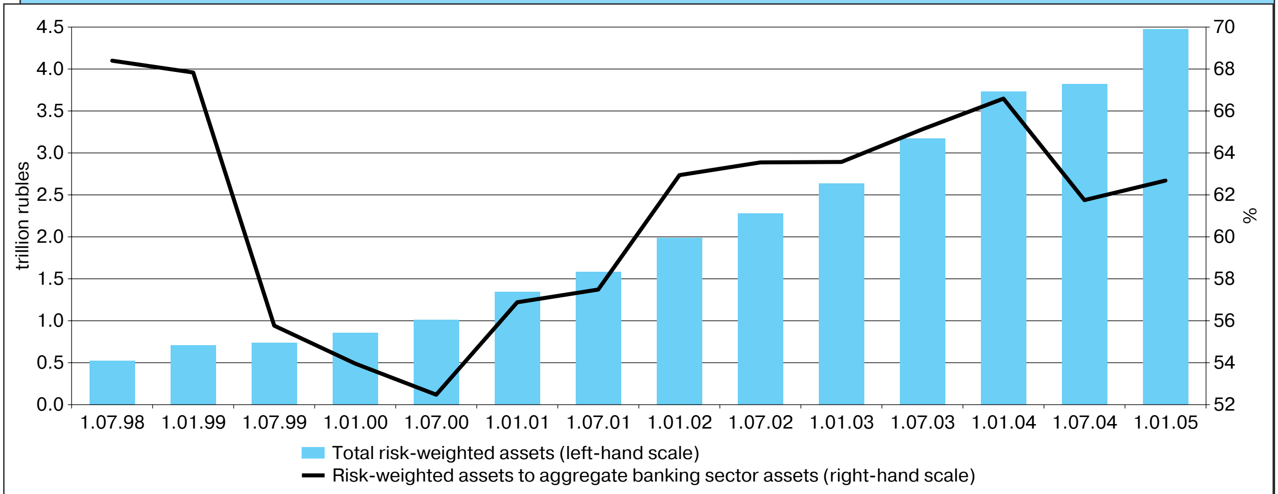
Banks grouped by N1 ratio

CHART 2.12



Dynamics of banking sector risk-weighted assets

CHART 2.13



Last year, 244 banks registered a decrease in their equity capital by the total amount of 7.2 billion rubles. These banks accounted for 9.5% of banking sector assets. There were no banks with a negative capital as of January 1, 2005, whereas there was one as of January 1, 2004, and two as of January 1, 2003.

II.4.2. Bank compliance with the capital adequacy requirement

The capital adequacy ratio decreased from 19.1% to 17.0% in 2004 as banks' risk-weighted assets grew faster than equity capital *(see Chart 2.11).* As of January 1, 2005, banks' risk-weighted assets increased 25.0% year on year, while banking sector equity capital expanded 16.2%[49] during the period. In comparison, the aggregate risk of credit institutions with positive capital rose 42.6% in 2003, while their equity capital increased 23.0%.

The change in the procedure for calculating this indicator[50], made on April 1, 2004, affected the capital adequacy ratio to some extent.

Only one bank failed to comply with the capital adequacy requirement (N1 ratio) as of January 1, 2005, whereas as of January 1, 2004, three banks failed to comply with this requirement[51].

[49] Before April 1, 2004, when calculating the capital adequacy indicator, one reduced aggregate risk by the amount of reserves created for the depreciation of securities and possible losses on Risk Group 2—4 loans. From May 1, 2004, credit risk on balance sheet assets has been calculated as the sum of assets net of the amount of the reserve for possible losses or reserve for loan losses or same-category debt on each risk-weighted asset.

[50] In accordance with Bank of Russia Instruction No. 110-I, dated January 16, 2004 "On Banks' Required Ratios," which replaced Bank of Russia Instruction No. 1, dated October 1, 1997, "On the Regulation of Banking Activities," from May 1, 2004, the amount of risk-weighted assets includes the amount of credit risk on balance sheet assets and the sum of the bank's claims to the counterparty with regard to the reverse (forward) part of the transactions, which arose as a result of the acquisition of financial assets and simultaneous assumption of obligations for their reverse alienation net of the imputed reserve and risk-weighted claims on persons affiliated with the bank; the amount of credit risk on forward transactions is reduced by the sum of the reserve created for forward transactions, while the amount of KRV credit risk is calculated as the amount of credit risk on contingent credit liabilities.

[51] Before April 1, 2004, non-compliance with the N1 ratio was registered as of the accounting date, after May 1, 2004, it was registered as non-compliance during a total of six business days or more within the 30 consecutive business days preceding the accounting date.

Among the banks that complied with the N1 ratio in 2004, banks with the capital adequacy ratio of more than 28% made up the largest group *(see Chart 2.12).* Banks with a capital adequacy ratio from 14% to 28% accounted for the largest part of banking sector assets (Sberbank excluded). The equity capital adequacy ratio of the top 20 banks in terms of assets stood at 13.0% as of January 1, 2005, as against 15.4% as of January 1, 2004.

II.4.3. Evaluation of risk-weighted assets

The ratio of credit risk-weighted assets[52] to aggregate banking sector assets contracted from 66.6% to 62.7% in 2004 *(see Chart 2.13).*

Risk Group 1—3 assets decreased 5.7%, while Risk Group 4 and 5 assets[53] increased 21.0% during the period under review. As a result, the ratio of the highest risk (Group 4 and 5) assets to aggregate risk-weighted banking sector assets expanded from 96.2% to 97.0%, while the ratio of Risk Group 5 assets stood at 92.7%.

Growth in risk-weighted assets was largely due to the increase (by 67.3%) in credit risk on balance sheet assets. As of January 1, 2005, credit risk on balance sheet assets accounted for 80.5% of total risk-weighted assets, credit risk on contingent credit liabilities 9.4%, market risk 4.7% and credit risk on forward deals 0.6%.

[52] Credit risk on balance sheet assets.
[53] Prior to April 1, 2004, Risk Groups are cited in accordance with Bank of Russia Instruction No. 1, dated October 1, 1997, “On the Procedure for Regulating Banking Activities,” and from May 1, 2004, in accordance with Bank of Russia Instruction No. 110, dated January 16, 2004, “On Banks’ Required Ratios.” Balance sheet assets are taken into account.

II.5. Bank management quality

In 2004, the ratio of loss-making credit institutions contracted from 2.9% to 1.7% of the total number of credit institutions, the lowest level in recent years. During the past year, banks reversed the negative tendency of 2001—2003 towards the reduction of the return on capital and this indicator rose from 17.8% at the beginning of the year to 20.3% at the end. Banks improved the quality of management and enhanced the effectiveness of the use of funds invested in them by members (shareholders).

The quality of bank management improved due to the reduction in 2004 of such indicators as the ratio of overdue debt on placements to total loans (from 1.6% at the beginning of the year to 1.4% at the end), the ratio of administrative costs to total expenses (from 4.81% to 4.47%) and the ratio of penalties and fines to total expenses (from 0.03% to 0.01%).

The work carried out by the Bank of Russia as the banking regulation and supervisory authority to select banks for the deposit insurance system had a favourable effect on the quality of bank management. The adoption and enforcement of the deposit insurance legislation compelled many banks to reconsider their strategies and market tactics. The owners and managers of many banks took a fresh view of governance, risk management and internal controls. As a result, banks improved their decision-making, disclosed and optimised hitherto opaque ownership structures, raised the quality of their loan portfolios and ensured compliance with economic and financial soundness requirements and the provisions of the legislation on countering the legalisation (laundering) of criminally obtained incomes and the financing of terrorism.

At the same time, serious bank management problems remained unresolved last year. Banks often failed to ensure a clear and effective separation of duties between their managerial structures and this frequently led to unjustified interference in bank affairs by affiliated persons. Boards of directors were too closely involved in the day-to-day management while paying litte attention to the strategies and objective analysis of the performance of their credit institutions and, at the same time, preventing their executive bodies from carrying out their duties and bearing the responsibility for the results of their work.

In addition, there were quite a few flaws in the structure of the boards of directors (supervisory boards) formed by banks. This applies to the number of board members and the participation of the so-called “independent directors” in them, that is, board members who do not represent bank owners or managers but have the necessary competence and ability to make objective judgements regardless of the views held by bank managers and owners.

There is room for improvement as far as the observance of professional ethics by banks is concerned. Some banks last year faced problems connected with unfair competition, formal approach to the implementation of the law against money laundering and terrorist financing and conflicts that arose as a result of the failure by banks to fully inform their customers about the actual price of the services they provide.

II.6. Stress testing the banking sector

To determine the extent of credit institutions' resistance to shocks in a crisis, the Bank of Russia stress tested the Russian banking sector. To evaluate the effect of risk on the capitalisation of the banking sector, it analysed data reported by the top 200 banks in terms of assets[54] (referred to below as the large Russian banks) in the period from January 1, 1998 to January 1, 2005[55].

In accordance with internationally accepted methods, capital losses of the large Russian banks were evaluated under the predetermined effect of three major kinds of risk — credit, market and liquidity — on the balance sheet of each bank. The initial event in the stressed situation is the slowing or complete cessation of economic growth, which may be provoked by a fall in oil prices. In this scenario, the ratio of bad debts would increase signficantly[56], banks' highly liquid assets would become devalued and the run on banks would aggravate the crisis. Eventually, the following negative changes would occur within the framework of the stress scenarios[57]:

- an expansion of the share of bad debts[58] in the loan portfolio of banks and the failure to pay off loans extended to enterprises in the real sector;
- a run on banks;
- a devaluation of banks' highly liquid assets, including the trade securities portfolio (notably, investments in listed stocks);
- losses of banks with a short currency position.

The quantitative characteristics of the above negative consequences are calculated for each bank on the basis of reported data as of January 1, 2005.

As a result of the calculations made, one can conclude that if the moderate scenario is realised, banks' aggregate capital losses would account for 1.4% of GDP and if the pessimistic scenario is realised, they would account for 2.7% of GDP (as against 1.3% and 2.2% a year earlier). Possible losses have also been calculated for a crisis on the real estate market, which may cause banks to lose additionally up to 11% of their capital.

The stress test has shown that in 2004 the banking sector was slightly more vulnerable to shocks than it was in 2003. One of the reasons for this was the expansion of the scale of the banking business, especially lending. Significant growth in the value of household sector deposits increases the liquidity risk, which in 2004 was contained by the establishment of the deposit insurance system. Judging by the results of stress testing, banks may incur considerable losses as a result of a crisis on the interbank loan market.

At the same time, despite growth in the banking sector's potential losses, the likelihood of a full-scale economic and banking crisis, caused by external economic factors, such as the change of the price situation on the energy market, is considered remote now that several factors that keep energy prices high have emerged in the world economy. Oil prices will hardly fall below $28 per barrel in the near future as demand remains high in Asia and the Pacific, especially China, and the leading oil-exporting countries have limited capability to rapidly increase oil production on a large scale.

A sharp fall in real estate prices, if it is limited in time and space, will hardly cause a systemic banking crisis. However, if the real estate crisis is a part of a general economic crisis, the financial standing of many banks will deteriorate significantly.

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[54] Excluding non-bank credit institutions.

[55] These top 200 banks account for 89% of aggregate banking sector assets.

[56] The ratio of bad debts would increase by the magnitude of their standard deviation, calculated for the period from July 1, 1998 to May 1, 1999.

[57] Two alternative scenarios are being considered at present, moderate and pessimistic, which differ in the extent of the negative change of the risk factors.

[58] For the purposes of the stress test, bad loans signify problem and loss loans in accordance with the classification established in Bank of Russia regulatory documents (Bank of Russia Regulation No. 254-P "On the Procedure for Making by Credit Institutions Loan Loss Provisions and Provisions for Loan Debts and Similar Debts"). Since this Regulation set new criteria and loan quality categories, the previous categories could no longer be used. Therefore, since August 1, 2004, bad loans signify not doubtful and loss loans as they are defined in defunct Regulation No. 62a, but problem and loss loans as they are defined in Regulation No. 254-P. Although this factor has little bearing on the amount of losses, it must be taken into account when interpreting stress test results.

III

Banking regulation and supervision in Russia

III.1. General characteristics of banking regulation and supervision

III.1.1. Objectives and tasks of the Bank of Russia in banking regulation and supervision

Being the body of banking regulation and supervision under the Federal Law on the Central Bank of the Russian Federation (Bank of Russia), the Bank of Russia is duty-bound to maintain the stability of the Russian banking system and guarantee protection of the interests of creditors and depositors.

The current banking sector reform will facilitate the achievement of the objectives set in the Medium-Term Programme for the Social and Economic Development of the Russian Federation in 2005—2008, especially the task of ending the excessive orientation of the Russian economy to raw materials by rapidly diversifying it and enabling it to use its competitive advantages.

The principal tasks of banking sector development are as follows:

— improving the protection of the interests of bank depositors and creditors;

— enhancing the effectiveness of banking sector activities aimed at accumulating household and enterprise sector funds and transforming them into loans and investments;

— increasing the competitiveness of Russian credit institutions;

— preventing the use of credit institutions for dishonest commercial practices and for illegal purposes, especially terrorist financing and money laundering;

— creating a competitive environment and ensuring the transparency of credit institutions;

— strengthening investor, creditor and depositor confidence in the Russian banking sector.

III.1.2. The organisational structure of Bank of Russia banking supervision

The supervisory divisions of the Bank of Russia head office comprise the Banking Regulation and Supervision Department, Credit Institutions Licensing and Financial Rehabilitation Department, Foreign Exchange Regulation and Control Department and Main Inspectorate for Credit Institutions. The main tasks of these divisions are to provide methodological and organisational support for the entire range of the legislatively established functions of the Bank of Russia in banking regulation and supervision, such as licensing credit institutions, exercising their current supervision, inspecting credit institutions and financially rehabilitating and, if necessary, liquidating financially unsound credit institutions.

At the top of the Bank of Russia supervisory divisions is the Bank of Russia Banking Supervision Committee headed by the Bank of Russia's First Deputy Chairman responsible for banking supervision. The Committee is responsible for working out decisions on policy implementation in the field of banking regulation and supervision.

The Bank of Russia implements its banking regulation and supervision policies through its regional branches (national banks and main divisions). As of January 1, 2005, the Bank of Russia system comprised 19 national banks and 59 main divisions.

III.1.3. Bank of Russia supervisory staff

The Bank of Russia supervisory divisions employ a staff of 4,165 specialists, of whom 87.4% are employees of regional branches and 12.6% work in head office departments. Most of them (95.2%) are university-educated specialists and 23.6% have worked in the banking system for more than 15 years.

In line with the Russian Banking Sector Development Strategy, the Bank of Russia continues to implement its long-term programme for the advanced training and retraining of Bank of Russia supervisors. This programme is being carried out in collaboration with Russia's top institutions of higher education, such as the Russian Government's Academy of the National Economy, the Higher School of Economics and the Russian Government's Financial Academy.

Last year, 247 Bank of Russia employees finished a course of retraining in commercial bank inspection and management and commercial bank curatorship and management. Training in these specialities was provided for a total of 474 employees (including those who finished the courses in 2003) from 77 Bank of Russia regional branches and head office divisions, including 289 curators, 164 inspectors and 21 receivers.

In addition to vocational retraining, the Bank of Russia continued to implement a programme designed to enhance the social awareness and personal efficiency of bank curators and inspectors. Training is conducted by specialists from the Personnel Department who teach trainees how to behave confidently, effectively cooperate with partners, conduct public presentations, persuade partners and win their confidence and willingness to cooperate.

In 2005, the best students among the heads of the Bank of Russia supervisory divisions will receive additional training and qualify for a MBA degree.

III.2. Upgrading the legislative and regulatory framework of credit institutions' activity in accordance with international standards

In 2004, the Russian Government and Bank of Russia continued to upgrade banking legislation in line with the Russian Banking Sector Development Strategy until 2008, Guidelines for the State Monetary Policy in 2004 and the plan of action for the implementation of the Medium-Term Programme for the Social and Economic Development of the Russian Federation (2003—2005).

To strengthen public confidence in the banking system, Russia passed Federal Law No. 96-FZ, dated July 29, 2004, "On Bank of Russia Payments on Household Deposits with Bankrupt Banks Uncovered by the Compulsory Deposit Insurance System," which set out the legal, financial and organisational principles of effecting payments by the Bank of Russia on personal deposits with bankrupt banks that do not participate in the deposit insurance system.

Federal Law No. 121-FZ, dated August 20, 2004, "On Amending the Federal Law on Insolvency (Bankruptcy) of Credit Institutions and Invalidating Some Laws (Provisions of Laws) of the Russian Federation" changed the procedure for regulating the relations arising as a result of bank failures.

The Bank of Russia participated in drafting Federal Law No. 218-FZ, dated December 30, 2004, "On Credit Histories," which set the procedure for creating, keeping and using credit histories and set out the principles of co-operation between credit bureaus and borrowers, federal and local government bodies and the Bank of Russia.

The Bank of Russia also took part in the discussion of the following draft federal laws on:

— making changes and amendments to the Tax Code of the Russian Federation with regard to the taxation of mortgage-backed bond issuers and settling problems involved in the taxation of interest income on household deposits with banks;

— making an amendment to Article 7 of the Federal Law on the Tax Authorities of the Russian Federation, ending control by banks of the observance by organisations or their associations of cash operation rules;

— establishing the procedure for issuing state housing certificates and granting subsidies to individuals.

In collaboration with the Ministry of Finance, in 2004, the Bank of Russia elaborated the concept and specifications of a federal law designed to amend the Federal Law on Banks and Banking Activities and Federal Law on the Central Bank of the Russian Federation (Bank of Russia). The purpose of the amendments is to grant to the Bank of Russia the power to supervise bank holding companies, review and specify the terminology and harmonise with international financial reporting standards the regulations relating to the activities of banking groups and bank holding companies and the disclosure of information by them to users concerned.

The Bank of Russia carried out work to bring the applicable banking regulation and supervision standards into compliance with the new laws. When building the system of standards and laws regulating the activities of credit institutions, the Bank of Russia was guided by the best international practice, especially the standards contained in the Basel Committee's Core Principles for Effective Banking Supervision.

