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[Danger and Dysfunction in Russia's Private Banking Sector]

The public has only recently and suddenly learned about the extent that some of Russia's largest banks are struggling. These problems are directly linked to how the Russian economy in general has been suffering from low oil prices for three years (resulting in obvious economic difficulties for the "oil and gas economy"). But how many of these problems also stem from Western sanctions hindering Russian banks' access to low-interest Western loans? After all, sanctions are not just hitting state-run banks; in the current geopolitical climate, the very act of cooperating with Russian credit institutions is deemed "toxic" by many of the major players within the Western business community. They would rather err on the side of caution and avoid deals with Russian banks where possible.

There is a possible correlation here. Namely, the "borrow at low rates in the West and lend at high rates in Russia" model has basically stopped working. Continued economic hardships in Russia mean that people are struggling to pay debts and are taking fewer and fewer new loans; businesses are simply unable to pay high rates. Russian banks, both private and state-owned, are not accustomed to playing in the "long term" and seek quick, easy profit. What could essentially be described as financial speculation remains the main focus. The current Russian banking system, to put it bluntly, lacks a healthy "fertile ground" in the form of a progressively developing, diversified Russian economy. In other words, even the existing bank system with over 500 banks is somehow "too extensive" for the Russian economy, which is far more one dimensional than the economies of developed countries, "murdered" as it has been by the state and its bureaucracy.

What, then, were the majority of Russian banks focused on originally? On inventing and testing tax-evasion schemes, currency-exchange transactions, and accumulating funds for the "right people" to privatise certain enterprises. As the state's grip has increased and the economic situation has changed drastically, profits from such transactions have fallen and risks have increased. Most banks have failed to adapt to the new realities, and Russian economic legislation, including its financial component, remains largely Soviet-style and archaic. This branch of the economy is incapable of facing 21st-century challenges. In these circumstances, the "aggressive growth" (which was the main reason that led *Otkritie* to the brink of oblivion) can only be achieved through risky, speculative transactions. Now, unless the clean-up operation results in a moratorium on satisfying creditors' demands, its effect on the economy as such will be comparatively small. However, previous bankruptcies of a range of relatively large banks incurred considerable losses for their clients.

The gradual "purging" from the banking system of small "pocket laundries", which mostly serve their owners and close associates according to far-from-healthy market rules, is largely justified. The Central Bank has been doing this for over a year, and there is no visible end in sight. Nevertheless, the "collateral damage" is also huge. Since the beginning of the post-Soviet Russian banking system, the total number of banks has already dropped by 80% (2600 out of over 3000 banks have lost their licences, and only slightly over 500 remain today). Imagine how it would have affected any other country in the course of only two decades – it would be a catastrophe.

In just over three years with Elvira Nabiullina at the helm of the Central Bank, over 300 credit organisations were removed from the database. 97 banks were "killed" last year, and over 30 so far this year, with assets totalling almost 3 trillion roubles (a total of over 24 trillion roubles are now held in bank accounts). Where did this money all go? Offhand, any Russian citizen would answer "it was stolen", since there are no hard data. The thing is, they would be right. Even before the collapse of *Otkritie,* there was a "hole" of over 1.4 trillion roubles in total on the balance sheets of the banks whose licences were withdrawn.

In most cases, it turns out that the money was sent abroad before the licence was revoked. The most arrogant examples being the former head of the Bank of Moscow, Borodin, and the former owner of *MezhPromBank*, Pugachyov. In the last 10 years, the government has only managed to retrieve about 100 billion roubles from former top managers and owners of bankrupt banks through the courts. This is the total "cost" of the court decisions. In reality, less than 200 million roubles were ever repaid. At the same time, at least 4 trillion roubles have already been spent on "healing" the banking system in the last three years.

Money from problematic banks is nearly always transferred abroad – in 80% of all bank bankruptcies. The question arises – in order to solve the problems of "bad" banks, wasn't it possible to sharpen the Central Bank's supervision to prevent actions which led to such losses that would later need to be either directly covered by the state, or the Deposit Insurance Agency, or the revived Bank Sector Consolidation Fund (in turn funded by the Central Bank itself)? In addition, the supervisor's bureaucratic reporting requirements are constantly multiplying. As it turns out, tonnes of "correct" reports don't solve the problem. For example, it was found that the cost of bonds in *Otkritie*'s balance sheets had been inflated *vis-à-vis* their real value, which could easily have been traced by simply checking Bloomberg. But this simple fraud was overlooked in the "many tonnes" of formal reports.

BinBank, in turn, was enthusiastically engaged in cleaning up problematic banks in the hope of making money out of it, rather than, let's say, earning on loans to real SMEs. In the end, these banks they were "towing along" have threatened *BinBank*'s existence.

The excessive reporting (the likes of which is unimaginable in the financial world of developed countries) imposed on banks by the Central Bank, tax authorities and RosFinMonitoring (which oversees the legality of currency transactions in particular) raises banks' expenses and forces them to employ extra staff members.

There are five times more employees per credit unit in Russian banks than in the United States. Work efficiency in Russian banking is 9(!) times lower than in "boring", unhurried Finland. There are also enormous constraints and bans on credit terms and conditions, which are not particularly simple or attractive in Russia anyway. In typical Russian style, these excessive restrictions have led to increased "shady dealings" and risky transactions.

Within the context of the whole Russian economy falling under state control in recent years, the problems of the largest Russian private banks seem, to some degree, natural. It is becoming more and more difficult for private entrepreneurs to work: they face a heavy tax burden, administrative pressure, pressure from the security agencies, and the still unpredictable and rather bad investment climate in the country. The government's share in the banking system's assets is already approaching 60%, and its share of funds allocated by private individuals is nearly 70%. The share of private banks in the Russian economy is only about 1% of GDP, making it impossible to encourage investment. In fact, the entire share of financial activity in Russian GDP is less than 4% (half that of developed countries).

In the meantime, the healthy private banks which focus on lending to the real economy, not the state-owned "monsters", could become a powerful driver for economic growth. But it doesn't look as if this will happen in the near future.

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