THE CENTRAL BANK OF THE RUSSIAN FEDERATION

BANKING SUPERVISION REPORT 2006

Printed by Open-end joint-stock company “Poligrafbankservis”

Print-run: 400 copies

The online version of this Report is available on the Bank of Russia website at *www.cbr.ru*

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Foreword

Dear readers,

The Bank of Russia presents below the new Banking Supervision Report for 2006.

In 2006, the favourable trends in the Russian banking sector gathered strength: most of the banking sector performance indicators grew faster than in the previous years and their ratio to GDP increased. The banking sector becomes considerably important for the domestic economy.

The Russian banking services market continued to expand as competition in the banking sector intensified, and the progressive growth of foreign capital in Russian credit institutions is now becoming an ever more substantial factor of this competition. Competition increased especially in the household lending sector. It leads to the improved quality of banking services and to new banking products coming out on the market, makes credit institutions more transparent, encourages the use of new information technologies and outsourcing and stimulates the spread of the banking business to the Russian regions.

Overall, 2006 was the year when the top Russian banks were busy preparing to make initial public offerings (IPOs) on the stock market. Some banks are expected to make IPOs in 2007 and this will become a landmark event in the development of the Russian banking sector and the domestic economy as a whole.

At the same time, as the banking business grew more sophisticated and expanded to new spheres of activity, including consumer lending, risks accumulated. This aspect of banking sector development is in the focus of the Bank of Russia supervisory attention. Its main tasks are to help credit institutions improve the quality of management and internal controls and ensure that it operates as an efficient regulator and supervisor. This Report deals with these issues as it analyses the activities of credit institutions and the current status and outlook for banking supervision.

It accords a special place to information on progress in implementing the Russian Banking Sector Development Strategy until 2008 and the Russian President's Directives aimed at further strengthening the national banking system and creating favourable conditions for the development of efficient and honest banking business.

The Report also focuses on the evaluation and regulation of risks in the banking sector at the micro- and macro-level, including the analysis of systemic risks, stress testing and the compilation of the financial soundness indicators for the Russian banking sector.

The Report contains information on the use of the internationally accepted substantive and risk-based methods of banking regulation and supervision, including those recommended by the Basel Committee on Banking Supervision.

Sergey M. Ignatiev,
Bank of Russia Chairman

I

The State of the Russian Banking Sector

I.1. General Economic Conditions

I.1.1. Macroeconomics

The economic situation in 2006 was characterised by slower inflation and sustained economic growth. Production growth surpassed the official forecast laid at the basis of the budget projections for 2006 and exceeded world economic growth. Fixed capital investment and household real money income continued to increase rapidly. There was a budget surplus.

Consumer prices rose 9.0% in 2006 as against 10.9% in 2005, the lowest inflation rate since 1991. The reduction in inflation was largely due to the significant slowing of growth in the prices of paid services provided to households (13.9% as against 21.0% in 2005). The slowdown was the result of the limits set in each region on growth in administered utility services prices. Core inflation fell from 8.3% to 7.8%.

The ruble's appreciation against the currencies of Russia's major trading partners contributed to slower inflation. The nominal effective rate of the ruble gained 2.2% in 2006 (December to December 2005). Its real effective rate rose 7.4%.

GDP grew 6.7% year on year in 2006 as against 6.4% in 2005. Industrial output expanded 3.9% as against 4.0% in 2005. The manufacturing sector made the biggest contribution to industrial production growth.

Production growth was due to the significant expansion of consumer and investor demand. The main factor of growth in the output of goods and services in 2006 was household demand, supported by the rapid expansion of consumer credit. Expenditures on final consumption increased 9.3% in 2006 as against 9.7% in 2005, of which expenditures on household final consumption grew 11.2% as against 12.8% in 2005.

The financial standing of Russian enterprises continued to improve in 2006. Total profits (net financial result) of the corporate sector, excluding small businesses, banks, insurance companies and budget-financed organisations, reached 3,845.9 billion rubles, an increase of 31.6% on 2005. The share of loss-making enterprises decreased by 3.8 percentage points to 29.7%. Unlike the situation in 2005, in 2006 growth in profits was largely due to the manufacturing sector (primarily the output of petroleum and metallurgy products) whereas in the mining increase in profits fell sharply.