The state registration of credit institutions and licensing of banking activities. To improve the applicable system of registration of credit institutions and licensing of banking activities, the Bank of Russia drafted and issued in March 2004 Instruction No. 109-I, dated January 14, 2004, "On the Bank of Russia Decision-Making Procedure for the State Registration of Credit Institutions and the Issue of Licences for the Conduct of Banking Operations." Among the novels established by this document are the following:

— the setting of a limit of 20% on the proportion of the property (non-pecuniary) contribution to the authorised capital of a credit institution. The limit is designed to ensure the financial stability of operating credit institutions;

— the conduct of an inspection of a credit institution by the Bank of Russia or its regional branch to establish the sources of funds paid for its shares (stakes) and the financial standing of the acquirers of its shares (stakes) and make sure that the latter have enough money of their own to pay for the shares (stakes) they acquire. The aim of the inspection is to tighten control over authorised capital formation. The procedure is applied when the authorised capital of credit institutions increases by more than 20% of the previously registered amount or when there is reason to believe that the shares (stakes) in credit institutions have been paid for in violation of the applicable standards;

— the possibility of creating a new kind of internal structural division called the cash and credit office (credit institutions opened 111 cash and credit offices in 2004). The cash and credit office may be opened outside the territory on which the Bank of Russia regional branch that supervises the credit institution (or the branch of the credit institution) that opened it is located. The cash and credit office is designed to make it easier for a small business or household to receive a loan.

Additional requirements for bank managers. To upgrade its regulations on access to the management of credit institutions, the Bank of Russia issued Ordinance

No. 1492-U, dated August 20, 2004, “On the Application of the Russian Federation Legislation on the Securities Market to the Chief Executive Officers and Members of the Boards of Directors of Credit Institutions That Are Professional Securities Market Participants.” Elaborated in pursuance of the Federal Securities Market Law, the document establishes additional requirements for persons who fulfil the functions of a one-man executive body, their deputies, members of the collegiate executive body of credit institutions, members of the boards of directors (supervisory boards) of credit institutions that are professional securities market participants and sets the procedure for monitoring compliance with these requirements.

Upgrading off-site banking supervision and regulation. Pursuant to Federal Law No. 86-FZ, dated July 10, 2002, “On the Central Bank of the Russian Federation (Bank of Russia),” the Bank of Russia issued Instruction No. 110-I, dated January 16, 2004, “On Banks’ Required Ratios,” which came into force on April 1, 2004. The Instruction requires credit institutions to comply with the required ratios on a daily basis, cuts the number of the required ratios, lowers the minimal levels of instant and current liquidity, changes the procedure for calculating the liquidity ratios and changes the method of calculating a bank’s equity capital adequacy ratio. In pursuance of some provisions of this Instruction and for the purpose of upgrading the methods of calculating the required ratios and improving control over the compliance with these ratios, the Bank of Russia issued a number of regulations in 2004.

Operating Ordinance No. 47-T, dated April 27, 2004, “On the Application of Chapter 10 of Bank of Russia Instruction No. 110-I, Dated January 16, 2004, On Banks’ Required Ratios,” stipulates the cases in which Bank of Russia regional branches can require a bank to present information on the required ratios as of an intramonth date (dates).

Bank of Russia Ordinance No. 1489-U, dated August 13, 2004, “On Making Amendments to Bank of Russia Instruction No. 110-I, Dated January 16, 2004, “On Banks’ Required Ratios,” introduces the following changes:

— the imputed base of the required ratios N6, N7, N9.1, N10.1 and N12, which limit a bank’s credit risks, will be reduced by the amount of the imputed reserves for possible losses;
— banks that are members of a banking group (bank holding company) will be granted a deferral until August 1, 2005, on the requirement to include in the N6 ratio the balances in corresponding accounts opened with credit institutions that are members of the same banking group (bank holding company);
— banks will be required to calculate as of an intramonth date all indicators involved in the calculation of the required ratios, including equity capital, should the Bank of Russia demand the calculation of the required ratios as of an intramonth date (dates);
— the procedure for using sanctions against banks that have failed to comply with the control values of the required ratios will be specifed.

Bank of Russia Operating Ordinance No. 105-T, dated September 9, 2004, “On the Provision of Information for the Purposes of Bank of Russia Regulation No. 248-P, Dated January 16, 2004,” recommends the Bank of Russia regional branches to report banks’ failures to comply with the N6 ratio as a result of calculating the balances in correspondent accounts with counterparty banks-members of a banking group (bank holding company) as part of information presented to the Bank of Russia under Bank of Russia Regulation No. 248-P, dated January 16, 2004, “On the Procedure for Considering by the Bank of Russia of a Bank’s Request to the Bank of Russia to Decide on the Bank’s Compliance with the Requirements for Participation in the Deposit Insurance System.”

Bank of Russia Operating Ordinance No. 106-T, dated September 10, 2004, “On the Calculation of Maximum Risk per Borrower or Group of Related Borrowers (N6 Ratio),” contains the recommendation to consider as a group of related borrowers a bank’s corporate and individual borrowers who are economically connected in such a way as the deterioration of the financial standing of one of them would lead to or make possible the deterioration of the financial standing of another borrower (other borrowers), which may result in the non-fulfilment (inappropriate fulfilment) by this borrower (these borrowers) of obligations on the bank’s credit claims.

Bank of Russia Official Interpretation No. 31-OR, dated December 17, 2004, “On the Application of Some Provisions of Bank of Russia Instruction No. 110-I, dated January 16, 2004, “On Banks’ Required Ratios,” contains a list of people who may be classified as bank insiders.

Implementing the Concept of the Development of the Housing Mortgage Lending System and taking into account the requirements of the Federal Law on Mortgage Securities, the Bank of Russia issued Instruction No. 112-I, dated March 31, 2004, “On the Required Ratios for Credit Institutions Issuing Mortgage-Backed Bonds,” which established additional required ratios and raised the minimum equity capital requirement (N1) to 14%.

To monitor the quality of banks’ equity capital, which is derived from subordinated loans, among other sources, and to ensure an adequate supervisory response to the early termination of subordinated loan agreements by the sides and its consequences, the Bank of Russia issued Operating Ordinance No. 114-T, dated September 28, 2004, “On the Termination of the Subordinated Loan Agreement.”

Improving the loan loss provision procedure. In 2004, the Bank of Russia enforced Regulation No. 232-P, dated July 9, 2003, “On Loan Loss Provisions by Credit Institutions” (came into force on March 1) and Regulation No. 254-P, dated March 26, 2004, “On the Procedure for Making by Credit Institutions Loan Loss Provisions and Provisions for Loan Debts and Similar Debts” (came into force on August 1). Drafted taking into account internationally accepted methods of evaluating the quality of assets and making provisions, these documents provide for the further development of the principle of professional judgement in evaluating credit risk, establish five risk classification groups, introduce “bracket” provisioning rates, specify the role of the collateral factor in determining the amount of loan loss provisions, provide for making provisions for the portfolio of similar loans and change the procedure for writing off bad loans from the balance sheet.

Bank of Russia Ordinance No. 1449-U, dated June 15, 2004, “On Making Changes in Bank of Russia Ordinance No. 1318-U, Dated August 7, 2003, On Provisioning and the Size of Provisions for Operations Conducted by Credit Institutions with Residents of Offshore Zones” (came into force on July 15, 2004), extended the list of operations with offshore zone residents for which credit institutions must make provisions by including in it operations with offshore zone residents under broker service agreements and clarified the procedure for making provisions for the guarantees and sureties issued to offshore zone residents if a credit institution is the guarantor on the operation in which offshore zone residents are the principal and beneficiary.

Upgrading internal control requirements. In 2004, the Bank of Russia enforced Regulation No. 242-P, dated December 16, 2003, “On Organising Internal Controls in Credit Institutions and Banking Groups,” which regards internal controls as a system and continuous and all-embracing process. The document was drafted taking into account the Basel Committee’s recently published recommendations on internal controls, which attach special importance to the participation of boards of directors and executive bodies in this process.

The Regulation eliminated flaws and discrepancies in the legal base of internal controls in credit institutions and facilitated conversion of Russian internal control practices to internationally accepted standards.

Internet banking. Taking into consideration the increased role of new information technologies in banking, including those connected with the Internet, the Bank of Russia issued Ordinance No. 1390-U, dated March 1, 2004, “On the Procedure for Informing the Central Bank of the Russian Federation by Credit Institutions on the Use of Internet Technologies.” The results of the preliminary processing of data received from credit institutions show that at the end of last year 910 Russian credit institutions had 1,140 sites on the Internet and 325 of them provided online banking services.

To ensure that credit institutions make their activities more transparent and provide accurate information to their customers, including potential ones, and to regulate the contents of credit institutions’ websites, the Bank of Russia issued Operating Ordinance No. 16-T, dated February 3, 2004, “On Recommendations on the Contents and Organisation of Credit Institutions’ Internet Sites.”

Optimisation of reporting. In 2004, the Bank of Russia continued to make efforts to upgrade and optimise prudential reporting by credit institutions. To determine whether a bank can qualify for participation in the deposit insurance system, the Bank of Russia introduced the new reporting form “Interpretation of Individual Balance Sheet Accounts and Profit and Loss Statement Symbols for the Compilation of the Balance Sheet (Published Form) and the Profit and Loss Statement (Published Form) and the Calculation of Financial Soundness Indicators.”

The Bank of Russia also specified the contents of and the procedure for compiling the published forms of the balance sheet and profit and loss statement and the requirements for compiling the reporting form “Information on the Quality of Loans, Loan Debt and Similar Debts.”

The Bank of Russia issued recommendations for its regional branches on the analysis of reports compiled to International Financial Reporting Standards (IFRS), which are set forth in Bank of Russia Letter No. 35-T, dated February 28, 2005, “On Methodological Recommendations for the Analysis of Financial Statements Compiled by Credit Institutions According to IFRS.”

At the same time, the Bank of Russia repealed its Instruction No. 17, dated October 1, 1997, “On Compiling Financial Statements” and amendments to it (Bank of Russia Ordinance No. 1503-U, dated September 22, 2004, “On Eliminating Discrepancies in Bank of Russia Regulations”).

Information disclosure. The Bank of Russia attaches special importance to transparency in the activities of individual credit institutions and the banking sector as a whole. In 2004, it compiled the annual Banking Supervision Report and it puts information on Russian banking sector developments on its website every month.

The Bank of Russia is broadening the range of information it discloses on its website. More than half of all Russian credit institutions now put information on their activities on it. Bank of Russia regional branches are broadening the exchange of analytical information in the Bank of Russia corporate portal and the new version of Recommendations on the Analysis of the Activities of Credit Institutions and the Development of Banking Services in a Region, which the Bank of Russia made known to its regional branches late in 2004, is expected to stimulate this work.

In 2004, the Bank of Russia continued to improve the conditions and forms of co-operation with foreign banking supervisory authorities. It issued Ordinance No. 1381-U, dated January 29, 2004, “On the Procedure for Exchanging Information and/or Documents between the Bank of Russia and Central Banks and Banking Supervisory Authorities of Foreign States.”

Monitoring non-financial sector enterprises. The Bank of Russia paid serious attention last year to the development and improvement of the analysis of risks involved in lending to the non-financial sector of the economy. This particularly applies to the practical application of the results of monitoring enterprises and the analysis of demand for banking services for the purposes of supervision and in the interest of the banking community. In 2004, the Bank of Russia carried out a pilot project in the course of which it supplied credit institutions with aggregate analysis materials based on enterprise monitoring results in order to evaluate the risks they assumed. The project involved 13 Bank of Russia regional branches and over 360 credit institutions based in many Russian regions.

Inspection. In 2004, the Bank of Russia continued to upgrade its legal regulation of inspections in order to evaluate the quality of risk management, internal controls and the financial standing and prospects for the future of credit institutions on the basis of an informed judgement.

To build a comprehensive inspection system and bring it into compliance with the requirements of the Federal Law on Insurance of Household Deposits with Russian Banks (Federal Deposit Insurance Law) and Federal Law on Foreign Exchange Regulation and Foreign Exchange Control and also the requirements of the new Bank of Russia documents on banking regulation and supervision, in 2004, the Bank of Russia made amendments to its regulations establishing the procedure for organising and conducting inspections[59].

The Bank of Russia paid considerable attention to the upgrading of the methods of conducting inspections of credit institutions and their branches. For this purpose, it issued methodological recommendations on inspecting specific activities of credit institutions and their branches[60] and on inspecting and evaluating risk management and internal controls in credit institutions[61].

Financial rehabilitation of credit institutions and control over their liquidation. The coming into force in 2004 of the Federal Law on Amending the Federal Law on Insolvency (Bankruptcy) of Credit Institutions and Invalidating Some Laws (Provisions of Laws) of the Russian Federation, the Federal Law on Amending Some Laws of the Russian Federation in Connection with the Adoption of the Federal Law on Mortgage Securities and the Federal Law on Bank of Russia Payments on Household Deposits with Bankrupt Banks Uncovered by the Compulsory Deposit Insurance System, all of them drafted with the participation of the Bank of Russia, determined a new line of upgrading the legislative framework of the financial rehabilitation and control over the liquidation of credit institutions.

It should be noted that the amendments made to the Federal Law on Insolvency (Bankruptcy) of Credit Institutions are of great importance for the further improvement of the bank financial rehabilitation and liquidation procedures. Specifically, they:

— reduced from one month to 14 days the period of insolvency of a bank on the expiry of which bankruptcy proceedings may be initiated;
— introduced the corporate liquidator, which under this Law is the Deposit Insurance Agency (DIA), a state corporation;
— set a simplified procedure for establishing creditors' claims, whereby these claims are considered by the receiver rather than the arbitration court;
— tightened control over the actions of the receiver, ensuring the transparency of the receiver's activities by increasing the number and volume of publications on bankruptcy proceedings.

In pursuance of these laws, the Bank of Russia issued a number of regulations.

Bank of Russia Ordinance No. 1510-U, dated October 28, 2004, "On Amending Bank of Russia Ordinance No. 1260-U, Dated March 24, 2003, On the Procedure for Matching Authorised Capital of a Credit Institution with its Equity Capital," stipulated that during the first two years since the issue of a banking licence, a credit institution will not be required to match its authorised capital with equity capital.

Bank of Russia Ordinance No. 1533-U, dated December 22, 2004, "On Establishing the Value of Property (Assets) and Liabilities of a Credit Institution," established the procedure for calculating the value of the property (assets) and liabilities of a credit institution for the purpose of declaring it bankrupt.

Bank of Russia Regulation No. 265-P, dated December 14, 2004, "On the Accreditation of Arbitration Managers with the Bank of Russia as Receivers of Bankrupt Credit Institutions," established the procedure for considering applications of arbitration managers, members of a self-regulating arbitration managers organisation, and the procedure for drafting and issuing certificates of accreditation, extending the term of accreditation, cancelling accreditation, redrafting and issuing duplicate certificates of accreditation and termination of certificates of accreditation.

To establish a standard curriculum for educational institutions training arbitration managers as receivers of bankrupt credit institutions, the Bank of Russia issued Ordinance No. 1532-U, dated December 21, 2004, "On Approving the Arbitration Managers Training Programme."

In connection with the coming into force of the Federal Law on Bank of Russia Payments on Household Deposits with Bankrupt Banks Uncovered by the Compulsory Deposit Insurance System, the Bank of Russia drafted and issued in 2004 regulations designed to guarantee Bank of Russia payments of up to 100,000 rubles on deposits with banks that have not joined the deposit insurance system.

Bank of Russia Ordinance No. 1517-U, dated November 17, 2004, "On Bank of Russia Payments on House-

[59] Bank of Russia Ordinance No. 1542-U, dated January 13, 2005, "On the Specifics of Conducting Inspections of Banks with the Participation of Employees of the State Deposit Insurance Agency;" Bank of Russia Ordinance No. 1543-U, dated January 13, 2005, "On Making Amendments to Bank of Russia Instruction No. 105-I, Dated August 25, 2003, "On the Procedure for Conducting Inspections of Credit Institutions and their Branches by Authorised Representatives of the Central Bank of the Russian Federation;" Bank of Russia Ordinance No. 1544-U, dated January 13, 2005, "On Making Changes in Bank of Russia Instruction No. 108-I, Dated December 1, 2003, "On Organising Inspections by the Central Bank of the Russian Federation (Bank of Russia)."

[60] Bank of Russia Operating Ordinance No. 116-T, dated October 1, 2004, "On Methodological Recommendations on the Inspection of Cash Operations in Credit Institutions and their Branches" and Bank of Russia Operating Ordinance No. 68-T, dated June 18, 2004, "On Interpretation of Questions Faced by Bank of Russia Regional Branches when Organising and Conducting Inspections of Credit Institutions and Their Branches."

[61] Bank of Russia Letter No. 47-T, dated March 24, 2005, "On Methodological Recommendations on Conducting an Inspection and Evaluating the Organisation of Internal Controls in Credit Institutions."

hold Deposits with Bankrupt Banks Uncovered by the Compulsory Deposit Insurance System and on the Procedure for Co-operation between Agent Banks and the Bank of Russia," set the procedure for effecting Bank of Russia payments, calculating their amount and co-operating between the Bank of Russia and agent banks through which depositors' applications are received and Bank of Russia payments are effected.

Bank of Russia Ordinance No. 1539-U, dated December 29, 2004, "On the Procedure for Making a Decision on Effecting Bank of Russia Payments on Household Deposits with Bankrupt Banks Uncovered by the Compulsory Deposit Insurance System," established the procedure for making a decision on effecting Bank of Russia payments and for co-operation between Bank of Russia structural divisions and regional branches in making a decision on effecting Bank of Russia payments.

Bank of Russia Ordinance No. 1516-U, dated November 17, 2004, "On the Procedure for the Competitive Selection of Agent Banks to Effect Bank of Russia Payments on Household Deposits," set the requirements a bank should meet to acquire the right to participate in the competitive selection and established the procedure for conducting the competitive selection by the Bank of Russia and making the decision on the selection of an agent bank.

In all, the Bank of Russia issued 52 regulatory documents on the licensing and financial rehabilitation of credit institutions and household deposit insurance in 2004, including one instruction, four regulations, 23 ordinances and 24 operating ordinances.

