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$1Bln Fund Will Support Smaller Banks

By Howard Amos

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A new fund for investing in private regional banks put together by the Finance Ministry, the International Financial Corporation and Vneshekonombank should reach $1 billion and speed up consolidation in a sector already being squeezed by competition from large state-controlled lenders.

The Russian government will contribute $50 million to the Russian Banking Opportunity Fund, or RBOF, unveiled during the St. Petersburg International Economic Forum last week. Vneshekonombank pledged up to $250 million, and the IFC committed the same amount.

Like the $10 billion Russian Direct Investment Fund, which was also formally introduced at the forum, the RBOF will seek private investors.

"You don't do consolidation for consolidation's sake ... [but] if I was to make a bet it would be that 10 years from now you will have significantly fewer banks," said Lars Thunell, chief executive of the IFC, the World Bank arm focused on private sector development.

The domestic financial scene is dominated by big players VTB and Sberbank, which have always controlled more than 50 percent of the market, but according to Central Bank statistics there were 1,075 banks registered in Russia at the end of May 2011.

That figure, Thunell told The Moscow Times, is "a little [too] much to my mind."

Finance Minister Alexei Kudrin told reporters that the idea for the RBOF appeared during the financial crisis when the state was not able to help all the small banks operating in Russia and that it would also help improve openness and transparency.

Thunell agreed that the fund arose out of a desire to strengthen the system in the wake of the crisis, but added that it was also designed to have a positive impact on the future shape of the banking system as a whole.

"The banking system in Russia is on the one hand extremely concentrated, and on the other extremely fragmented," he said.

Industry analysts emphasized that although the quantity of banks in Russia is large, the top 200 account for 95 percent of the market. The total number of banks has been steadily dropping since the mid-1990s when it peaked at about 2,500 licensed banks.

"The bottom end of the Russian banking sector by size does not have very much relevance in terms of the overall sector," said Stuart Lawson, executive director of Ernst & Young in Russia and a former head of HSBC Russia.

Relevant or not, the Finance Ministry has outlined a process that will ratchet up the pressure on small banks over the next four years with incremental increases in capital thresholds. The current minimum level is 90 million rubles ($3.2 million), but this will rise to 180 million rubles in 2012 and 300 million rubles by 2015.

Small banks are also vulnerable to increasing competition from state-backed banks heavily supported by the government during the crisis. Sberbank alone received $17.8 billion in subordinated loans.

Foreign banks have also fallen victims to increased competition — HSBC and Barclays announced their exit from the Russian retail banking market this year, and Rabobank, Santander and Swedbank have cut back their retail operations.

Thunell said the RBOF should be understood as a private equity fund for investing in the financial sector outside Moscow and St. Petersburg. The IFC only works in emerging markets and is looking to diversify its Russian operations to the regions as a way of fulfilling its development targets.

The RBOF is likely to look to a selective strengthening of the best regional banks, said Mikhail Shlemov, a financial analyst at VTB Capital.

With low interest rates as a potential catalyst, the subsequent process of mergers and consolidation will weed out the weakest players and help strengthen private banking within Russia.

"We would welcome the emergence of a large private bank that could compete with the big state owned ones," Shlemov said.

Alexandra Lozovaya, a financial analyst with InvestCafe, said that up to 30 percent of banks could leave the sector within the next three to five years.

But Anatoly Aksakov, president of the Association of Regional Russian Banks, warned that "whether [consolidation] takes place slowly or quickly, it should take place according to market conditions."

"The process of consolidation within the banking system has been happening and will continue to happen. ... It shouldn't be that there is one set of conditions for state banks and another for private banks; [or] that there is one set of conditions for small banks and another for big banks," he said.

An earlier version of this article should have said HSBC announced its exit from the Russian retail market this year but continues to serve corporate and institutional clients. Barclays still has an investment banking presence after announcing the sale of its commercial and retail arm. The article incorrectly said both banks had completely exited the Russian market.

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