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INDEPENDENT NEWS FROM RUSSIA

State Boosts Grip on Economy With Bank Crackdown

By Alexander Panin

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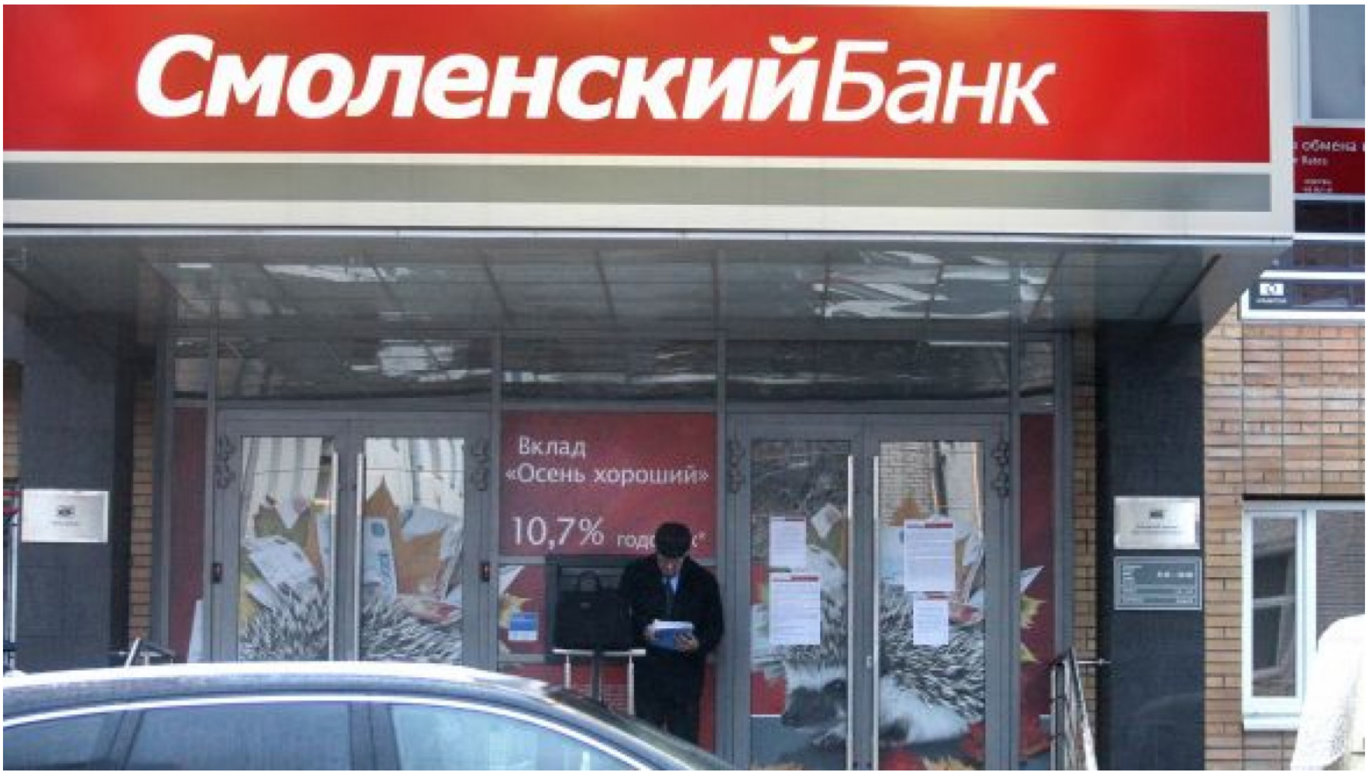

A man standing outside Smolensky Bank,one of the institutions shut down in the Central Bank's crackdown. **Andrei Makhonin**

For some bank depositors, the second half of 2013 has been a year to increase their intimacy with the state, whether they wanted to or not.

Anyone with funds in the more than 30 small and medium-sized commercial banks that lost their licenses this year would have gone to bed thinking their life savings was resting safely in one institution, but woken up to find themselves chasing the Deposit Insurance Agency and whichever state-backed lender it chose to return up to 700,000 rubles ($21,000) of his lost funds.

The game of musical chairs continued on Tuesday, with the Central Bank revoking operating licenses of two more small commercial banks — Moscow-based Rublyovsky and Askold, a subsidiary of recently closed Smolensky Bank, the latest in a series of closures in an ongoing clean-up of the banking system by the revitalized regulator, which has rattled a complacent sector and sparked a rush of capital into state-owned behemoths.

Only three banks had their license revoked by the regulator in the first half of the year. But since Elvira Nabiullina took the helm in June, 29 more lenders have lost the right to operate — and the year is not over yet.

Industry players see the bank closures as a symptom of greater problems — a lack of overall consolidation of the sector and control over shady operations. But some point out that the shakeout is also a methodical part of a carefully orchestrated effort to address the country's macro economic woes.

The government is in a bind over its spending commitments, said Jacob Nell, executive director of Morgan Stanley in Russia, and the crackdown on banks is a key part of the chosen solution — the "deoffshorization" of the economy. As economic growth stumbles, the Finance Ministry is facing a widening gap between spending and tax revenue. To boost income, the government is trying by hook or by crook to pull business out of offshore tax avoidance schemes. To this end, the regulator was given the green light to clamp down on financial institutions abetting the flow of funds overseas.