III.3. Bank of Russia evaluation of banks' compliance with requirements for participation in deposit insurance system

The establishment of the compulsory household deposit insurance system became a major step forward in strengthening credibility of the Russian banking system. Represented by the Deposit Insurance Agency and Bank of Russia, the state has assumed serious social responsibility to the public, compelling bank owners and managers to take additional measures to increase the financial stability of their banks. The Bank of Russia has created and is now upgrading the legislative framework of the deposit insurance system. All applications made by banks for admission to the deposit insurance system have been considered without delays.

The Federal Depoposit Insurance Law established for the first time the legal, financial and organisational principles of building and operating the deposit insurance system. Under this Law, banks that as of the day on which the Law came into effect had the licence to take household funds on deposit and open and keep household accounts must participate in the deposit insurance system to retain their right to take household funds on deposit. To participate in the deposit insurance system, a bank must comply with all the requirements set by Part 1 of Article 44 of the Federal Depoposit Insurance Law, notably:

- have its accounting and reporting recognised as reliable by the Bank of Russia;
- comply with the required ratios established by the Bank of Russia;
- have its financial stability recognised as adequate by the Bank of Russia;
- have no record of being subjected to measures stipulated by Article 74 of the Federal Law on the Central Bank of the Russian Federation (Bank of Russia), Article 20 of the Federal Law on Banks and Banking Activities and Article 3 of the Federal Law on Insolvency (Bankruptcy) of Credit Institutions and give no reason for using these measures as a result of the selective inspection conducted pursuant to Part 4 of Article 45 of the Federal Deposit Insurance Law.

The Bank of Russia issued a number of regulations in pursuance of the Federal Deposit Insurance Law.

Regulation No. 248-P, dated January 16, 2004, “On the Procedure for Considering by the Bank of Russia a Bank's Request to the Bank of Russia to Make the Decision on the Bank's Compliance with the Requirements for Participation in the Deposit Insurance System,” established the stages, terms and procedure for making the decision (positive or negative) by the Bank of Russia Banking Supervision Committee on a bank's compliance with the requirements for participation in the deposit insurance system.

Bank of Russia Regulation No. 247-P, dated January 16, 2004, “On the Procedure for Considering by the Bank of Russia an Appeal against its Negative Decision on a Repeat Request by a Bank to Consider its Compliance with the Requirements for Participation in the Deposit Insurance System,” set the procedure for making an appeal against the Bank of Russia's negative decision on a repeat request by a bank to consider its compliance with the requirements for the participation in the deposit insurance system, considering an appeal by the Bank of Russia and passing the decision by the Bank of Russia Banking Supervision Committee or Bank of Russia Chairman to meet (or refuse to meet) a bank's request.

Bank of Russia Ordinance No. 1379-U, dated January 16, 2004, “On the Evaluation of the Financial Soundness of a Bank for the Purpose of Recognising it Sufficient for Participation in the Deposit Insurance System,” established a set of indicators and the methods of calculating them and determining the overall result on them for the purpose of recognising a bank's financial soundness sufficient for participation in the deposit insurance system. When selecting the bank performance indicators, the Bank of Russia assumed that banking supervision would be proactive only if the supervisory authority had the necessary information on the owners of the bank, its business, risks and the quality of corporate governance. Therefore, the set of assessment indicators embraced ownership structure transparency and bank management quality, including the assessment of risk management and internal controls, and the evaluation of capital, assets, profitability and liquidity.

Bank of Russia Ordinance No. 1417-U, dated April 1, 2004, “On the Form of the Register of Bank Obligations to Depositors,” drafted at the proposal of the Deposit Insurance Agency, established the procedure for registering a bank's obligations to individual depositors when taking money on deposit, the form of the bank register of obligations to depositors and the duty of the bank in respect to which the insured event has occurred to compile a register of obligations, taking into account the bank's obligations to depositors and counter-claims to depositors, and present it to the DIA within seven days after the insured event occurred. The document also set the procedure for co-operation between the DIA and provisional administration of a bank, appointed by the Bank of Russia, in compiling and submitting a register of obligations when the insured event occurred.

The Bank of Russia also issued a number of regulations establishing the procedure for terminating the right of a bank that has refused to participate or been found unfit to participate in the deposit insurance system to take household funds on deposit and open household accounts with a bank.

Bank of Russia Ordinance No. 1476-U, dated July 16, 2004, “On the Procedure for Requiring a Bank by the Bank of Russia to Submit an Application for the Termination of the Right to Handle Deposits,” set the procedure and the time period within which the Bank of Russia should require a bank to make an application for the termination of its right to conduct deposit operations in the event of the bank’s refusal to participate in the deposit insurance system or its failure to meet the conditions set for the participation in this system.

Bank of Russia Ordinance No. 1477-U, dated July 16, 2004, “On the Procedure for Invalidating the Licence of a Bank to Take Household Funds on Deposit in Rubles, Licence to Take Household Funds on Deposit in Rubles and Foreign Currency or General Licence in the Event of the Bank’s Refusal to Participate in the Deposit Insurance System or Failure to Qualify for Participation in the Deposit Insurance System,” set the procedure for replacing (cancelling) the licences of banks that had not joined the household deposit insurance system.

Bank of Russia Ordinance No. 1483-U, dated July 30, 2004, “On the Procedure for Prohibiting a Bank that Has Refused to Participate in the Deposit Insurance System or Has Been Found Unfit to Participate in the Deposit Insurance System from Taking Household Funds on Deposit and Opening Household Accounts with Banks,” set the procedure for the Bank of Russia to prohibit banks that had the right to handle household accounts as of the day the Federal Deposit Insurance Law came into force from taking household funds on deposit and opening household accounts with banks and stipulated the conditions and terms of notifying credit institutions of the ban.

In 2004, the Bank of Russia considered banks’ applications for the participation in the deposit insurance system. In all, 1,150 banks submitted such applications by the deadline set by the law. Of these, 16 banks recalled their applications and 11 banks had their banking licences revoked by the Bank of Russia in 2004.

The Bank of Russia declared 421 banks fit for the participation in the deposit insurance system in 2004. This represents 37% of the total number of applicant banks. As of January 1, 2005, the value of household deposits covered by the deposit insurance system amounted to 1,760.2 billion rubles, or 90% of the total value of household deposits with Russian banks (as of April 1, 2005, the deposit insurance system covered 824 banks and the value of household deposits with the banks covered by the deposit insurance system accounted for 98% of the total value of household deposits with Russian banks).

Banks denied access to the deposit insurance system by the Bank of Russia Banking Supervision Committee may submit a repeat application. The Federal Deposit Insurance Law and Bank of Russia Regulation No. 247-P, dated January 16, 2004, “On the Procedure for Considering by the Bank of Russia an Appeal against its Negative Decision on a Repeat Request by a Bank to Consider its Compliance with the Requirements for Participation in the Deposit Insurance System,” allows banks to appeal against the decision by the Bank of Russia to deny them access to the deposit insurance system. The Bank of Russia is to consider banks’ repeat applications and make decisions on them by September 27, 2005.

In addition, in pursuance of the Federal Deposit Insurance Law, the Bank of Russia and DIA signed a number of documents on co-operation and exchange of information in 2004.

It should be noted that in the course of the selection of banks for the deposit insurance system, the quality of capital, assets and the transparency of the ownership structure of many banks have improved significantly. Banks that have entered the deposit insurance system meet all requirements and, most significantly, must comply with them on a permanent basis.

The preliminary analysis of credit institutions’ activities, conducted with the participation of various Bank of Russia divisions and co-ordinated by the off-site supervision service, resulted in the drawing up of a list of questions for a selective inspection. This list only included questions to which off-site supervision could not provide answers, such as questions necessary for the evaluation of the sources of equity capital, the quality of assets, the loan loss provisions and the compliance with the required ratios on a daily basis.

In 2004, the Bank of Russia conducted 1,125 selective inspections of banks that called for it to decide if they complied with the requirements made for participation in the deposit insurance system. Those represented more than 43% of all inspections conducted last year. Household deposits with banks inspected in 2004 accounted for 99.7% of the total value of household deposits kept in Russian banks.

When considering inspection materials and the positions held by Bank of Russia regional branches on banks’ compliance with the deposit insurance system requirements, the Bank of Russia attached great importance to the financial soundness of credit institutions, including the appropriateness of the evaluation of the quality of a bank’s loan portfolio, the adequacy of loan loss provisions, the quality of internal controls for the evaluation of risk assumed by banks and the reliability of accounting and reporting. This work was carried out in accordance with the principle of making an informed judgement on each particular issue. Therefore, additional information was requested on some credit institutions and their assets and some questions were raised and discussed at meetings held in the Bank of Russia with representatives of credit institutions. The prime objectives of these measures were to investigate the nature and level of risk assumed by banks, make an objective assessment of the financial soundness of banks and optimise the supervisory procedure.

As for credit institutions that have entered the deposit insurance system, the Bank of Russia is monitoring them to make sure that their current state meets access requirements.

III.4. Regulating access to banking services market

In 2004, the Bank of Russia continued to upgrade the licensing of banking activities in compliance with the Basel Committee's Core Principles for Effective Banking Supervision. A major problem in the field of the registration and licensing of banking activities which the Bank of Russia prioritized last year, was that of improving the transparency of the ownership structure of credit institutions and enhancing the efficiency of Bank of Russia control over persons who can exert a significant influence on the management of credit institutions due to direct or indirect (through a third person) ownership of shares (stakes) in credit institutions.

In 2004, as in the previous years, the total number of registered credit institutions had a tendency to decline. During 2004, it fell from 1,666 to 1,516, or by 9% as against 8.8% in 2003, when the total number of registered credit institutions decreased from 1,826 to 1,666. The number of operating credit institutions with a licence to conduct banking operations also fell in 2004 year on year, from 1,329 to 1,299, of which 50 are non-bank credit institutions *(see Chart 3.1)*.

Three new credit institutions (two banks and a non-bank credit institution) were registered in the year under review as against 16 credit institutions (14 banks and two non-bank credit institutions) in 2003.

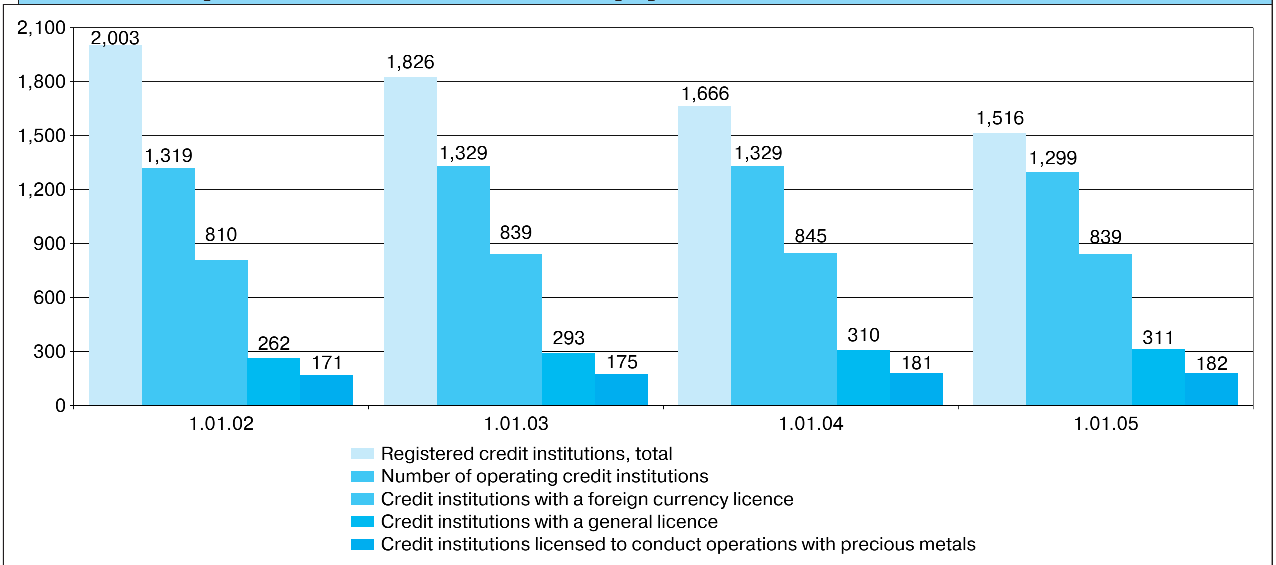
The reorganisation of credit institutions continued in 2004: three credit institutions merged with other credit institutions (as against seven in 2003), five changed their status from a limited liability company to a joint-stock company (as against 10 in 2003 and 41 in 2002) and one non-bank credit institution became a bank last year.

Fifty-four credit institutions, or 4.16% of the total, expanded the range of their activities in 2004 by getting additional licences (65 credit institutions, or 4.89% of the total, in 2003).

In 2004, the Bank of Russia did not allow 17 credit institutions to expand the range of their activities, of which eight credit institutions were denied permission because their authorised capital ownership structure was not transparent enough and nine for other reasons (violation of the federal laws and Bank of Russia regulations requiring Bank of Russia's permission for the acquisition of more than 20% of stakes (shares) in the authorised capital of a credit institution by a group of persons related by an agreement or group of corporate entities that are subsidiary to or dependent on one another, equity capital formation with inappropriate assets, non-compliance with Bank of Russia financial soundness requirements, etc.).

The measures taken by shareholders and members of credit institutions to strengthen the capital base of their credit institutions in 2004 led to the expansion of the aggregate authorised capital of operating credit institutions by 18.5 billion rubles from 362.0 billion rubles to 380.5 billion rubles, or 5.1% *(see Chart 3.2)*. In 2003, the aggregate authorised capital of operating credit institutions increased from 300.4 billion rubles to 362.0 billion rubles, or by 61.6 billion rubles, or 20.5% as against a growth of 39.4 billion rubles, or 15.1% in 2002.

Dynamics of the number of registered operating credit institutions and licences granted to them to conduct banking operations *CHART 3.1*



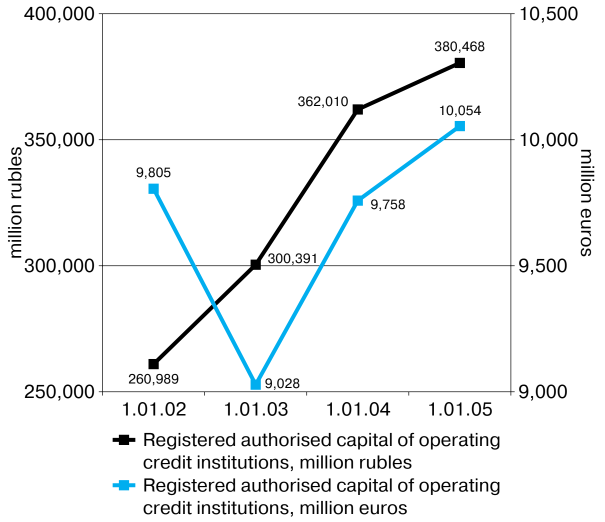
As securities-issuing credit institutions stepped up their issuing activity in 2004, the total value of their securities increased from 53.6 billion rubles to 73.6 billion rubles, of which the value of registered share issues rose from 41.4 billion rubles to 50.3 billion rubles, or 17.7%. The same tendency applies to corporate bonds. The value of the registered bond issues amounted to 23.2 billion rubles last year, an increase of 11.1 billion rubles, or 90%, on 2003.

Most of bond issuing credit institutions were Moscow-based banks that registered 18 issues with a total value of 21.2 billion rubles. It should be noted that three banks in the Republic of Tatarstan issued 2.0 billion rubles worth of bonds in the year under review.

The aim of regulation in licensing banking activities is to ensure the necessary quality of bank governance in compliance with Russian legislation and international best practice, prevent incompetent or dishonest persons from becoming managers of credit institutions and thus doing harm to credit institutions and their creditors and depositors.

Dynamics of registered authorised capital of operating credit institutions

CHART 3.2



III.5. Off-site supervision

Off-site supervision conducted by the Bank of Russia last year was aimed at implementing the provisions of Federal Law No. 177-FZ, dated December 23, 2003, "On Insurance of Household Deposits with Russian Banks," and Bank of Russia regulations issued in pursuance of this Law as well as Bank of Russia Regulation No. 254-P, dated March 26, 2004, "On the Procedure for Making by Credit Institutions Loan Loss Provisions and Provisions for Loan Debts and Similar Debts," and Bank of Russia Instruction No. 110-I, dated January 16, 2004, "On Banks' Required Ratios."

The new principles of substantive analysis of the situation in a bank required the use of new financial soundness indicators, such as the ownership structure transparency and the organisation of the risk management system and internal controls and bank profitability indicators.

In 2004, the Bank of Russia continued to evaluate the quality of credit institutions' capital and implemented measures stipulated by Instruction No. 1246-U, dated February 10, 2003, "On Actions to Be Taken in Response to the Established or Suspected Instances of the Formation of Equity Capital or a Part Thereof with Improper Assets." In the course of selective inspections of credit institutions, conducted in compliance with the requirements of Bank of Russia Regulation No. 215-P, dated February 10, 2003, "On the Methodology of Determining the Equity Capital of Credit Institutions," the Bank of Russia assessed the quality of the capital of 761 credit institutions, or 58.6% of the total number of operating credit institutions.

At the proposal of the Bank of Russia, 14 credit institutions readjusted their equity capital to a total amount of 413.5 million rubles in 2004. After the Bank of Russia Banking Supervision Committee had studied the corresponding materials submitted by Bank of Russia regional branches, the Bank of Russia ordered four credit institutions to readjust their capital to the total amount of 614.2 million rubles. This work was carried out taking into consideration the evaluation of the quality of a bank's current assets and on the basis of materials collected by inspectors when the Bank of Russia was making decisions on the access of banks to the deposit insurance system.

As in 2003, the number of sanctions used against credit institutions and the number of sanctioned credit institutions continued to decline in 2004 due to additional measures taken by credit institutions in order to qualify for the deposit insurance system.

Taking into consideration the results of the analysis of credit institutions' reports, in 2004, the Bank of Russia notified in writing the management and/or boards of directors (supervisory boards) of 1,175 credit institutions (as against 1,188 in 2003) about shortcomings in their work and met with the managers of 373 banks.