The payments and settlements situation continued to improve. As of the end of 2006, the share of non-payments in total receivables of large and medium-sized enterprises contracted from 13.5% to 13.2% year on year and the share of non-payments in total payables dropped from 15.0% to 10.7%.

Gross capital formation increased 13.4% in 2006 as against 7.2% in 2005. Fixed capital investment grew 13.7% as against 10.9% in 2005. The major investments were made in transport and the hydrocarbon sector.

As imports grew much faster than exports in 2006, net exports decreased 15.8%.

The average price of Urals crude on the world market in 2006 rose 20.9% year on year, to $60.9 per barrel, the price of natural gas in Europe and world prices of non-ferrous metals increased 40% and petroleum product prices were up 20% on average; prices of other Russian exports also grew. The favourable price situation on world commodity markets for Russian exporters, the expansion of demand for Russian goods and significant growth in foreign capital inflow to the private sector brought about a substantial influx of foreign exchange to Russia and contributed to growth in the country's foreign exchange reserves.

Russia's international reserves in 2006 increased almost 70% to $303.7 billion, ensuring this country medium-term financial stability. In this respect Russia rose to the third place in the world, following China and Japan.

Russia's foreign debt decreased significantly in 2006 due to not only the scheduled payments but also the early repayment of debt to the Paris Club of Creditor Nations. The debt burden[1] on the Russian economy decreased despite growth in the private sector's foreign debt.

The balance of payments in 2006 was characterised by unprecedented growth since 1992 in the current account surplus, foreign exchange reserves and private sector foreign capital inflow. The current account surplus increased 12.7% to $94.5 billion, or 9.6% of GDP (in 2005, it stood at $83.8 billion, or 11% of GDP).

Net foreign capital inflow to the private sector increased from $700 million in 2005 to $41.7 billion in 2006.

Household and enterprise sector savings being held in foreign exchange continued to decrease. Total foreign cash held by individuals on hand declined by $11.6 billion in 2006, whereas in 2005 it decreased by $1.2 billion.

As Russia improved its creditworthiness and investment climate, Fitch Ratings international rating agency in July raised the country's long-term foreign and national currency issuer default rating from BBB to BBB+ and Standard & Poor's in September upgraded Russia's long-term foreign currency credit rating from BBB to BBB+ and national currency credit rating from BBB+ to A-.

[1] Calculated as the ratio of foreign debt to GDP.

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

The non-financial sector in 2006 retained the rising trend in output in major economic activity categories. As Russia's GDP expanded 6.7%, the output index by major activity category registered 106.1% as against 105.2% in 2005.

Industrial output increased 3.9% in 2006. The mining sector output index rose from 101.3% to 102.3% year on year. At the same time, growth in the production of bituminous and brown coal and peat stood at 103.6%, of which the production of coal concentrate and bituminous coal stood at 105.3% and 107.1% respectively. As growth in the production of crude oil, natural gas and the related services stood at 102.4%, the production of liquefied gas and stable gas condensate increased by 107.0% and 111.4% respectively. Output growth in the manufacturing sector slowed down from 105.7% in 2005 to 104.4% in 2006, although production growth was registered in all major manufacturing sector categories. Growth in the production of chemicals, machinery and equipment and transport vehicles and equipment stood at 102%—105%, foodstuffs, coke, petroleum products, pulp and paper, textile and clothing, metallurgy and finished metal products 105%—109%, and other non-metal mineral products, rubber and plastic goods, leather and footwear 110%—117%. The output index in the production and distribution of electricity, gas and water registered 104.2% in 2006 as against 101.2% in 2005.

Transport turnover and agricultural output grew almost equally (2.2% and 2.8%, respectively).

As compared with other economic activity categories, faster rates of growth were registered in 2006 in the communications sector (123.7%), retail trade turnover (113.0%) and the provision of paid services to households (108.1%).