A New Approach

The number of revoked licenses so far this year is not in itself alarming — twice as many licenses were revoked in 2006. But the approach is different, which, financial analysts say, is a warning sign.

The main change coming from Nabiullina is that the licenses can be annulled at banks that are well-known and considered reliable, said Pavel Gagarin, head of Gradient Alfa consulting company at a conference held last week in an attempt to give a forecast on the future of Russia's banking sector in 2014.

The sudden closure in November of Master Bank — the country's 72nd largest by assets —heralded a new regulatory assertiveness. Master Bank had been considered too large and too well-connected to fall. Igor Putin, a cousin of the country's president, sat on its board. The Central Bank cited "dubious operations" as the reason for revoking the license, but Master Bank's activities had long been an open secret. For many, its closure marked a sea change.

"Nabiullina is demonstrating a fundamental approach here, and we can state with a great deal of confidence that more licenses in the passing and the coming year are apt to be revoked, including major league banks," Gagarin said.

Its not only institutions that are systematically breaking the law that should fear for their licenses, he said. Those banks who have valuable assets, like a well-developed branch network, should take precautions.

Master Bank, had 1,600 cash machines and 30 offices in Moscow which were given by the bank's temporary management to Alfa Bank to run following the collapse.

Shared Fate

Following the spate of licenses revocations, the regulator is neither mincing words nor trying to calm depositors or bankers.

"The banking sector is the nervous system of the economy. The fact that some parts of this system are being cut off at the current pace is not a good sign. This may have negative consequences for the economy in general," said Stepan Chitipakhovyan, deputy chairman of the board of Transstroibank.

Several top-ranking government officials have said there are other banks that deserve the same fate as Master Bank. The idea of a broad house cleaning in the sector is being discussed in the media and blogosphere, while rumors circulate of blacklists of banks — which many claim to have seen — and the wholesale collapse of the system.

The panic atmosphere is forcing a reaction. "As the news of more banks losing licenses increase, depositors and businesses will look more closely at their banking arrangements. Of course convenience and location will play a part but so too will safety and disruption concerns. That will favor the strong banks and the state banks in particular," said Chris Weafer, a senior partner with Macro Advisory, a Russia-based investment consultancy.

The big players already seem to be reaping a dividend. Fitch ratings agency calculated that in November, withdrawals from banks not included in the list of top-100 by asset size may have equaled up to 430 billion rubles ($13 billion), or 7 percent of their overall funds.

Start of Consolidation

Financial authorities, analysts and board members of large private banks have been saying that Russia's economy needs only 200 to 300 banks — less than a third of the almost 900 lenders today. The latest moves by the regulator suggest that it is finally being serious about limiting the number of banks, Weafer said.

"It is inevitable that the state banks will strengthen their position in the sector and in the economy generally," he added.

According to Fitch, more than 80 percent of the $13 billion removed from smaller banks wound up in the top lenders: Sberbank, Gazprombank, VTB group and Unicredit. Only one of them, the smallest, Unicredit, is privately owned.

"Currently, the top five banks have accumulated more than 50 percent of all assets in the sector while the top 20 banks have gathered more than 70 percent of the assets," said Alexander Turbanov, former head of state-established Deposits Insurance Agency.

Favored Institutions

While the concentration of capital in itself is a natural process, the problem is that the list of largest banks is topped by two state-owned monsters, which are remnants from the era of a centralized economy, Turbanov said.

"And the fact that the government creates favorable conditions for these particular banks does not help generate competition in the sector," he added.

The biggest advantage, besides the administrative levers state banks have access to, is accessible funding.

"The cheapest funds can be found through repurchase agreements. Collateral is required in order to get the money there and state banks have a lot more resources to provide it," said Vasiliy Solodkov, director of Banking Institute, Higher School of Economics.

Another source of affordable funding is deposits by the Finance Ministry. "As a general rule, these are also placed with the state banks," Solodkov said.

But privately owned lenders are not surrendering, with some counting on their perceived differentiators to maintain and grow business.

"If we are talking about individual depositors, the revoking of licenses may prompt them to transfer their money to state-owned banks, although top private banks will also continue to be attractive," said Natalya Orlova, chief economist at Alfa Bank — which is the largest non-state bank in the country. "The corporate sector, however, is looking towards private banks which offer better service and better interest rates," she added.

Top 12 banks

Name	Importance rating	Net assets (trillions of rubles) as of Dec. 1, 2013
Sberbank*	27.4	15.8
VTB*	9.8	5.2
Gazprombank*	4.5	3.5
VTB 24*	5.2	2
Rosselhozbank*	3.1	1.8
Bank of Moscow*	3	1.8
Alfa Bank	2.6	1.4
Nomos Bank	1.5	0.8
Unicredit	1.3	0.8
Rosbank	1.3	0.7
Promsvyazbank	1.3	0.7
Raiffeisenbank	1.3	0.7

* Banks fully or partly owned by the state.
Source: Gaidar Institute, official bank reports
The Gaidar Institute rated banks on the basis of the size of their assets, the extent to which they are interlinked with other financial institutions and the quantity of deposits they hold. The final score is a percentage representing the importance of the bank within the sector.

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