As for enforcement measures used against credit institutions in 2004, 82 banks were prohibited from or restricted in taking household funds on deposit (75 banks in 2003) and 50 banks were prohibited from opening branches (51 banks in 2003). Three hundred banks were fined for violating prudential standards (342 banks in 2003) and 764 banks (936 in 2003) received various orders, such as to comply with Bank of Russia required ratios, to increase loan loss provisions, to meet reporting deadlines and to eliminate shortcomings in the work of branches.

It should be noted that while the total number of enforcement measures declined (from 1,721 in 2003 to 1,447 in 2004), the measures used last year were considerably tougher. In 2004, 33 credit institutions had their banking licences revoked as against 16 in 2003 and the number of bans imposed on individual banking operations conducted by credit institutions increased 39%, of which the number of bans on taking household deposits rose 47.8%.

In 2004, beginning from reporting for the first nine months of the year, the off-site supervision services of Bank of Russia regional branches began to collect and scrutinise credit institutions' IFRS financial statements. This work will be continued in 2005.

IFRS statements for the first nine months of 2004 were presented in compliance with Bank of Russia Ordinance No. 1363-U, dated December 25, 2003, "On the Compilation and Presentation of Financial Statements by Credit Institutions," by 1,290 credit institutions, or 99.31% of the total number of credit institutions that were in operation as of January 1, 2005. The Bank of Russia had its regional branches to provide information on credit institutions that failed to report to IFRS standards for the first nine months of 2004. According to data provided by Bank of Russia regional branches, 13 credit institutions supervised by seven Bank of Russia regional branches failed to present IFRS statements for the first nine months of 2004. The Bank of Russia studied the reasons why these credit institutions failed to present the required reports and penalised them.

III.6. Inspection of credit institutions

In inspecting credit institutions, the Bank of Russia in 2004 switched from formal control over the observance of Russian legislation and Bank of Russia regulations by credit institutions to the qualitative assessment of their activities. It attached priority to inspecting credit institutions and their branches for the purpose of increasing the stability of the banking sector and building the deposit insurance system in pursuance of the Federal Deposit Insurance Law.

In 2004, the Bank of Russia conducted 2,595 scheduled and unscheduled inspections of credit institutions and their branches. The total number of inspections increased 19% year on year.

In line with the General Plan for Comprehensive and Selective Inspections of Credit Institutions and their Branches in 2004, the Bank of Russia conducted 1,442 inspections (771 inspections of the head offices of credit institutions and 671 inspections of the branches of credit institutions). This represents an increase of 7.5% on the previous year. The number of comprehensive inspections stood at 330 and the number of selective ones at 1,112. Interregional inspections were conducted in 53 credit institutions and 120 branches of credit institutions.

The total number of unscheduled inspections of credit institutions and their branches stood at 1,153 in 2004 (of these, 1,033 inspections were conducted in the head offices and 120 in the branches of credit institutions). The principal objectives of unscheduled inspections in 2004 were to ascertain banks' compliance with the deposit insurance system requirements, to analyse the sources of funds used to increase the registered authorised capital of credit institutions by more than 20%, to verify the sources of funds used as payment for shares (stakes) in credit institutions by their acquirers and to find out if there are grounds for implementing bankruptcy-prevention measures.

The inspections of credit institutions and their branches, conducted in 2004, revealed 17,883 violations of federal legislation and Bank of Russia regulations, a decrease of 30% on 2003. Sanctions were used against credit institutions after inspections in 1,562 cases in 2004, of which preventive measures were taken in 815 cases.

Typical violations uncovered in 2004 were violations of accounting and reporting rules, credit operation rules (credit risk evaluation and loan loss provision), required ratio calculation and compliance, equity capital measurement and the failure by credit institutions to comply with internal control rules for the purpose of preventing money laundering and financing of terrorism.

To increase the effectiveness of inspections in 2004 state-of-the-art computer technologies were introduced. Its regional branches began a test run of the Automated inspection unit system, which pools in real time all information relating to inspections. The system provides additional opportunities for efficient inspection management and for upgrading reports presented by the inspection units of Bank of Russia regional branches.

III.7. Financial rehabilitation and restructuring of credit institutions

The number of credit institutions which as of the accounting date had ground for being subjected to bankruptcy-prevention measures under Article 4 of the Federal Law on Insolvency (Bankruptcy) of Credit Institutions continued to decline in 2004.

The number of such credit institutions fell from 20, or 1.5% of the total number of operating credit institutions, as of January 1, 2004, to 16 as of January 1, 2005, or 1.2% of the total number of operating credit institutions.

In 2004, 44 credit institutions avoided being subjected to bankruptcy-prevention measures as they eliminated the grounds for them on their own without waiting for the Bank of Russia to order them to do so.

In the period under review, 59 credit institutions were ordered by the Bank of Russia to implement financial rehabilitation measures, of which 45 credit institutions were ordered to do so as they allowed their equity capital to become smaller than their authorised capital at the end of the accounting month.

Last year, Bank of Russia regional branches monitored the implementation of the financial rehabilitation plans by 26 credit institutions, most of which (62%) had improved their financial standing during the year and were taken off the watch list.

When analysing the activities of credit institutions that had lost their liquidity in May—July 2004, the Bank of Russia discovered significant flaws in capital formation, asset quality and management, which did not allow these credit institutions to maintain a proper level of liquidity and risk management. At the same time, some credit institutions overcame their financial problems with the support of founders and creditors.

To protect the interests of creditors and depositors of problem credit institutions and credit institutions that had their licences revoked, the Bank of Russia appointed provisional administrations to manage these credit institutions.

In 2004, the Bank of Russia monitored the activities of 35 provisional administrations of credit institutions, of which 30 were appointed in the period under review. Of these, 28 were appointed to credit institutions that had had their banking licences revoked and two were appointed to operating credit institutions.

During 2004, the Bank of Russia recalled 21 provisional administrations, of which four were recalled after the arbitration court had ordered compulsory liquidation and the appointment of a liquidator and 17 after the arbitration court had declared credit institutions insolvent (bankrupt) and appointed receivers.

In 2004, the Bank of Russia continued to co-operate with the Agency for Restructuring Credit Organisations (ARCO). Last year, the ARCO completed the bankruptcy proceedings against the commercial joint-stock bank SBS-AGRO. The Moscow Arbitration Court finished bankruptcy proceedings on April 20, 2004.

As the ARCO had fulfilled its duties, the Federal Law “On Invalidating the Federal Law on Restructuring Credit Institutions and on the Procedure for Liquidating the Agency for Restructuring Credit Organisations” was passed in June 2004 and as of January 1, 2005 the ARCO liquidation proceedings were in their final stage.

III.8. Liquidation of credit institutions

Pursuant to Article 74 of the Federal Law "On the Central Bank of the Russian Federation (Bank of Russia)" and Articles 20 and 23 of the Federal Law "On Banks and Banking Activities," the Bank of Russia ordered in 2004 the revocation (cancellation) of banking licences from 33 credit institutions, of which two credit institutions had their licences revoked for repeated violations within a year of the Federal Law "On Countering the Legalisation (Laundering) of Criminally Obtained Incomes and the Financing of Terrorism" and 19 credit institutions were stripped of their banking licences for failing to meet creditors' pecuniary claims and/or effect compulsory payments *(see Chart 3.3).*

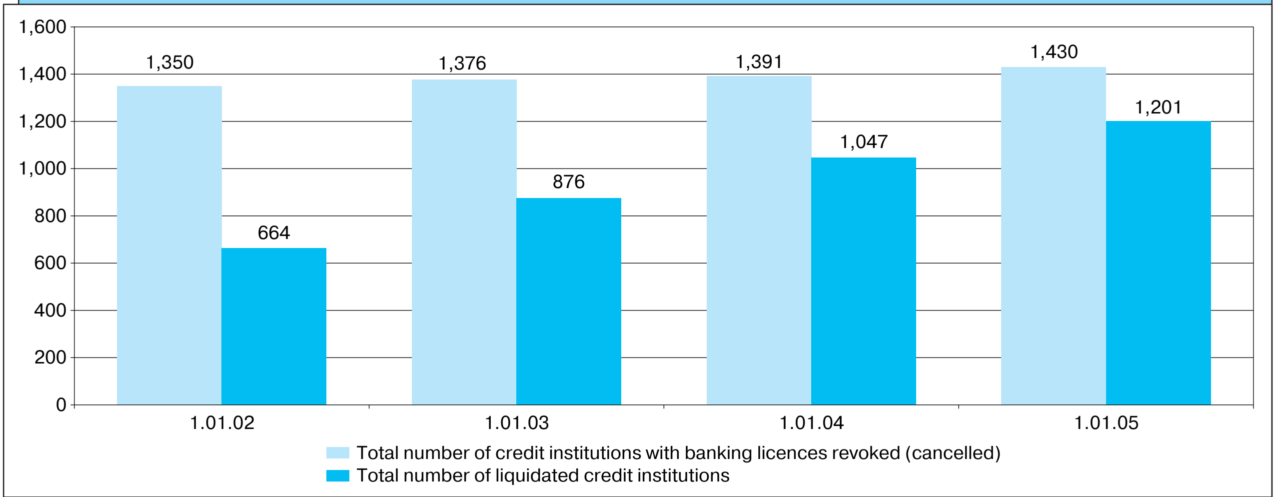
As of January 1, 2005, liquidation proceedings were conducted in 205 out of 218 credit institutions that had their banking licences revoked. Most of the liquidated credit institutions (161) were declared bankrupt by arbitration courts and bankruptcy proceedings were initiated in them (in 2004, bankruptcy proceedings were started in 36 of these credit institutions); in 33 credit institutions arbitration courts appointed liquidators (in 2004, liquidators were appointed in four credit institutions); seven credit institutions were being liquidated in accordance with the decision of their members (founders) and creditors (pursuant to legislative provisions effective at the time) to declare bankruptcy and voluntary liquidation and four credit institutions were being voluntarily liquidated by the decision of their members (in 2004, such a decision was taken on one credit institution). In 45 credit institutions declared absentee debtors by arbitration courts, liquidation proceedings were conducted by Bank of Russia specialists (in 17 of these credit institutions, Bank of Russia specialists were appointed receivers in 2004). In 28 credit institutions liquidated by Bank of Russia specialists, bankruptcy proceedings were completed in 2004. Liquidation proceedings in these credit institutions took no more than one year, as a rule. The upgrading of the bank liquidation and bankruptcy legislation allowed the Bank of Russia to initiate liquidation proceedings and withdraw from the banking sector credit institutions which had had their banking licences revoked a long time ago but the decisions to liquidate them taken by their members or arbitration courts had not been fulfilled. In 2004, arbitration courts decided to change the method of liquidating 18 such credit institutions.

Creditors' claims to liquidated credit institutions struck off the state register were met by 5% on average; of these, creditors of the 1st priority group had 69.5% of their claims met, creditors of 2nd priority group 69.5% and corporate entities 3.3%.

Twenty-seven inspections of receivers (liquidators) were conducted in 2004. After inspections, receivers (liquidators) were ordered to eliminate shortcomings in their work within specified time periods. Information on violations discovered in the course of inspections was passed to arbitration courts, the Ministry of Justice and creditors' committees of credit institutions in the process of liquidation.

In 2004, pursuant to Article 6 of the Federal Law on Insolvency (Bankruptcy) of Credit Institutions and Article 20 of the Federal Law on Insolvency (Bankruptcy), the

Number of credit institutions stripped of licences by the Bank of Russia and number of liquidated credit institutions (on accrual basis) *CHART 3.3*



Bank of Russia issued certificates to 48 receivers (liquidators) of credit institutions, extended the term of the certificates of 236 receivers (liquidators), cancelled the certificates of five receivers (liquidators) and refused to certify 135 applicants for the receiver's (liquidator's) certificate, including one person who was not certified when he applied for the extension of his certificate.

In the course of implementing the provisions of the Federal Law on Insolvency (Bankruptcy) of Credit Institutions, notably, the clause stipulating that the Deposit Insurance Agency may be appointed the receiver of bankrupt credit institutions, in 2004, the Moscow Arbitration Court appointed the DIA the receiver of one credit institution declared bankrupt.

Three educational establishments accredited by the Bank of Russia in 1999—2000 had their accreditation terms extended in 2004 so that they could continue to train receivers (liquidators) of bankrupt credit institutions.

III.9. Countering the legalisation (laundering) of criminally obtained incomes and the financing of terrorism

In 2004, the Bank of Russia carried out a large amount of work to upgrade the legal and methodological support provided to credit institutions in countering the legalisation (laundering) of criminally obtained incomes and the financing of terrorism (AML/FT).

Federal Law No. 88-FZ, dated July 28, 2004, "On Amending the Federal Law on Countering the Legalisation (Laundering) of Criminally Obtained Incomes and the Financing of Terrorism" (hereinafter referred to as Federal Law No. 88-FZ), which came into force on August 30, 2004, gave the Bank of Russia the powers to establish qualification requirements for executives responsible for the observance of internal control rules and the implementation of internal control programmes, requirements for the training of personnel and identification of customers and beneficiaries by credit institutions.

Therefore, the Bank of Russia focused its efforts in 2004 on the creation of conditions conducive to the effective implementation by credit institutions of the new AML/FT legislative provisions.

Implementing the powers granted to it by Federal Law No. 115-FZ, dated August 7, 2001, "On Countering the Legalisation (Laundering) of Criminally Obtained Incomes and the Financing of Terrorism" (hereinafter referred to as Federal Law No. 115-FZ), in 2004, the Bank of Russia drafted and issued a number of AML/FT regulations, establishing the following requirements for:

— the training of personnel in a credit institution (specifically, on issues relating to the elaboration and approval in a credit institution of programme of training in AML/FT and a programme implementation plan, including the subjects and duration of training and persons responsible for it, a list of the divisions of a credit institution whose staff must receive training and the procedure for examining the trainees)[62];

— qualification requirements for the executive and the staff of the division of a credit institution responsible for AML/FT if such a division is organised under the guidance of the responsible executive[63];

— the identification by credit institutions of their customers and beneficiaries (lists of data have been compiled, which a credit institution is required to collect for the purpose of identifying individuals, legal entities and self-employed entrepreneurs, the persons and entities have been established who should be regarded as beneficiaries and a list of operations has been drawn up, which are particularly risky from the viewpoint of money laundering and terrorist financing[64];

— the procedure for passing information by credit institutions to the authorised agency, stipulated by the Federal Law on Countering the Legalisation (Laundering) of Criminally Obtained Incomes and the Financing of Terrorism (specifically, in regard to new operations subject to mandatory control under Federal Law No. 88-FZ)[65];

— the procedure for passing information by credit institutions to the authorised agency in the event of the refusal to conclude a bank account (deposit) agreement with an individual or legal entity and/or conduct operations on grounds established by the Federal Law on Countering the Legalisation (Laundering) of Criminally Obtained Incomes and the Financing of Terrorism[66].

In addition, taking into consideration the provisions of Federal Law No. 88-FZ and its own regulations, the Bank of Russia established the procedure for exercising control over the activities of credit institutions and their branches from the viewpoint of money laundering and terrorist financing.

To provide methodological support to credit institutions in implementing AML/FT measures, in 2004, the Bank of Russia made known to credit institutions the FATF Report on Money Laundering and Terrorist Financing Typologies 2003—2004 and five information circulars explaining various aspects of the application of AML/FT legislation.

To enhance the effectiveness of the implementation of Federal Law No. 115-FZ on May 17, 2004, the Bank of Russia and Federal Financial Monitoring Service, signed an agreement on co-operation in the field of information to be implemented in pursuance of the Federal Law on

[62] Bank of Russia Ordinance No. 1485-U, dated August 9, 2004, "On the Requirements for the Training and Instruction of Personnel in Credit Institutions."

[63] Bank of Russia Ordinance No. 1486-U, dated August 9, 2004, "On the Qualification Requirements for the Special Executives Responsible for the Observance of Internal Control Rules for the Purpose of Countering the Legalisation (Laundering) of Criminally Obtained Incomes and the Financing of Terrorism and the Implementation of Internal Control Programmes in Credit Institutions."

[64] Bank of Russia Regulation No. 262-P, dated August 19, 2004, "On the Identification by Credit Institutions of Customers and Beneficiaries for the Purpose of Countering the Legalisation (Laundering) of Criminally Obtained Incomes and the Financing of Terrorism."

[65] Bank of Russia Ordinance No. 1490-U, dated August 17, 2004, "On Amending Bank of Russia Regulation No. 207-P, Dated December 20, 2002, on the Procedure for Passing by Credit Institutions to the Authorised Agency Information Stipulated by the Federal Law on Countering the Legalisation (Laundering) of Criminally Obtained Incomes and the Financing of Terrorism."

[66] Bank of Russia Ordinance No. 1519-U, dated November 26, 2004, "On the Procedure for Passing Information to the Authorised Agency in the Event of the Refusal to Conclude a Bank Account (Deposit) Agreement with an Individual or Legal Entity and to Conduct Operations with Monetary Funds or Other Property."

Countering the Legalisation (Laundering) of Criminally Obtained Incomes and the Financing of Terrorism.

The agreement provides for the sharing of information between the Bank of Russia and the Federal Financial Monitoring Service for the purpose of countering money laundering and terrorist financing, the conduct of joint training on methods in this sphere, the provision of consultative aid on issues within the competence of each party and other measures aimed at promoting co-operation in the field of information.

Exercising their legislatively established powers to monitor compliance by credit institutions with the requirements of Federal Law No. 115-FZ, in 2004, Bank of Russia regional branches conducted 2,592 inspections of 1,185 credit institutions within the framework of banking regulation and supervision.

Violations of Federal Law No. 115-FZ and Bank of Russia regulations issued in pursuance of this Law were discovered in 56.4% of inspected credit institutions. The most common violations were the failure to present to the authorised agency on time information on operations subject to mandatory control and errors in composing electronic messages.

As a result of the inspections, the credit institutions were subjected to both preventive measures, such as informing their managers about the shortcomings discovered in their work, and enforcement measures, such as ordering the elimination of the uncovered shortcomings, placing restrictions on and banning some banking operations, imposing fines and revoking banking licences.