The overall trend towards slower growth in the prices of goods and services continued in 2006. The industrial producer price index registered 110.4% in December 2006 as against 113.4% in December 2005, while the price index relating to the communication services provided to corporate entities fell from 102.2% to 101.3%. At the same time, the agricultural product price index rose from 103.0% in December 2005 to 110.4% in December 2006 and the freight transportation price index registered 132.1% as against 116.6%. The aggregate building materials price index remained unchanged on the previous year at 112.4%.

The development of the non-financial sector was affected by the change in demand and supply on the domestic and international raw material and commodity markets and by the size of investments made in this sector. Overall growth in fixed capital investment in 2006 stood at 113.5% as against 110.7% in 2005.

The number of unemployed registered with the government employment service decreased 4.4% in 2006 as compared with previous year when jobless numbers rose almost 11.0%.

The improvement of the economic situation was reflected in the financial performance of non-financial institutions.

According to official statistics, the net financial result, which is the difference between profits and losses, increased 131.6% in 2006 year on year. At the same time, the net financial result more than doubled in fishing and fish farming, the production of textile and clothing, coke, rubber and plastic goods, other non-metal mineral products and transport vehicles and equipment. In the manufacturing sector, the net financial result increased 153.4%, construction sector 157.6%, wholesale and retail trade and car and household appliance repairs 149.7%, transport and communications 129.6% and mining 103.2%. In the production and distribution of electricity, gas and water, the net financial result decreased 11.5% as compared with 2005.

The national average rate of return on the goods and services, products, works and assets sold by non-financial institutions stood at 9.3% in 2006. The return on assets in the mining sector stood at 16.5% (17.6% in the production of non-metal ores) and in the manufacturing sector 15.1%. At the same time, the return on assets in the metallurgy sector and the output of finished metal products reached 25.7% (in the metallurgy sector it was 27.8%) and in the production of coke and petroleum products 24.3%. In 2006, the return on assets in fishing and fish farming stood at 6.5% and agriculture, hunting and forestry 4.0%. The return on assets in transport and communications was 5.0%, of which the return on assets in pipeline transport stood at 10.5% and communications 13.4%.

There were profit-making and loss-making enterprises in the non-financial sector in 2006. Overall, the share of profit-making enterprises in all activity categories reached 70.3%. At the same time, in the mining sector the share of profit-making enterprises stood at 65%. In the manufacturing sector, it was 70.2%, of which the share of profit-making enterprises in the production of coke stood at 83.3%, petroleum products 80.5% and electrical, electronic and optical equipment 80.4%. In the production and distribution of electricity, gas and water, the share of profit-making enterprises was 49.9%, of which the share of profit-making enterprises in the production, transmission and distribution of electricity stood at 69.5%. Profit-making enterprises accounted for 75.1% of all construction organisations in the period under review. The share of profit-making enterprises in agriculture, hunting and forestry stood at 67.0% and in fishing and fish farming 63.8%. In wholesale and retail trade and car and household appliance repairs, profit-making enterprises accounted for 80.7% and in transport and communications 62.6% (of this, the share of profit-making enterprises in pipeline transport stood at 85.5% and communications 73.4%).

The structure analysis of overdue debt on bank loans by economic activity in the non-financial sector shows that the manufacturing sector accounted for 33.3% of this debt, the mining sector 18.0%, agriculture, hunting and forestry 12.2%, fishing and fish farming 6.0%, the production and distribution of electricity, gas and water and transport and communications 4.5%, wholesale and retail trade and car and household appliance repairs 2.8%, and construction 2.4%.

The economic situation, financial standing, availability of working capital and improvement of the terms and conditions of borrowing determined the investment policy of non-financial institutions in 2006.

The results of the monitoring of enterprises conducted by the Bank of Russia show that there was a trend towards growth in investment activity in 2006. Maintaining the production capacity was the principal motivation for investment.