In accordance with the Catalogue of the Vocational Training of Personnel, the Bank of Russia continued in 2004 to provide comprehensive and continuous training to executives and specialists of its regional branches responsible for providing support for the Bank of Russia's efforts to combat money laundering and terrorist financing. Seven seminars, in which more than 300 employees of the corresponding divisions of Bank of Russia regional branches, were held last year.

III.10. Co-operation with the Russian banking community

In 2004, the Bank of Russia closely co-operated with the banking community in drafting documents on banking regulation and supervision.

Last year, in collaboration with the Association of Russian Banks and the Association of Regional Banks of Russia it placed on its website for discussion with the banking community the drafts of the following Bank of Russia regulations: "On Banks' Required Ratios," "On the Procedure for Making by Credit Institutions Loan Loss Provisions and Provisions for Loan Debts and Similar Debts," and "On Setting Limits on Open Currency Positions, the Methods of Calculating them and the Specifics of Supervision of their Observance by Credit Institutions."

The Bank of Russia sent to the banking associations and put on its official website for public discussion the draft of Bank of Russia Letter on Organising the Management of Legal Risk and Reputation Risk in Credit Institutions and Banking Groups.

In the second quarter of 2004, the Bank of Russia sent to the banking associations a draft of the Questionnaire on Self-Appraisal of the Operation Risk Management in a Credit Institution. It also put the draft on the websites of the Association of Russian Banks, Association "Russia" and National Stock Market Association. Having discussed the draft in the second and third quarters of the year, the associations commented on it and set forth proposals that were favourable and constructive on the whole.

At the request of the Association of Russian Banks, Bank of Russia experts lectured during the seminars organised for credit institutions on the application of Bank of Russia Regulation No. 254-P, dated March 26, 2004, "On the Procedure for Making by Credit Institutions Loan Loss Provisions and Provisions for Loan Debts and Similar Debts" (the seminars were held in Rostov-on-Don, Novosibirsk and Moscow).

In addition, the Bank of Russia advised banks on a wide range of issues relating to the improvement of financial risk regulation.

To help banks cut their costs and become more competitive, in 2004, the Bank of Russia proposed discussing with them and their associations the possibility of replacing the numerous internal divisions of a bank and a bank branch by one universal internal division, an outlet, a list of operations which might be delegated to the outlet and the procedure for accounting of the operations conducted by the outlet in the balance sheet of a bank or bank branch and appointing the manager and chief accountant of the outlet and their deputies.

At the request of credit institutions and banking associations, the Bank of Russia put on its website the methods (algorithms) of calculating banks' financial soundness indicators established by Bank of Russia Ordinance No. 1379-U, dated January 16, 2004, "On the Evaluation of the Financial Soundness of a Bank for the Purpose of Recognising it Sufficient for Participation in the Deposit Insurance System." At the same time, the Bank of Russia proposed that the firms which designed the software for the implementation of this Ordinance (close-end joint-stock company Prognoz and limited liability company EDS-LANIT) develop similar software for credit institutions.

Chief executives of the supervisory divisions of the Bank of Russia and some of its regional branches participated in the Second International Banking Forum, "Russian Banks in the 21st Century," organised by the Association of Regional Banks of Russia in Sochi.

Representatives of the Bank of Russia, Federal Assembly of the Russian Federation, Russian President's Office, Russian Government's Office, federal ministries, foreign central (national) banks and supervisory authorities, international financial organisations and banking community took part in the 13th International Banking Congress, The Russian Banking System in the Context with International Trends and Standards, held in St Petersburg in June 2004.

The Congress discussed the specific conditions of the modernisation of the Russian banking sector, issues relating to banking risks and their management in the context of international best practice and Russian experience, deposit insurance, cross-border banking services, foreign exchange liberalisation and competition on the international banking services market, corporate governance and internal controls in banks and transition to international financial reporting standards.

III.11. Co-operation with international financial organisations and foreign central banks and supervisory authorities

Co-operation with international financial organisations

The International Monetary Fund and World Bank

Bank of Russia representatives participated in working meetings, consultations and the drafting of materials and comments within the framework of the IMF mission in the Bank of Russia. Specifically, the sides discussed issues relating to the establishment of the deposit insurance system, forecasting the situation in the banking sector, asset securitisation, mortgage lending, risk regulation and stress testing methods. The Bank of Russia continued to co-operate with the World Bank in implementing the Financial Institution Development Project and discussed the possibility of developing a new project in support of regional banks and small and medium-sized businesses.

When participating in the Co-ordinated Compilation Exercise (CCE), a phase of the IMF work programme designed to improve the macro-prudential analysis of financial systems[67], the Bank of Russia was involved in the Inventory Survey conducted by the IMF in 2004 to receive information on the current state of the work connected with the calculation and dissemination of financial soundness indicators (FSI).

Bank of Russia representatives also took part in a CCE meeting held by the IMF in Washington in November 2004 that discussed, among other things, standard reporting forms on FSI and metadata to them and approved a CCE work schedule.

The Bank of Russia in 2004 co-operated with the World Bank Moscow office in conducting a comparative analysis of Russian legislation and legislation of the industrialised nations on the registration of credit institutions and licensing of banking activities.

Basel Committee on Banking Supervision and its working groups

In 2004, Bank of Russia representatives participated in:

— two meetings of the working group on the dissemination of the Basel Committee's Core Principles for Effective Banking Supervision at the invitation of the Basel Committee's Secretariat;

— the meeting of the 17th Conference of the Banking Supervisors from Central and Eastern Europe Group, held in Dubrovnik, Croatia, in May, which discussed the optimisation of provisioning and the development of the organisational structures of banking and financial market supervision;

— the 13th International Conference of Banking Supervisors, held in Spain in September, at the invitation of the Basel Committee's Secretariat.

The Bank of Russia took part in organising and holding in August 2004 in St Petersburg the Basel Committee's 14th Conference of the Regional Group on Banking Supervision of Caucasus and Central Asia States and Russia, which discussed issues relating to the upgrading of the legislative framework of the capital adequacy calculation, made taking into account all kinds of risk, financial crisis and bank failures and the evaluation of their possible effect on the financial market, and co-operation between bank supervisors with bank internal controllers and extermal auditors.

EU European Commission

The Bank of Russia co-operated with the EU in carrying out the following TACIS projects:

— "Banking Supervision and Reporting," a project designed to enhance the effectiveness of banking supervision and create a system of prudential reporting based on IFRS and international supervisory best practice;

— "Central Bank Training — III," a project designed to provide training for employees of Bank of Russia head office and supervisory divisions of Bank of Russia regional branches.

The Bank of Russia continued to improve the forms and conditions of co-operation with foreign supervisory authorities. It signed an agreement on co-operation in banking supervision with the National Bank of the Kyrgyz Republic.

In 2004, the Bank of Russia discussed the wording of agreements (memorandums of understanding) on co-operation in banking supervision with the supervisory authorities of 15 countries and the drafting of new agreements (memorandums of understanding) with the supervisory authorities of two countries, with which it already had co-operation agreements.

The activities of the sub-group Banks/Financial Services of the Russian-German Intergovernmental Working Group on the Strategy of Economic and Financial Co-operation. In 2004, the Bank of Russia organised a number of events to discuss the most urgent problems of individual segments of the Russian financial market:

[67] The aim of the Co-ordinated Compilation Exercise is to improve the country's capability to compile financial soundness indicators (FSI) representative of their financial systems, facilitate inter-country comparability of FSI, co-ordinate the efforts of the national agencies in compiling FSI and publish FSI data compiled within the CCE along with corresponding comments for the purpose of increasing financial sector transparency in different countries.

— a working meeting of the sub-group on Financing Russian Small and Medium-Sized Enterprises was held in the Bank of Russia on February 5, 2004, with the participation, on the German side, of representatives of the Ministry of Finance, Economics and Labour Ministry, KfW, International Raiffeisen Union, Dresdner Bank, Commerzbank and German Embassy in Russia and representatives of the Bank of Russia, Ministry for Anti-Monopoly Policy and Support of Entrepreneurship, Association of Russian Banks, Federal Fund for Small Business Support, Russian Venture Investment Association, Russian Microfinancial Centre, Agricultural Credit Co-operation Development Fund, Vneshtorgbank and Sberbank. The discussion focused on banks' participation in financing small and medium-sized enterprises, the role of, and prospects for microfinancial institutions in financing small and medium-sized businesses and venture funds' possibilities in financing small and medium-sized enterprises;

— a working meeting of the sub-group on Building Savings Banks was held in the Bank of Russia on April 28, 2004, with the participation, on the German side, of representatives of the Union of Private Building Savings Banks and representatives of the Federation Council's Committee on Financial Markets and Money Circulation, State Committee on Construction and Housing and Utilities Complex, banking associations and Federal Agency on Housing and Utilities. The participants in the meeting considered issues relating to the legal framework of building savings banks and prospects for housing financing development through mutual savings banks;

— a meeting of the sub-group on Transparency of Credit Institutions' Activities was held in Berlin on May 25—26, 2004, with the participation, on the German side, of representatives of the Bundesbank, Finance Ministry, Economics and Labour Ministry, KfW and Commerzbank and representatives of the Bank of Russia, Ministry of Finance, Economic Development and Trade Ministry and Russian banks. The discussion centred on the transparency of the banking business, including the quality of reporting, Bank of Russia requirements for the ownership structure transparency and the upgrading of bank capital and asset quality standards and implementing the substantive approach to supervision;

— a working meeting of experts of the sub-group on Leasing was held in the Bank of Russia on September 28, 2004, with the participation, on the German side, of representatives of the Ministry of Finance, German Leasing Union and German Embassy in Russia and representatives of the Bank of Russia, Association of Russian Banks, Vneshtorgbank, Sberbank, Russian Association of Leasing Companies and a number of Russian leasing companies. The participants in the meeting discussed the legal aspects of leasing in Russia, the main problems of Russian leasing market operators, the leasing situation in Russia from the viewpoint of a leasing company with foreign investment capital, real estate leasing in Russia, the fiscal and balance sheet aspects of leasing in Russia, the fiscal aspects of leasing operations involving the use of foreign bank loans, some aspects of the taxation and legalisation of the cession of the right of claim on leasing contracts and the financing of leasing operations.

Participation in international banking conferences. Bank of Russia representatives participated in the 12th Interbank Conference on "Capitalisation of Banks: Ways and Possibilities" and "Foreign Capital in Central and Eastern European Banking Systems: a Driving Force or a Brake," held in Yalta, Ukraine, in April 2004.

Participation in creating a single economic space (SES). To contribute to the efforts made by Belarus, Kazakhstan, Russia and Ukraine to create a single economic space, Bank of Russia representatives participated as experts in the meetings of Working Group No. 4 "Fiscal and Monetary Policy. Foreign Exchange Regulation and Control and Macroeconomic Indicators," held in Astana, Kazakhstan, on April 1, 2004, in Yalta, Ukraine, on May 20 and 21, 2004, in Kiev on October 20 to 22, 2004, in Moscow on November 15, 2004, and in Minsk on December 14, 2004.

Within the framework of this working group, Bank of Russia representatives took part in developing the SES Design Specification and Plan of Action and later in drafting the agreements on harmonising banking legislation with Basel principles and on harmonising the deposit insurance systems. At the meeting of Working Group No. 4 held in Minsk, Belarus, on December 14, 2004, experts of the SES member states approved the draft agreements in principle and at the meeting of the SES High-Level Group held in Minsk on December 15, 2004, the draft agreements were approved in principle and recommended for the negotiating process.

Co-operation with international organisations in countering the legalisation (laundering) of criminally obtained incomes and the financing of terrorism. In February, June and October 2004, Bank of Russia representatives participated as members of the Russian delegation in the plenary meetings of the Financial Action Task Force (FATF) and its working groups. In addition, in July 2004, the Bank of Russia took part in the meeting of the MONEYVAL Committee of the Council of Europe, the Select Committee of Experts on the Evaluation of Anti-Money Laundering Measures, which approved the second round anti-money laundering evaluation report on Russia.

III.12. Outlook for banking regulation and supervision in Russia

In the next few years, the Bank of Russia is to continue to carry out a set of measures designed to increase the stability of the Russian banking sector, protect the interests of creditors and depositors and upgrade the methods and organisation of banking supervision in line with the Russian Banking Sector Development Strategy until 2008.

The Bank of Russia will focus its efforts on further improving the legal framework of the banking sector, creating a favourable environment for the enhancement of the role played by banks in financial intermediation, encouraging competition, increasing the transparency of credit institutions, strengthening market discipline in the banking sector, creating a level playing field for all credit institutions and tightening corporate governance requirements.

Deposit insurance system development. As regards the practical actions aimed at ensuring the functioning of the deposit insurance system, the Bank of Russia is to carry out a series of measures designed to minimise the insurance system risks, especially by barring financially unstable banks from it. In addition, the guarantees provided by the Federal Deposit Insurance Law are to be extended to household deposits of precious metals with banks.

It should be noted that one of the tasks set by the Banking Sector Development Strategy for the Bank of Russia is that of using information received in the course of examining banks' applications for deposit insurance system entry for uncovering violations of law endangering creditors' and depositors' interests and taking corresponding supervisory measures in response. In addition, the Bank of Russia will closely watch the banks whose entry requests have been turned down.

In 2005, the Bank of Russia will continue to build the deposit insurance system, consider banks' repeat requests for entry and improve the regulation of the system.

Licensing banking activities. To create more favourable conditions for the implementation of bank reorganisation procedures, in 2005, the Ministry of Finance will co-operate with the Bank of Russia and Economic Development and Trade Ministry in drafting amendments to the Federal Law on Banks and Banking Activities, simplifying bank reorganisation procedures and providing better protection for the interests of the creditors of reorganised credit institutions.

In line with the Banking Sector Development Strategy, the Bank of Russia will make amendments in its regulations to simplify the procedure for opening bank branches.

Changes will continue to be made in applicable banking legislation to lower Bank of Russia-controlled threshold amounts of shares (stakes) acquired in a credit institution. The acquisition of more than 1% of shares in a credit institution will require notification and the acquisition of more than 10% of shares prior permission. This will help to make the ownership structure of credit institutions more transparent and allow the Bank of Russia to have more control over decision-making in credit institutions.

Legislators continue to make changes in the federal laws establishing the procedure for identifying the actual owners of a credit institution and disclosing information on them and other persons capable of directly or indirectly influencing the decisions made by bank management, setting requirements for the financial standing and business reputation of actual owners and granting to the Bank of Russia the right to end the participation of persons who do not meet the established requirements in the management of credit institutions. Business reputation criteria are being worked out for the founders (members) and actual owners of credit institutions and members of their boards of directors (supervisory boards) and chief executive officers.

When controlling the quality of governance in credit institutions, the Bank of Russia will pay special attention to members of boards of directors (supervisory boards). This is necessitated by the increased role and responsibility of boards of directors (supervisory boards) in the management of credit institutions and, consequently, in the improvement of corporate governance in the banking sector and the task of tightening requirements for the competence and business reputation of members of boards of directors (supervisory boards).

Of great importance for tackling the task of making the Russian banking sector more competitive, set in the Banking Sector Development Strategy, is attracting foreign capital, which will bring advanced technology and high corporate governance standards to the Russian banking services market. To create equal conditions for resident and non-resident participation in banking sector capital, Russia will have to make amendments in its legislation, establishing the same procedure for acquiring large blocks of shares in credit institutions by residents and non-residents.

In 2005, the Bank of Russia is to complete the drafting of its new Regulation on the Procedure and Criteria for Evaluating the Financial Condition of Individual Founders (Members) of a Credit Institution.

To strengthen the resource base of credit institutions, the Bank of Russia will lift restrictions on the issue of bonds with a value equalling that of the authorised capital of a bond-issuing credit institution.

Off-site supervision. The Bank of Russia will continue to carry out measures aimed at encouraging the use of substantive supervision, including a more accurate evaluation of the financial soundness of credit institutions and, whenever necessary, an adequate supervisory response. This work will also be carried out as part of the procedure for selecting banks entering the deposit insurance system.

To create conditions for the development of substantive supervision, the Bank of Russia will participate in drafting amendments to the provisions of the Federal Law on the Central Bank of the Russian Federation (Bank of Russia), establishing Bank of Russia powers in using professional (informed) judgement in supervisory practice.

In 2005, the Bank of Russia plans to begin preparing for the implementation of the Basel Committee's document "International Convergence of Capital Measurement and Capital Standards: a Revised Framework," known as Basel II. Specifically, it intends to form a working group of Bank of Russia experts and representatives of the Association of Russian Banks and Association of Regional Banks of Russia.

The Bank of Russia will continue to upgrade the procedure for regulating risks assumed by credit institutions in conducting lending operations with related persons and economically interrelated borrowers.

To harmonise credit risk evaluation standards used in provisioning with IFRS, the Bank of Russia is to revise its Regulation No. 232-P, dated July 9, 2003, "On the Procedure for Loan Loss Provisions by Credit Institutions" and Regulation No. 254-P, dated March 26, 2004, "On the Procedure for Making by Credit Institutions Loan Loss Provisions and Provisions for Loan Debts and Similar Debts," including the risk evaluation procedure for a portfolio of homogeneous credit claims, taking into account the new version of IAS 39.

To upgrade market risk regulation standards, the Bank of Russia is to introduce, in addition to the standardized method of market risk measurement, the Basel Committee-encouraged Value at Risk method.

To minimise risks connected with the economic, social and political conditions of the borrower country (country risk) as well as legal, operating and reputation risks involved in the relations with offshore zones, the Bank of Russia is to revise the provisioning requirements for credit institutions' operations with offshore zone residents.

In 2005, the Bank of Russia will continue to optimise and upgrade prudential reporting within the framework of the EU/TACIS Project "Banking Supervision and Reporting." Changes are to be made in the contents of prudential reports and the procedure for presenting them and recommendations are to be worked out for their analysis. In addition, within the framework of this Project, the Bank of Russia will be upgrading the legal framework of consolidated supervision and its procedures. This work is expected to result in changes in applicable Bank of Russia regulations and the Bank of Russia will issue new regulations on these matters, taking into account international experts' recommendations.

A series of measures is to be implemented to upgrade the legal framework of consolidated supervision. The Bank of Russia is to draft in collaboration with the Finance Ministry amendments to the Federal Law on Banks and Banking Activities and the Federal Law on the Central Bank of the Russian Federation (Bank of Russia). It will also continue to draft a new version of its Regulation No. 191-P, dated July 30, 2002, "On Consolidated Reporting," which will contain a revised methodology for compiling consolidated reports and measuring consolidated risk on their basis.

The Bank of Russia plans to complete the drafting of a regulation on the evaluation of financial soundness of a credit institution, based on standards used in determining banks' fitness for the participation in the deposit insurance system and requiring the use of professional judgement in evaluation, and a regulation on the regimes of credit institutions' supervision, which will require supervisors to be guided by the evaluation of the financial soundness of credit institutions and make supervisory decisions on the basis of professional (substantive) judgement. The Bank of Russia is also to complete the development of methodologies for the introduction of the curatorship in supervisory practices, notably, the Bank of Russia's Regulation on the Curator of a Credit Institution and Methodological Guidance for the Curator, known as "The Curator's Handbook."

The recommendations on the analysis of the financial standing of credit institutions and the computerised system of analysis of the financial standing of a bank, worked out in 2000, are to be revised and upgraded. In 2005, all Bank of Russia regional branches are to test run the subsystem "Forecasting the financial standing of credit institutions," designed to detect problems in credit institutions at an early stage (an early warning system).

The results of polls of credit institutions will be used to upgrade the methodological recommendations on conducting the stress testing of credit institutions.

To improve corporate governance in the Russian banking sector, the Bank of Russia will provide credit institutions with information, compiled according to international standards, on the contemporary principles of organising corporate governance in credit institutions and circulate among them a questionnaire designed to help credit institutions to evaluate corporate governance on their own. The Bank of Russia will continue to develop the methods of evaluating the quality of internal controls in credit institutions and banking groups and improve the reporting of internal control management. The Bank of Russia also plans to work out recommendations on the management of individual kinds of non-financial risk.

To be able to make a comprehensive assessment of banking risks, the Bank of Russia will develop methodologies for monitoring the use by credit institutions of new, remote banking technologies, including Internet banking.

The Bank of Russia is determined to adhere to its policy of increasing banking sector transparency, informing all users concerned about major developments and trends in the Russian banking sector. It will continue to publish macroprudential indicators of the Russian banking sector and it is determined to expand the sphere of analysis and the set of tools used in this analysis, gradually approaching international best practice in financial stability reports.

The volume of information disclosed by credit institutions on the Bank of Russia website will be expanded and the Bank of Russia will continue to build a system to monitor the state of the banking sector, which in the long run will make it possible to detect problems in the Russian banking sector at an early stage[68].

To improve the quality of the evaluation of the financial stability of the Russian banking sector, the Bank of Russia will continue to implement the IMF Financial Sector Assessment Program (FSAP), compiling financial soundness indicators (FSI) that allow one to evaluate the financial state of the country's financial institutions and their corporate counterparties, as well as the household sector. FSI include data on individual institutions and the markets on which these financial institutions operate. The Bank of Russia will adapt the methods of calculating FSI to the conditions of the Russian banking sector and applicable regulations.

Inspections. The upgrading of inspection standards is part of the general effort to enhance the effectiveness of supervision for the stability of the banking sector.

Building upon the experience gained in conducting inspections and realising the short-term objectives in this area, the Bank of Russia will continue to improve the quality of inspections. To this end, it will focus on such aspects of importance for the quality of inspections as the upgrading of inspection methodologies and improving preparations for inspections and the recording of inspection results (the structure of the inspection report and memorandum).

From the organisational point of view, the effectiveness of inspections could be increased by expanding and strengthening co-operation with bank curators, especially at the stage of preparing for and conducting an inspection. The Bank of Russia intends to make better use of interregional inspections as a means of co-ordinating and organising inspections in the regions, especially in conducting inspections of multi-branch banks, and their information and analysis capabilities.

The Bank of Russia will continue to introduce advanced software and hardware systems to enhance the practical uses of analysis and increase information support for inspection planning and management.

Financial rehabilitation and liquidation of credit institutions. To raise bank capitalisation requirements, Russia will make amendments to its legislation, increasing the capital adequacy requirement and stipulating that non-compliance with this requirement will be regarded as grounds for the revocation of a banking licence. This requirement will apply to all credit institutions, bank and non-bank, regardless of their equity capital, from 2007.

As for preventing bank insolvency (bankruptcy), the principal objectives set in this field by the Banking Sector Development Strategy are to ensure the timely and effective use of sanctions stipulated by the Federal Law on Insolvency (Bankruptcy) of Credit Institutions and improve the procedure for liquidating credit institutions, including the establishment of an effective procedure for selling the assets of liquidated banks and the exclusion of collateral from bankrupt's assets in the event of the debtor's bankruptcy.

The Bank of Russia is currently drafting a new version of its Regulation No. 241-P, dated November 26, 2003, "On the Provisional Administration of a Credit Institution," in connection with the granting to the Deposit Insurance Agency of the powers of the receiver (liquidator) of credit institutions, the broadening of the powers of the provisional administration of a credit institution appointed by the Bank of Russia after the revocation of a banking licence from the credit institution, the possibility of including DIA employees in the provisional administrations and the establishment of the compulsory deposit insurance system.

In connection with the changes made in the Federal Law on Insolvency (Bankruptcy) of Credit Institutions, which introduced the corporate liquidator of credit institutions and granted the corresponding powers to the DIA, the Bank of Russia has drafted a regulation on the procedure for conducting settlement operations by a credit institution after the revocation (cancellation) of its banking licence and on the accounts of the receiver (liquidator or liquidation commission) and a regulation on how Bank of Russia regional branches should deal with credit institutions that had their banking licences revoked in order to regulate the procedure for using the accounts of the liquidated credit institution by receivers (liquidators or liquidation commissions), including the DIA.

In addition, in order to monitor liquidation procedures, the Bank of Russia is drafting an ordinance establishing the list, forms and procedure for compiling and presenting reporting forms of liquidated credit institutions to the Central Bank of the Russian Federation. The indicators included in the monthly reporting forms are an effective means of control over bankruptcy proceedings, which will enable the Bank of Russia to obtain on a constant basis data on the financial standing of the credit institution being liquidated, the value of bankrupt's assets, the course and outcome of asset sale, the extent to which creditors' claims have been met and the availability of funds that could be used to meet creditors' pecuniary obligations.

Credit bureaus from which banks can receive information on borrowers' bona fide fulfilment of obligations to banks serve the purpose of evaluating and reducing credit risks.

The Federal Law on Credit Histories, which comes into effect on June 1, 2005, regulates the establishment and operation of credit bureaus and the Central Catalogue of Credit Histories, a special division of the Bank of Russia.

The Bank of Russia is currently working on legalising the establishment of the Central Catalogue of Credit Histories and tackling related technical problems.

[68] For details, see Annex IV.2. Building a system of monitoring banking sector stability.

Annexes

IV

IV.1. The situation in the banking sector in May—July 2004

The “confidence crisis” that hit the Russian banking system in the spring and summer of 2004 had a marked effect on the dynamics of banking sector indicators. In May 2004, the Bank of Russia revoked Sodbiznesbank’s banking licence. It was the first time a bank was stripped of its licence for non-compliance with the law on countering the legalisation (laundering) of criminally obtained incomes and the financing of terrorism. After that, many banks overhauled their risk evaluation systems, reducing and sometimes closing their mutual credit limits on the interbank market.

These developments provoked alarming reports in the media. The deposit insurance system was not yet in place and depositors felt understandable concern for their money. The situation was compounded by unfair competition, such as the spreading of false bank “black lists” and the mentioning of known banks in a negative context. As a result, the level of mutual confidence of banks and the level of customer and depositor confidence in the banks declined dramatically.

These developments were accompanied by an absolute contraction in banking sector ruble liquidity amid significant growth in banks’ foreign assets, caused by the reversal of the ruble/dollar exchange rate. As ruble liquidity shrank, interbank interest rates soared.

As a result of the combined effect of these events and factors, the volume of the interbank market declined between May and July. Interbank credit turnovers on the domestic market decreased 12.2% in May and 13.3% in June. Many banks preferred to stop extending interbank loans altogether and accumulate additional liquidity.

At the same time, there was a run on some Moscow-based banks in June. The net outflow of deposits (outflow net of inflow) amounted to 5.2 billion rubles in June and 18.1 billion rubles in July, excluding those of Sberbank and Vneshtorgbank. The adversity spread to regional banks in July when the outflow of deposits from these banks amounted to 6.3 billion rubles. Tension escalated early in July when Guta-bank, which had branches in many regions, stopped payments.

The following measures were taken to stabilise the situation.

On June 15, the Bank of Russia set a single required reserve ratio of 7% and on July 8, it lowered it to 3.5%. This gave the banking sector additional liquidity in July. The value of required reserves deposited with the Bank of Russia declined by 118.6 billion rubles, or almost by half.

To boost depositor confidence in the banking system, Russia urgently drafted and passed the Federal Law on Bank of Russia Payments on Household Deposits with Bankrupt Banks Uncovered by the Compulsory Deposit Insurance System, which applies to depositors of the banks that do not participate in the deposit insurance system and had their licences revoked after the Federal Depoposit Insurance Law came into force after December 27, 2003.

Vneshtorgbank urgently made the decision to acquire Guta-bank, assuming the obligation to restore its solvency. At the same time, the Bank of Russia deposited $700 million in Vneshtorgbank.

As a result of the implementation of these measures, the “confidence crisis” was overcome, and in August, the interbank market began to recover and the flow of household deposits to banks resumed.

Despite the adverse developments of the spring and summer of 2004, the banking sector continued to move forward.

IV.2. Building a system of monitoring banking sector stability

The Bank of Russia is currently working to organise banking sector monitoring. The banking sector monitoring system is largely based on the financial soundness indicators (FSI) and the IMF Compilation Guide on Financial Soundness Indicators.

So far, the Bank of Russia has carried out the following preparatory work:

— it has selected from the Compilation Guide the indicators which, in its opinion, are best suited for the analysis of the Russian banking sector;

— it has added to these indicators a number of other indicators, including those used to evaluate banks' compliance with the requirements for entry to the deposit insurance system;

— it has calculated series of financial soundness indicators for borrowing enterprises on the basis of monitoring data;

— it has included in the analysis information on the state of the financial markets and macroeconomic indicators and FSI on other financial intermediaries and the household sector;

— it has calculated series on the basis of quarterly data compiled during the past five years (monthly data for 2004) and analysed them to find out the most sensitive indicators of change in the banking sector.

At present, the Bank of Russia is working to determine, on the basis of expert estimates, the limits of the accumulation of adverse changes in the banking sector and further select and upgrade financial soundness indicators.

The Bank of Russia is considering the possibility of finding out the reasons for the sharp fluctuations of the aggregate banking sector indicators by determining the systemically important banks that had the most significant effect on the dynamics of a specific indicator.

IV.3. Statistical appendix

Dynamics of key macroeconomic indicators in 2001—2004

TABLE 1

Indicator	2001	2002	2003	2004
GDP, billion rubles	8,944	10,818	13,201	16,779
as % of previous year	105.1	104.7	107.3	107.1
GDP deflator index, %	116.5	115.5	113.7	118.6
Federal budget surplus, as % of GDP	3.0	1.4	1.7	4.4
Industrial output, as % of previous year	104.9	103.7	107.0	106.1
Agricultural output, as % of previous year	107.5	101.5	101.3	101.6
Retail trade turnover, as % of previous year	111.0	109.3	108.8	112.5
Fixed capital investment, as % of previous year	110.0	102.8	112.5	110.9
Household real disposable income, as % of previous year	108.7	111.1	115.1	108.4
Unemployment rate, as % of economically active population (average for period)	9.0	8.1	8.6	8.2
Consumer price index (December as % of December of previous year)	118.6	115.1	112.0	111.7
US dollar/ruble nominal rate, average for period	29.17*	31.35	30.68	28.81

** Estimate.*

Macroeconomic indicators of the Russian banking sector

TABLE 2

Indicator	1.01.02	1.01.03	1.01.04	1.01.05
Banking sector assets (liabilities), billion rubles	3,159.7	4,145.3	5,600.7	7,136.9
as % of GDP	35.3	38.3	42.4	42.5
Banking sector equity capital, billion rubles	453.9	581.3	814.9	946.6
as % of GDP	5.1	5.4	6.2	5.6
as % of banking sector assets	14.4	14.0	14.6	13.3
Loans and other funds extended to resident non-financial enterprises, including overdue debt, billion rubles	1,176.8	1,591.4	2,266.9	3,149.9
as % of GDP	13.2	14.7	17.2	18.8
as % of banking sector assets	37.2	38.4	40.5	44.1
Securities acquired by banks, billion rubles	562.0	779.9	1,002.2	1,086.9
as % of GDP	6.3	7.2	7.6	6.5
as % of banking sector assets	17.8	18.8	17.9	15.2
Household deposits and other funds, billion rubles	677.9	1,029.6	1,514.4	1,964.0
as % of GDP	7.6	9.5	11.5	11.7
as % of banking sector liabilities	21.5	24.8	27.0	27.5
as % of household money income	12.8	15.2	17.0	18.4
Funds attracted from enterprises and organisations*, billion rubles	902.6	1,091.4	1,384.8	1,986.1
as % of GDP	10.1	10.1	10.5	11.8
as % of banking sector liabilities	28.6	26.3	24.7	27.8

** Including deposits, government extra-budgetary funds, funds of the Finance Ministry, financial bodies, customers in factoring and forfeiting operations, float, and funds written down from customers' accounts but not entered in a credit institution's correspondent account.*

Quantitative characteristics of Russian credit institutions (numbers)

TABLE 3

Indicator	1.01.04	1.04.04	1.07.04	1.10.04	1.01.05
Credit institutions registered by the Bank of Russia and other bodies	1,668	1,621	1,586	1,549	1,518
Operating credit institutions (credit institutions licensed to conduct banking operations)	1,329	1,330	1,326	1,314	1,299
Credit institutions which have been registered by the Bank of Russia but have not yet paid in their authorized capital and have not received licences (within the time period set by law)	4	2	0	0	1
Credit institutions which had their banking licences revoked (cancelled)	335	289	260	235	218
Credit institutions licensed to conduct operations in foreign currency	845	852	855	849	839
Credit institutions with general licences	310	312	311	309	311

Data on registration and licensing of credit institutions as of January 1, 2005*

TABLE 4

Registration of credit institutions		
1.	No. of credit institutions[1] registered by the Bank of Russia or by the Authorized registration authority on the basis of Bank of Russia decision, total[2]	1,516
	of which:	
	— banks	1,464
	— non-bank credit institutions	52
1.1.	No. of registered wholly foreign-owned credit institutions	33
1.2.	Credit institutions which have been registered by the Bank of Russia but have not yet paid in authorised capital and have not received licences (within the time period set by law)	1
	of which:	
	— banks	0
	— non-bank credit institutions	1
2.	Non-bank credit institutions registered by other bodies prior to July 1, 2002	2
Operating credit institutions		
3.	Credit institutions licensed to conduct banking operations, total[3]	1,299
	of which:	
	— banks	1,249
	— non-bank credit institutions	50
3.1.	Credit institutions with licences (permits):	
	— to take household funds on deposit	1,165
	— to conduct operations in foreign currency	839
	— general licences	311
	— to conduct operations with precious metals	
	— Permits	4
	— licences[4]	178
3.2.	Credit institutions with a foreign stake, total	131
	of which:	
	— wholly foreign-owned credit institutions	33
	— credit institutions with a 50%-plus foreign stake	9
4.	Registered authorised capital of operating credit institutions, million rubles	380,468
5.	Branches of operating credit institutions in Russia, total	3,238
	of which:	
	— Sberbank branches[5]	1,011
	— branches of wholly foreign-owned credit institutions	16
6.	Branches of operating credit institutions abroad, total[6]	3
7.	Non-resident bank branches in Russia	0
8.	Representative offices of operating Russian credit institutions, total[7]	350
	of which:	
	— in Russia	306
	— in non-CIS countries	31
	— in CIS countries	13

END

Licence revocation and liquidation of legal entities	
9. Credit institutions which had their banking licence revoked (cancelled) but were not struck off the State Register[8]	218
10. Liquidated credit institutions struck off the State Register, total[9]	1,569
of which:	
— due to licence revocation (cancellation)	1,201
— due to reorganisation	367
of which:	
— by merger	0
— by acquisition	367
of which:	
— transformed into other banks' branches	329
— merged with other banks (without establishing a branch)	38
— due to non-compliance with authorised capital payment requirement	1

** Including data provided by the Authorized registration authority as of the accounting date.*

[1] The term "credit institution" in this Table includes one of the following terms:
— a legal entity registered by the Bank of Russia (prior to July 1, 2002) or the Authorized registration authority and having the right to conduct banking operations;
— a legal entity registered by the Bank of Russia (prior to July 1, 2002) or the Authorized registration authority, which had but lost the right to conduct banking operations;
— a legal entity registered by other bodies (before the Federal Law on Banks and Banking Activities came into force) and having Bank of Russia licence to conduct banking operations.

[2] Credit institutions which have the status of a legal entity as of the accounting date, including credit institutions that have lost the right to conduct banking operations but have not yet been liquidated as legal entities.

[3] Credit institutions registered by the Bank of Russia (prior to July 1, 2002) or the Authorized registration authority and having the right to conduct banking operations and also non-bank credit institutions registered by other bodies and holding Bank of Russia licences to conduct banking operations.

[4] Issued since December 1996 in accordance with Bank of Russia Letter No. 367, dated December 3, 1996.

[5] Sberbank branches put on the State Register of Credit Institutions and assigned serial number. Before January 1, 1998, the total number of Sberbank branches indicated in this row in the monthly Bulletin of Information on Credit Institutions was 34,426.

[6] Branches opened by Russian credit institutions abroad.

[7] Representative offices of Russian credit institutions abroad include the offices of whose opening abroad the Bank of Russia was notified.

[8] Total number of credit institutions stripped of banking licences by the Bank of Russia, including credit institutions struck off the State Register, is 1,430.