This particularly applies to enterprises producing, transmitting and distributing electricity: about 60% of enterprises in this sector cited this motivation. At the same time, 65% of enterprises in the metallurgy sector said they were motivated in their investment policy by the need to intensify and modernise production and 38% of enterprises in this sector said they were motivated by the desire to expand production. Plans to turn out new products mostly motivated enterprises manufacturing electrical, electronic and optical equipment, whereas making profits from financial investment and borrowing were more important as a motivation for investment for metallurgical enterprises.

I.1.3. Payment system

The level of efficiency and security achieved by the Russian payment system in 2006 contributed to financial stability in the country and allowed the Bank of Russia to enhance the effectiveness of its monetary policy instruments.

The number and volume of payments effected through the Russian payment system continued to grow in 2006: the number of payments reached 1,672.6 million and volume 446.0 trillion rubles.

As in the previous years, the payment system of the Bank of Russia was the main element of the Russian payment system in 2006, accounting for 90.4% of total interbank payments and 90.3% of their total volume.

In 2006, 696.3 million payments with a total volume of 267.3 trillion rubles were effected through the Bank of Russia payment system. The average daily number of payments stood at 2.8 million and the average sum of payment was 383,900 rubles. The ratio of the volume of payments effected through the Bank of Russia payment system to GDP stood at 10.0.

As in the previous years, in the period under review most of the payments were effected through the Bank of Russia payment system electronically: the share of electronic payments expanded to 99.5% of total number and 99.6% of total volume.

The share of Bank of Russia client banks and bank branches involved in the exchange of electronic documents with the Bank of Russia increased from 95.2% in 2005 to 96.4% of total credit institutions and their branches as of January 1, 2007. This enabled credit institutions and their branches to efficiently manage their intraday liquidity and plan the effectuation of payments.

The share of payments that entered the Bank of Russia payment system by communication channels in total payments increased in pace with the rise in the number of client banks and bank branches involved in the exchange of electronic documents with the Bank of Russia and reached 97.7% in 2006 as against 95.0% in 2005.

The payment system average monthly accessibility ratio, measured as the Bank of Russia system's capability to accept electronic and paper settlement documents from its customers, ranged between 99.57% and 99.96% in 2006 in respect to electronic settlement documents and 99.99% and 100% in respect to paper settlement documents.

In order to implement the Russian Banking Sector Development Strategy until 2008, which specifies the development of a real-time gross settlement system by the Bank of Russia, the latter continued to carry out measures to accomplish this task on time.

Having determined the major aspects of the development and operation of the real-time gross settlement system, described its main elements and structure and established requirements for the participants and the functions fulfilled by the system, the Bank of Russia drafted the relevant rules and regulations.

In addition to drafting the documents regulating the real-time gross settlement system, the Bank of Russia developed an experimental real-time gross settlement system, tested it and put it in operation in several Bank of Russia regional branches and credit institutions.

The number of accounts opened for customers with Bank of Russia establishments, credit institutions and their branches for the effectuation of payments increased 4.4% in 2006 and as of January 1, 2007, it stood at 369.1 million. At the same time, compared to January 1, 2006, the ratio between the accounts of corporate entities other than credit institutions and individual accounts remained unchanged (1.4% and 98.6% respectively).

Payment cards continued to be increasingly used in the period under review. The number of cards issued by credit institutions increased 36.8% in 2006 to 74.8 million. The number of operations conducted with payment cards increased 39.0% to 1,198.5 million and the volume of these operations expanded 47.3% to 4,396.7 million rubles.

The dynamic development of the payment card infrastructure (during the year, the number of trading and service establishments and ATM used to pay for services rose 27.0% to 181,000) led to the expansion of the share of non-cash payments using payment cards from 16.7% in 2005 to 18.6% in 2006. The share of cash withdrawal operations stood at 81.4% by number and 91.4% by volume.

The credit card market continued to grow in 2006, its growth rate was 128.3% by card number. Credit card operations increased 77.2% by number and 88.4% by volume. However, despite substantial growth, credit card operations accounted for a lowly 2.0% of total payment card operations.