[9] After July 1, 2002, a liquidated credit institution is struck off the State Register only after its liquidation has been registered by the Registration Authority.

Dynamics of operating credit institutions' organisational and legal form structure

TABLE 5

Title	1.01.04		1.01.05	
	Number	% share	Number	% share
Operating credit institutions with licences to conduct banking operations, total	**1,329**	**100**	**1,299**	**100**
of which:				
— joint-stock companies	838	63.05	824	63.43
— close-end joint-stock companies	350	26.34	341	26.25
— open-end joint-stock companies	488	36.72	483	37.18
— unit trusts	490	36.87	474	36.49
— additional liability companies	1	0.08	1	0.08
— limited liability companies	489	36.79	473	36.41
— Russian Finance Corporation (government enterprise)	1	0.08	1	0.08

Number of credit institutions and their branches by region as of January 1, 2005

TABLE 6

Region	No. of credit institutions in region	No. of branches in region		
		Total	Credit institutions with head office in this region	Credit institutions with head office in another region
1	2	3	4	5
Total in Russia:	**1,299**	**3,238**	**866**	**2,372**
Central Federal District	**742**	**722**	**225**	**497**
Belgorod Region	6	32	5	27
Bryansk Region	2	21	2	19
Vladimir Region	3	31	0	31
Voronezh Region	4	40	1	39
Ivanovo Region	5	22	3	19
Kaluga Region	5	31	2	29
Kostroma Region	5	18	1	17
Kursk Region	2	19	0	19
Lipetsk Region	2	19	1	18
Orel Region	2	21	3	18
Ryazan Region	4	25	2	23
Smolensk Region	4	31	5	26
Tambov Region	2	21	7	14
Tver Region	8	36	3	33
Tula Region	6	36	6	30
Yaroslavl Region	11	37	4	33
Moscow Region	671	282	180	102
of which: Moscow	656	133	37	96
Moscow Region	15	149	9	140
North-Western Federal District	**87**	**364**	**56**	**308**
Republic of Karelia	1	20	2	18
Komi Republic	5	35	7	28
Arkhangelsk Region	4	31	0	31
of which Nenets Autonomous Area	0	2	0	2
Vologda Region	8	29	9	20
Kaliningrad Region	12	32	6	26
Leningrad Region	3	42	2	40
Murmansk Region	4	27	2	25
Novgorod Region	2	16	2	14
Pskov Region	4	10	0	10
St Petersburg	44	122	26	96
Southern Federal District	**130**	**468**	**156**	**312**
Republic of Adygeya	5	6	1	5
Republic of Daghestan	36	75	62	13
Republic of Ingushetia	2	5	1	4
Kabardino-Balkar Republic	7	9	1	8
Republic of Kalmykia — Khalmg Tangch	2	5	0	5
Karachai-Circassian Republic	5	5	0	5
Republic of North Ossetia — Alania	6	17	8	9
Chechen Republic	0	1	0	1
Krasnodar Territory	21	105	23	82
Stavropol Territory	10	54	9	45
Astrakhan Region	5	29	7	22
Volgograd Region	6	58	13	45
Rostov Region	25	99	31	68

END

Region	No. of credit institutions in region	No. of branches in region		
		Total	Credit institutions with head office in this region	Credit institutions with head office in another region
1	2	3	4	5
Volga Federal District	**151**	**648**	**155**	**493**
Republic of Bashkortostan	13	45	1	44
Republic of Marii El	1	26	4	22
Republic of Mordovia	4	18	6	12
Republic of Tatarstan	27	102	55	47
Udmurt Republic	9	26	0	26
Chuvash Republic	5	22	0	22
Kirov Region	3	27	0	27
Nizhni Novgorod Region	19	81	33	48
Orenburg Region	10	43	4	39
Penza Region	2	32	0	32
Perm Region	10	54	3	51
of which: Komi-Permyak Autonomous Area	0	2	0	2
Samara Region	24	77	23	54
Saratov Region	18	65	23	42
Ulyanovsk Region	6	30	3	27
Ural Federal District	**71**	**394**	**165**	**229**
Kurgan Region	5	25	0	25
Sverdlovsk Region	30	105	42	63
Tyumen Region	25	157	82	75
of which: Khanty-Mansi Autonomous Area	12	41	13	28
Yamalo-Nenets Autonomous Area	5	20	3	17
Chelyabinsk Region	11	107	41	66
Siberian Federal District	**75**	**433**	**52**	**381**
Republic of Altai	5	2	0	2
Republic of Buryatiya	2	28	5	23
Republic of Tyva	3	5	0	5
Republic of Khakassia	3	12	1	11
Altai Territory	9	56	13	43
Krasnoyarsk Territory	6	79	10	69
of which: Taimyr Autonomous Area	0	1	0	1
Evenk Autonomous Area	0	0	0	0
Irkutsk Region	9	62	9	53
of which: Ust-Orda Buryat Autonomous Area	0	2	0	2
Kemerovo Region	10	37	0	37
Novosibirsk Region	14	45	1	44
Omsk Region	8	44	0	44
Tomsk Region	4	31	9	22
Chita Region	2	32	4	28
of which: Agin-Buryat Autonomous Area	0	0	0	0
Far Eastern Federal District	**43**	**209**	**57**	**152**
Republic of Sakha (Yakutia)	6	54	9	45
Primorskiy (Maritime) Territory	9	42	17	25
Khabarovsk Territory	6	23	5	18
Amur Region	5	18	4	14
Kamchatka Region	8	19	7	12
of which: Koryak Autonomous Area	1	2	0	2
Magadan Region	3	19	6	13
Sakhalin Region	6	21	9	12
Jewish Autonomous Region	0	6	0	6
Chukchee Autonomous Area	0	7	0	7

Columns “No. of credit institutions in region” and “No. of branches in region” for St Petersburg and the Leningrad Region show the number of credit institutions and their branches as they are indicated in the State Register of Credit Institutions by the Bank of Russia Main Division for St Petersburg and Main Division for the Leningrad Region.

Provision of Russian regions with banking services as of January 1, 2005*

TABLE 7

Region	No. of credit institutions	No. of branches	Assets (net), million rubles	Loans and other placements with resident non-financial enterprises and households, million rubles	Deposits and other funds attracted from households, million rubles	Gross Regional Product in 2004, billion rubles (estimate)	Population, thousand (estimate)	Average monthly per capita money income in 2004, rubles	Institutional saturation with banking services (by population)	Financial saturation with banking services (by assets)	Financial saturation with banking services (by lending volume)	Savings index (per capita deposits to income)	Composite index of region's provision with banking services
1	2	3	4	5	6	7	8	9	10	11	12	13	14
Central Federal District (excluding Moscow and Moscow Region)	**71**	**440**	**304,583**	**215,175**	**171,995**	**1,329**	**20,500**	**3,895**	**0.88**	**0.92**	**1.07**	**1.14**	**1.00**
Belgorod Region	6	32	30,287	24,732	16,263	102	1,510	4,016	0.89	1.20	1.60	1.42	1.25
Bryansk Region	2	21	12,542	8,630	7,948	64	1,346	3,675	0.60	0.79	0.89	0.85	0.77
Vladimir Region	3	31	19,415	15,662	12,763	83	1,487	3,257	0.81	0.95	1.25	1.39	1.07
Voronezh Region	4	40	46,009	30,593	22,995	137	2,333	3,909	0.67	1.36	1.48	1.33	1.15
Ivanovo Region	5	22	11,549	5,232	7,206	46	1,115	2,620	0.85	1.02	0.76	1.30	0.96
Kaluga Region	5	31	14,727	10,428	9,281	62	1,020	4,051	1.25	0.95	1.10	1.19	1.12
Kostroma Region	5	18	7,867	4,710	5,086	43	717	3,693	1.13	0.74	0.73	1.01	0.89
Kursk Region	2	19	17,586	14,695	8,291	72	1,199	4,326	0.62	0.98	1.34	0.84	0.91
Lipetsk Region	2	19	22,952	15,654	9,787	110	1,191	4,263	0.62	0.84	0.94	1.02	0.84
Orel Region	2	21	9,269	7,225	5,564	60	842	3,801	0.96	0.62	0.79	0.92	0.81
Ryazan Region	4	25	15,666	11,091	10,343	85	1,194	3,568	0.86	0.75	0.86	1.28	0.92
Smolensk Region	4	31	14,353	10,759	8,374	73	1,018	4,341	1.21	0.79	0.98	1.00	0.98
Tambov Region	2	21	12,233	10,298	6,922	61	1,145	4,072	0.71	0.81	1.12	0.78	0.84
Tver Region	8	36	13,975	8,209	9,048	91	1,425	3,776	1.09	0.62	0.60	0.89	0.77
Tula Region	6	36	22,431	16,957	14,553	105	1,621	3,940	0.91	0.86	1.06	1.20	1.00
Yaroslavl Region	11	37	33,724	20,297	17,572	135	1,338	4,934	1.26	1.01	0.99	1.41	1.15
North-Western Federal District	**87**	**364**	**509,048**	**280,392**	**210,552**	**1,454**	**13,727**	**6,587**	**1.16**	**1.41**	**1.27**	**1.23**	**1.27**
Republic of Karelia	1	20	9,955	7,962	5,685	65	703	5,762	1.05	0.62	0.82	0.74	0.79
Komi Republic	5	35	22,234	11,928	14,464	144	996	9,181	1.42	0.62	0.55	0.84	0.80
Arkhangelsk Region	4	31	19,292	15,650	11,643	131	1,304	6,011	0.95	0.59	0.79	0.78	0.77
Vologda Region	8	29	40,433	20,845	14,661	128	1,245	5,192	1.05	1.27	1.07	1.20	1.14
Kaliningrad Region	12	32	22,766	13,755	11,472	64	944	4,530	1.64	1.44	1.43	1.42	1.48
Leningrad Region	3	42	19,258	9,821	12,686	158	1,652	3,739	0.96	0.49	0.41	1.08	0.68
Murmansk Region	4	27	21,500	13,996	14,725	105	872	7,888	1.25	0.82	0.88	1.13	1.01
Novgorod Region	2	16	7,422	4,442	4,506	49	674	4,140	0.94	0.61	0.59	0.85	0.73
Pskov Region	4	10	6,737	3,717	4,156	38	736	3,994	0.67	0.71	0.64	0.75	0.69
St Petersburg	44	122	339,451	178,275	116,554	570	4,600	8,665	1.27	2.40	2.06	1.54	1.77

CONT.

1	2	3	4	5	6	7	8	9	10	11	12	13	14
Southern Federal District	**130**	**468**	**270,656**	**167,770**	**140,747**	**1,153**	**22,813**	**3,818**	**0.92**	**0.95**	**0.96**	**0.85**	**0.92**
Republic of Adygeya	5	6	2,670	1,276	1,827	13	444	2,999	0.87	0.83	0.65	0.72	0.76
Republic of Daghestan	36	75	6,058	2,204	1,861	66	2,622	2,962	1.49	0.37	0.22	0.13	0.35
Republic of Ingushetia	2	5	723	191	301	6	482	1,758	0.51	0.49	0.21	0.19	0.32
Kabardino-Balkar Republic	7	9	4,242	3,004	2,579	36	897	3,200	0.63	0.47	0.54	0.47	0.53
Republic of Kalmykia — Khalmg Tangch	2	5	1,372	1,075	574	21	290	2,269	0.85	0.26	0.34	0.46	0.43
Karachai-Circassian Republic	5	5	2,317	1,779	1,055	16	435	3,344	0.81	0.57	0.72	0.38	0.60
Republic of North Ossetia — Alania	6	17	7,804	3,605	4,937	26	704	4,062	1.15	1.21	0.92	0.91	1.04
Krasnodar Territory	21	105	76,925	52,774	47,685	364	5,099	4,119	0.87	0.85	0.96	1.20	0.96
Stavropol Territory	10	54	39,218	24,296	21,952	133	2,717	3,881	0.83	1.19	1.21	1.10	1.07
Astrakhan Region	5	29	13,571	7,122	7,972	69	998	4,490	1.20	0.79	0.68	0.94	0.88
Volgograd Region	6	58	33,577	22,817	19,370	174	2,655	4,523	0.85	0.78	0.87	0.85	0.84
Rostov Region	25	99	79,229	47,563	30,541	228	4,334	4,913	1.01	1.40	1.38	0.76	1.10
Volga Federal District	**151**	**648**	**693,156**	**454,449**	**278,473**	**2,524**	**30,699**	**4,658**	**0.92**	**1.11**	**1.19**	**1.03**	**1.06**
Republic of Bashkortostan	13	45	108,070	43,251	31,023	333	4,078	4,991	0.50	1.31	0.86	0.80	0.82
Republic of Marii El	1	26	5,032	4,130	2,979	29	717	2,575	1.33	0.69	0.93	0.85	0.92
Republic of Mordovia	4	18	10,994	7,687	4,524	38	866	3,287	0.90	1.18	1.35	0.84	1.04
Republic of Tatarstan	27	102	128,350	83,907	41,155	406	3,765	5,130	1.21	1.28	1.37	1.13	1.24
Udmurt Republic	9	26	30,035	23,717	11,115	129	1,552	3,623	0.80	0.94	1.22	1.04	0.99
Chuvash Republic	5	22	13,630	11,815	7,147	62	1,299	3,175	0.73	0.89	1.26	0.92	0.93
Kirov Region	3	27	15,981	12,922	9,544	83	1,461	3,695	0.72	0.77	1.02	0.93	0.86
Nizhni Novgorod Region	19	81	91,837	63,835	40,524	305	3,445	4,730	1.02	1.21	1.38	1.31	1.23
Orenburg Region	10	43	28,540	22,486	14,863	160	2,150	3,812	0.87	0.72	0.93	0.96	0.86
Penza Region	2	32	14,560	10,336	9,164	70	1,421	3,280	0.84	0.84	0.98	1.04	0.92
Perm Region	10	54	65,962	50,459	28,852	301	2,769	6,247	0.81	0.88	1.11	0.88	0.92
Samara Region	24	77	126,065	84,571	47,161	369	3,200	6,871	1.11	1.38	1.51	1.13	1.27
Saratov Region	18	65	40,713	24,612	21,513	162	2,624	3,897	1.12	1.01	1.00	1.11	1.06
Ulyanovsk Region	6	30	13,387	10,722	8,910	76	1,351	3,559	0.94	0.71	0.94	0.98	0.89
Ural Federal District	**71**	**394**	**443,018**	**220,404**	**168,595**	**2,205**	**12,271**	**7,188**	**1.34**	**0.81**	**0.66**	**1.01**	**0.92**
Kurgan Region	5	25	7,144	5,640	3,969	50	992	3,710	1.07	0.58	0.75	0.57	0.72
Sverdlovsk Region	30	105	152,548	99,422	55,221	382	4,428	6,496	1.08	1.61	1.72	1.01	1.32
Tyumen Region	25	157	215,203	65,960	77,934	1,489	3,301	11,819	1.94	0.58	0.29	1.05	0.77
Chelyabinsk Region	11	107	68,124	49,382	31,470	284	3,550	4,717	1.17	0.97	1.15	0.99	1.07

END

1	2	3	4	5	6	7	8	9	10	11	12	13	14
Siberian Federal District	**75**	**433**	**352,463**	**250,132**	**157,825**	**1,597**	**19,787**	**5,233**	**0.91**	**0.89**	**1.04**	**0.81**	**0.91**
Republic of Altai	5	2	1,759	1,277	588	10	204	3,501	1.21	0.72	0.86	0.44	0.76
Republic of Buryatiya	2	28	12,500	9,049	4,696	61	969	4,601	1.09	0.83	0.99	0.56	0.84
Republic of Tyva	3	5	974	741	578	10	308	3,347	0.92	0.38	0.47	0.30	0.47
Republic of Khakassia	3	12	4,876	4,148	2,602	38	541	4,664	0.98	0.52	0.72	0.54	0.67
Altai Territory	9	56	35,981	29,096	14,098	117	2,564	3,475	0.89	1.24	1.64	0.84	1.11
Krasnoyarsk Territory	6	79	58,035	41,304	29,346	366	2,925	6,541	1.02	0.64	0.75	0.81	0.79
Irkutsk Region	9	62	40,857	27,840	21,942	232	2,545	5,441	0.98	0.71	0.79	0.84	0.83
Kemerovo Region	10	37	48,580	32,175	23,911	224	2,854	6,058	0.58	0.87	0.95	0.73	0.77
Novosibirsk Region	14	45	72,548	48,396	25,343	202	2,661	4,820	0.78	1.45	1.59	1.04	1.17
Omsk Region	8	44	41,159	31,981	17,048	141	2,044	5,447	0.90	1.18	1.50	0.81	1.06
Tomsk Region	4	31	25,048	18,154	12,032	126	1,036	6,220	1.19	0.81	0.96	0.99	0.98
Chita Region	2	32	10,145	5,972	5,640	70	1,136	4,606	1.06	0.59	0.56	0.57	0.67
Far Eastern Federal District	**43**	**209**	**155,649**	**78,531**	**79,852**	**753**	**6,591**	**6,965**	**1.35**	**0.83**	**0.69**	**0.92**	**0.92**
Republic of Sakha (Yakutia)	6	54	19,764	9,759	11,172	178	950	9,229	2.23	0.45	0.36	0.67	0.70
Primorskiy (Maritime) Territory	9	42	37,282	21,441	19,812	157	2,036	5,349	0.88	0.96	0.90	0.96	0.93
Khabarovsk Territory	6	23	46,253	22,939	21,950	158	1,420	7,480	0.72	1.18	0.96	1.09	0.97
Amur Region	5	18	10,848	8,432	5,640	72	888	5,213	0.91	0.61	0.77	0.64	0.72
Kamchatka Region	8	19	10,309	4,850	6,142	39	352	8,035	2.70	1.06	0.81	1.15	1.28
Magadan Region	3	19	11,270	4,064	3,857	33	175	9,286	4.45	1.40	0.83	1.26	1.59
Sakhalin Region	6	21	15,879	5,279	8,743	87	532	9,362	1.79	0.73	0.40	0.93	0.83
Jewish Autonomous Region	0	6	1,446	947	983	10	189	5,029	1.12	0.57	0.61	0.55	0.68
Chukchee Autonomous Area	0	7	2,597	821	1,553	18	51	12,280	4.88	0.57	0.29	1.32	1.02
Total (excluding Moscow and Moscow Region)	**628**	**2,956**	**2,728,573**	**1,666,854**	**1,208,039**	**11,014**	**126,390**	**5,048**	**1.00**	**1.00**	**1.00**	**1.00**	**1.00**