To further stimulate the retail consumer lending market, the Bank of Russia established the procedure for extending ruble loans to resident individuals without opening bank accounts in settlements using credit cards (Bank of Russia Ordinance No. 1725-U, dated September 21, 2006, “On Amending Bank of Russia Regulation No. 266-P, dated December 24, 2004, on the Issuance of Bank Cards and on the Payment Card Operations” has been registered by the Ministry of Justice of the Russian Federation).

I.1.4. Banking sector macroeconomic performance indicators

The dynamics of the major banking sector performance indicators allows one to come to the conclusion that 2006 was a fairly successful year for the banking sector: most of the indicators registered growth unseen in the previous years.

Banking sector assets increased 44.1% in 2006 as against 36.6% in 2005 and 27.4% in 2004. Growth in capital reached 36.3% in that period as against 31.2% in 2005 and 16.2% in 2004. The value of loans extended to nonfinancial institutions and households expanded 47.3% as against 40.3% in 2005 and 44.8% in 2004. Household deposits grew 37.7% in the period under review, which represents a minor fall on the previous year’s increment of 39.3%.

As a result, the ratio of these indicators to GDP increased substantially in 2006. Banking sector assets to GDP grew by 7.3 percentage points to 52.4% and banking sector capital to GDP went up by 0.6 percentage points to 6.3%. Household deposits to GDP increased by 1.4 percentage points to 14.2% and lending to non-financial institutions and households relative to GDP grew by 4.8 percentage points to 30.0%.

Growth in banking sector assets in 2006, as in the previous year, was largely due to the expansion of lending. Loan debt increased 48.2% (as against 42.7% in 2005) and relative to GDP it expanded by 6 percentage points to 35.2%, while loan debt to banking sector assets increased from 65.3% to 67.2%. Loans extended to households grew the fastest (by 75.1%).

Funds raised from enterprises and organisations were the main source of credit institutions’ resources in 2006. Their volume expanded 54.8% in 2006 as against 48.7% in 2005 and relative to GDP they increased by 3.4 percentage points to 17.1%, while their share in banking sector liabilities grew by 2.3 percentage points to 32.5%.

The favourable dynamics of all major banking sector performance indicators amid their growth relative to GDP show that the role of the banking sector in the Russian economy continues to grow.

I.2. Institutional Aspects of Banking Sector Development

I.2.1. Banking sector quantitative characteristics

In 2006, the number of operating credit institutions decreased from 1,253 to 1,189 *(see Chart 1.1)*. Therefore, we can see that the number of credit institutions continues to decline: in the period from 2004 to 2006, their number fell by 140. The reduction was due to a great extent to the withdrawal from the banking services market of credit institutions that failed to meet the requirements of the Federal Law on Countering the Legalisation (Laundering) of Criminally Obtained Incomes and Terrorist Financing.

The number of credit institutions decreased in all federal districts without exception, including Moscow and the Moscow Region (where the number of credit institutions was reduced by 39).

Meanwhile, the branch network of credit institutions continued to expand in the period under review. The number of branches of operating credit institutions, except the Savings Bank (Sberbank), increased from 2,286 to 2,422. In a bid to optimise its branch network, Sberbank cut the number of its branches by 150 in 2006.

The trend towards increasing the number of credit institutions' internal divisions, such as additional offices and cash and credit offices, continued in the period under review. The total number of internal divisions of credit institutions and their branches increased 7.6% in 2006, to 31,888, or 22.4 per 100,000 people.

As in the previous year, the number of branches of banks based in other regions exceeded the number of local credit institutions and their branches in all federal districts, except the Central Federal District.

I.2.2. Development of regional banking

The number of regional banks[2] slightly decreased in 2006: from 607 as of January 1, 2006, to 582 as of January 1, 2007. Assets of the regional banks grew more slowly than aggregate banking sector assets in the period under review (by 38.6% as against 44.1%). As a result, the share of the regional banks in aggregate banking sector assets somewhat contracted and as of January 1, 2007, it stood at 14.4% as against 15.0% as of January 1, 2006.