** Calculated according to the methodology developed by Bank of Russia Banking Regulation and Supervision Department.*

Some performance indicators of credit institutions with foreign interest relative to indicators of operating credit institutions (%)

TABLE 8

	1.01.01	1.01.02	1.01.03	1.01.04	1.01.05
Credit institutions with a 50%-plus foreign stake					
Assets	9.5	8.8	8.1	7.4	7.6
Equity capital	9.4	7.7	7.1	6.6	7.8
Correspondent accounts with non-resident banks	15.6	20.0	22.9	19.7	14.0
Loans and other placements with non-financial enterprises and organisations, including non-resident legal entities	7.1	7.2	7.1	6.1	6.2
Loans, deposits and other placements with banks	33.0	31.3	25.9	22.0	15.8
Funds in household accounts	1.8	2.2	2.2	2.2	2.9
of which deposits and other borrowed funds	1.7	2.3	2.3	2.2	2.8
Funds attracted from enterprises and organisations*	14.0	11.7	10.4	9.3	9.4
of which wholly-foreign owned credit institutions					
Assets	5.1	5.2	5.6	5.6	5.9
Equity capital	6.2	5.2	5.4	5.4	6.3
Correspondent accounts with non-resident banks	9.0	10.5	19.2	16.8	7.7
Loans and other funds placed with non-financial enterprises and organisations, including non-resident legal entities	5.5	5.2	5.5	4.6	4.6
Loans, deposits and other placements with banks	13.2	20.4	16.3	17.0	11.4
Funds in household accounts	1.0	1.4	1.5	1.5	2.4
of which deposits and other borrowed funds	1.0	1.5	1.5	1.5	2.2
Funds attracted from enterprises and organisations*	5.5	5.3	5.5	5.7	6.6

** These include deposits, government extra-budgetary funds, funds of the Finance Ministry, financial bodies and customers in factoring and forfeiting operations, float, and funds written down from customers' accounts but not entered in a credit institution's correspondent account.*

Structure of credit institutions' assets by kind of investment (billion rubles)

TABLE 9

	Assets	1.01.04	1.04.04	1.07.04	1.10.04	1.01.05
1	Money, precious metals and gemstones, total	137.9	111.2	120.3	134.8	196.3
1.1	of which money	133.5	107.8	115.8	127.8	190.7
2	Accounts with the Bank of Russia, total	658.6	628.4	511.7	383.1	695.5
	of which					
2.1	Credit institutions' correspondent accounts with the Bank of Russia	296.1	217.8	204.6	201.8	463.3
2.2	Credit institutions' required reserves transferred to the Bank of Russia	267.4	287.6	250.6	116.0	121.6
2.3	Deposits placed with the Bank of Russia	87.3	109.7	38.4	45.5	91.4
3	Correspondent accounts with credit institutions, total	305.6	311.7	253.2	215.4	227.8
	of which					
3.1	Correspondent accounts with correspondent credit institutions	123.8	103.9	70.7	68.6	86.5
3.2	Correspondent accounts with non-resident banks	181.8	207.8	182.5	146.8	141.3
4	Securities acquired by banks, total	1,002.2	1,098.7	1,117.2	1,090.4	1,086.9
	of which					
4.1	Debt obligations	625.1	681.8	715.9	770.4	752.6
	of which					
4.1.1	Russian government debt obligations	447.0	451.0	460.7	471.8	435.6
4.2	Stocks and shares	115.8	118.2	127.4	144.8	140.9
	of which					
4.2.1	Controlling shareholdings	17.4	17.4	17.3	16.8	19.6
4.3	Discounted promissory notes	261.3	298.7	273.8	175.2	193.4
5	Other participation in authorised capital	4.2	4.5	4.3	4.9	6.1
6	Loan debt, total	3,048.0	3,354.4	3,715.8	4,170.5	4,463.8
	of which					
6.1	Loans, deposits and other placements	3,047.4	3,353.9	3,714.3	4,169.0	4,462.4
	including overdue debt	48.0	53.7	61.0	66.6	61.9
	of which					
6.1.1	Loans and other placements with non-financial enterprises and organisations	2,385.0	2,524.5	2,758.8	3,000.6	3,268.7
	of which overdue debt	37.2	42.0	47.7	51.8	49.5
6.1.2	Loans, deposits and other placements with banks	263.7	373.0	406.5	514.2	425.8
	of which overdue debt	6.9	6.8	7.0	6.7	3.3
6.2	Financing of government programmes and capital investment on a repayable basis	0.6	0.5	1.4	1.6	1.4
7	Fixed and intangible assets and inventories	179.0	187.3	196.3	206.3	222.8
8	Disposition of profits	25.3	30.1	23.9	29.6	34.4
9	Other assets, total	239.9	247.4	239.3	219.2	203.2
	of which					
9.1	Float	120.8	121.6	107.8	91.7	80.9
9.2	Debtors	22.9	24.0	26.8	29.7	27.4
9.3	Overdue interest on loans	3.7	3.6	3.8	4.2	3.1
9.4	Deferred expenses	77.1	81.6	83.4	85.7	81.4
Total assets		**5,600.7**	**5,973.8**	**6,182.0**	**6,454.3**	**7,136.9**

Structure of credit institutions' liabilities by source (billion rubles)

TABLE 10

	Liabilities	1.01.04	1.04.04	1.07.04	1.10.04	1.01.05
1	Bank funds and profits, total	834.3	888.1	897.4	954.3	1,006.1
	of which					
1.1	Bank funds	719.6	724.4	769.7	789.4	806.7
1.2	Profit (loss), including financial results of previous years	114.7	163.7	127.8	164.9	199.4
	of which					
1.2.1	Accounting year's profit (loss)	128.4	47.4	82.8	142.4	177.9
2	Loans, deposits and other funds received by credit institutions from the Bank of Russia	0.1	0.0	3.7	20.9	19.5
3	Bank accounts, total	202.3	169.8	101.2	104.0	116.3
	of which					
3.1	Correspondent credit institutions' correspondent accounts	118.4	93.8	64.8	55.4	69.1
3.2	Non-resident banks' correspondent accounts	78.6	67.2	26.4	18.6	17.5
4	Loans, deposits and other funds received from other banks, total	525.3	559.3	567.3	650.9	737.1
	of which					
4.1	Overdue debt	3.1	3.0	3.1	3.1	0.0
5	Customers' funds, total	2,999.6	3,252.2	3,534.7	3,685.3	4,151.5
	of which					
5.1	Budget funds in settlement and current accounts	56.3	70.8	96.3	132.8	138.7
5.2	Government extra-budgetary funds in settlement and current accounts	22.3	17.7	18.5	19.7	19.2
5.3	Corporate funds in settlement, current and other accounts	978.5	994.6	1,081.5	1,077.1	1,273.1
5.4	Customer float	22.9	60.0	65.8	71.6	30.3
5.5	Corporate deposits	312.5	357.4	401.4	444.0	564.0
5.6	Funds in household accounts	1,558.5	1,704.0	1,818.4	1,849.7	2,026.7
	of which					
5.6.1	Deposits and other funds attracted from households	1,514.4	1,658.6	1,767.4	1,797.0	1,964.0
5.7	Other borrowed funds	48.4	47.5	49.0	86.4	94.7
5.8	Customers' funds in factoring and forfeiting operations	0.3	0.2	2.7	3.5	4.8
5.9	Funds written down from customers' accounts but not entered in a credit institution's correspondent account	0.0	0.0	1.2	0.5	0.1
6	Debt obligations issued, total	634.5	650.8	611.0	572.0	644.2
	of which					
6.1	Bonds	13.8	23.6	25.6	26.6	30.6
6.2	Certificates of deposit	148.2	130.2	86.7	62.2	99.2
6.3	Savings certificates	1.7	2.3	3.1	3.3	3.6
6.4	Promissory notes and bank acceptances	466.0	489.5	489.9	474.7	506.2
7	Other liabilities, total	404.5	453.6	466.6	466.9	462.1
	of which					
7.1	Reserves	216.6	235.7	235.7	240.3	257.9
7.2	Float	118.1	139.8	147.1	152.1	139.1
7.3	Creditors	8.2	10.9	16.3	10.1	7.5
7.4	Fixed and intangible asset depreciation	23.9	26.4	29.0	32.0	34.9
7.5	Deferred income	30.1	31.4	27.9	19.1	10.8
Total liabilities		**5,600.7**	**5,973.8**	**6,182.0**	**6,454.3**	**7,136.9**

Major characteristics of banking sector lending operations (billion rubles)

TABLE 11

Indicators		Rubles					Foreign currency					Total				
		1.01.04	1.04.04	1.07.04	1.10.04	1.01.05	1.01.04	1.04.04	1.07.04	1.10.04	1.01.05	1.01.04	1.04.04	1.07.04	1.10.04	1.01.05
1.	Loans, deposits and other placements, total	1,987.6	2,206.0	2,433.0	2,738.5	3,125.9	1,059.8	1,147.9	1,281.3	1,430.5	1,336.5	3,047.4	3,353.9	3,714.3	4,169.0	4,462.4
	of which overdue debt	32.4	37.8	41.6	46.5	47.3	15.6	15.8	19.4	20.0	14.6	48.0	53.7	61.0	66.6	61.9
1.1.	Loans and other placements with resident non-financial enterprises and organisations	1,516.9	1,646.8	1,825.2	2,002.9	2,280.0	749.9	758.1	795.0	857.1	869.9	2,266.9	2,404.9	2,620.2	2,860.0	3,149.9
	of which overdue debt	25.8	30.3	32.6	36.2	36.3	10.1	10.6	14.1	14.9	12.4	35.8	41.0	46.6	51.1	48.7
1.2.	Loans and other placements with non-resident legal entities, except banks	27.1	28.5	26.5	27.3	18.7	91.0	91.1	112.0	113.2	100.1	118.2	119.6	138.5	140.5	118.8
	of which overdue debt	0.25	0.25	0.25	0.24	0.24	1.08	0.78	0.80	0.50	0.56	1.33	1.02	1.04	0.74	0.80
1.3.	Loans, deposits and other placements with financial sector	129.9	163.5	143.5	189.0	209.8	61.2	56.3	55.4	71.2	79.0	191.1	219.8	198.9	260.2	288.9
	including overdue debt	3.9	3.8	4.0	3.7	3.4	0.1	0.0	0.0	0.1	0.0	3.9	3.9	4.0	3.7	3.4
	of which															
1.3.1.	Loans, deposits and other placements with resident credit institutions	95.5	130.5	116.4	155.4	162.9	47.5	45.5	43.6	58.8	66.9	143.0	175.9	160.0	214.2	229.8
	of which overdue debt	3.8	3.8	3.9	3.7	3.3	0.0	0.0	0.0	0.0	0.0	3.8	3.8	3.9	3.7	3.3
1.3.2.	Loans, deposits and other placements with resident financial organisations of different forms of ownership	34.5	33.0	27.1	33.6	46.9	13.6	10.9	11.8	12.4	12.1	48.1	43.9	38.8	46.0	59.0
	of which overdue debt	0.02	0.03	0.08	0.03	0.06	0.06	0.04	0.03	0.05	0.01	0.08	0.07	0.12	0.08	0.07
1.4.	Loans, deposits and other placements with non-resident banks	20.3	16.5	10.3	6.2	14.5	100.5	180.6	236.1	293.8	181.4	120.7	197.1	246.4	300.0	196.0
	of which overdue debt	0.01	0.01	0.00	0.00	0.00	3.09	2.99	3.05	3.07	0.02	3.10	2.99	3.05	3.07	0.02
1.5.	Loans and other funds provided to government financial agencies and extra-budgetary funds	46.8	59.2	55.8	52.6	53.3	3.4	1.9	1.9	1.8	1.3	50.1	61.1	57.6	54.3	54.6
	of which overdue debt	0.17	0.14	0.39	0.55	0.36	0.10	0.10	0.09	0.07	0.04	0.27	0.23	0.49	0.62	0.40
1.6.	Loans extended to resident individuals	246.1	291.2	363.6	432.7	525.2	52.2	58.0	73.6	82.2	91.3	298.4	349.2	437.2	514.9	616.5
	of which overdue debt	2.4	3.3	4.4	5.8	7.0	1.0	1.1	1.2	1.3	1.3	3.4	4.4	5.5	7.1	8.4
1.7.	Loans extended to non-resident individuals	0.1	0.1	0.1	0.2	0.2	1.3	1.4	2.0	2.1	2.1	1.3	1.4	2.1	2.3	2.3
	of which overdue debt	0.00	0.01	0.01	0.01	0.01	0.21	0.19	0.20	0.20	0.20	0.21	0.20	0.21	0.21	0.21
For the record																
Overdue interest on loans, deposits and other placements with residents		1.5	1.4	1.4	1.3	1.4	2.2	2.2	2.3	3.0	1.7	3.7	3.6	3.8	4.2	3.1
Overdue interest on loans, deposits and other placements with non-residents		0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Credit institutions' investments in residents' promissory notes		237.9	280.9	256.8	159.3	166.0	17.5	11.6	11.1	11.5	20.7	255.4	292.6	267.9	170.8	186.7
Credit institutions' investments in non-residents' promissory notes		1.2	0.8	0.6	0.5	0.5	4.7	5.3	5.3	3.9	6.1	5.9	6.1	5.9	4.4	6.6

Return on capital in key sectors of the Russian economy in 2004

TABLE 12

Sector	Return on capital*, %
Electric-power industry	5.4
Fuel sector	23.8
Trade and public catering	16.9
Communications	32.0
Transport	6.6
Ferrous metallurgy	58.2
Non-ferrous metallurgy	36.9
Food industry	18.3
Woodworking and pulp-and-paper industry	11.0
Building materials industry	20.6
Construction	10.9
Machine-building and metalworking	9.3
Chemical and petrochemical industry	17.8
Light industry	—0.7
Economy as a whole	**14.9**
Banking sector**	18.8

Source: data by sector have been compiled by the Federal Statistics Service; data for banking sector by the Bank of Russia.

** Return on capital is calculated as the ratio of profit net of loss to capital and reserves. Capital and reserves comprise authorised capital, additional capital, reserve capital, social security fund, targeted allocations and receipts, retained profit and uncovered loss of the past years and accounting period.*

*** Calculated by the Bank of Russia according to Federal Statistics Service methodology. Return on capital is calculated as the ratio of banking sector profits to equity capital as of the end of 2004.*

Number of inspections of credit institutions and their branches conducted by the Bank of Russia in 2004

TABLE 13

Federal district	No. of inspections conducted according to Summary Annual Plan of Comprehensive and Selective Inspections of Credit Institutions and their Branches			Actual number of inspections		
	Total	Comprehensive inspections	Selective inspections	Total	Credit institutions	Branches of credit institutions
Central Federal District	492	113	379	1 181	981	200
of which Moscow and Moscow Region	286	77	209	887	875	12
North-Western Federal District	115	33	82	188	125	63
Southern Federal District	181	50	131	274	182	92
Volga Federal District	223	42	181	356	226	130
Ural Federal District	204	27	177	259	109	150
Siberian Federal District	130	40	90	210	121	89
Far Eastern Federal District	97	25	72	127	61	66
TOTAL	**1,442**	**330**	**1,112**	**2,595**	**1,805**	**790**

Household assets and funds in inspected credit institutions as a percentage of total household assets and funds in operating credit institutions

TABLE 14

Federal district	Credit institutions' assets		Household funds	
	2003	2004	2003	2004
Central Federal District	71.14	56.89	20.30	99.66
of which Moscow and Moscow Region	71.07	56.75	19.90	99.66
North-Western Federal District	72.00	99.74	64.46	99.78
Southern Federal District	71.19	98.19	68.12	99.99
Volga Federal District	60.15	99.84	61.58	100.00
Ural Federal District	80.05	99.17	86.31	100.00
Siberian Federal District	86.06	99.30	87.69	100.00
Far Eastern Federal District	77.49	99.81	82.67	100.00
TOTAL	**71.17**	**60.13**	**26.41**	**99.68**

Quantitative and qualitative characteristics of the supervisory staff at the Bank of Russia head office and regional branches as of January 1, 2005

TABLE 15

Division title	Nominal number of jobs as of January 1, 2005	Total number of employees as of January 1, 2005 (excluding part-timers)	of whom							
			age			education		length of work in banking system		women
			under 30 (born in 1975 and later)	over 50 (born in 1954 and earlier)	of whom women over 55 and men over 60	higher	vocational secondary	3 years and less	15 years and more	
Head office										
Banking Regulation and Supervision Department	177	169	32	54	15	165	3	16	49	121
Credit Institution Licensing and Financial Rehabilitation Department	133	130	33	26	10	121	8	13	26	98
Foreign Exchange Regulation and Control Department	103	96	25	22	6	91	2	12	7	56
Main Inspectorate for Credit Institutions	147	130	32	29	5	126	3	33	11	67
Head office total	**560**	**525**	**122**	**131**	**36**	**503**	**16**	**74**	**93**	**342**
Regional branches										
Credit Institution Supervision Division (Section)	1,479	1,450	218	236	59	1,385	57	69	500	1,224
Credit Institution Inspection Division (Section)	981	955	150	161	30	937	17	55	184	523
Foreign Operations and Foreign Exchange Regulation and Control Division (Section)	609	602	124	70	19	585	15	49	128	408
Sections of the Moscow Branch	635	633	223	99	31	557	65	88	77	452
Main Divisions/National Banks total	**3,704**	**3,640**	**715**	**566**	**139**	**3,464**	**154**	**261**	**889**	**2,607**
Bank of Russia total	**4,264**	**4,165**	**837**	**697**	**175**	**3,967**	**170**	**335**	**982**	**2,949**
%		97.7	20.1	16.7	4.2	95.2	4.1	8.0	23.6	70.8

For notes

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