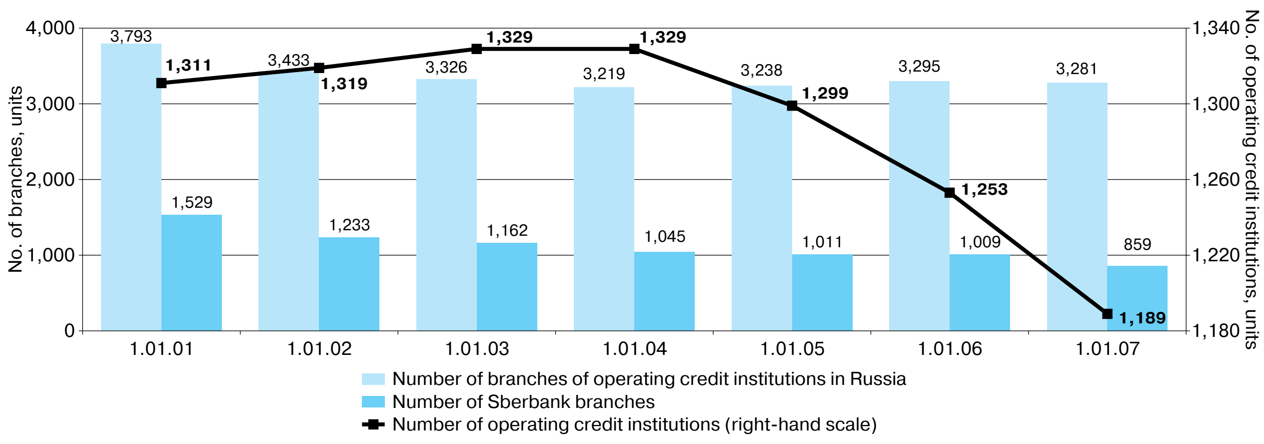
Aggregate capital of the regional banks increased 43.8% in 2006, to 83.7 billion rubles, while its share in aggregate banking sector capital expanded from 15.4% to 16.2%.

Regional banks remained profit-making in 2006, as in the previous years. Their total profits amounted to 53.3 billion rubles, an increase of 56.2% on 2005. As of January 1, 2007, the share of the profit-making regional banks in total regional banks remained unchanged at 99.3% and they accounted for 99.9% of the regional banks' aggregate assets.

In the period under review, the Central Federal District had the highest concentration of banking services and it was followed by the North-Western Federal District and the Volga Federal District. The leadership of the Central Federal District was due to Moscow, the absolute leader in terms of the concentration of banking services.

Number of credit institutions and their branches

CHART 1.1



[2] Regional banks are the banks registered outside Moscow and the Moscow Region.

In 2006, the Southern Federal District outdid the Far Eastern Federal District and rose to the fourth place. The change is due to the accelerated growth of credit institutions' number, their branches and additional offices, assets, loans to resident enterprises and households and household deposits in the Southern Federal District.

The lowest concentration of banking services was, as before, in the Ural Federal District.

The lowest concentration of banking services in the Russian regions was registered, as before, in the Republics of Ingushetia and Daghestan and the highest in Moscow, St Petersburg, the Kaliningrad and Sverdlovsk Regions.

I.2.3. Banking concentration

The share of the largest 200 banks by assets in aggregate banking sector assets barely changed in 2006 and as of January 1, 2007, it stood at 90.6% (as against 89.6% as of January 1, 2006), whereas the share of the top five banks decreased from 43.8% to 42.5%.

The largest 200 banks by capital as of January 1, 2007, accounted for 87.4% of aggregate banking sector capital (as against 85.1% as of January 1, 2006), of which the top five banks accounted for 35.9% (as against 35.7% as of January 1, 2006).

The number of credit institutions with a capital in the amount of the ruble equivqlent of more than €5 million increased from 602 to 676, or 12.3% in 2006 and the aggregate capital of this group of banks grew 38.4%, while their share in aggregate banking sector capital expanded from 96.6% to 98.0% *(see Chart 1.2).* As expected, the number of credit institutions with a capital in the amount of the ruble equivalent of more than €5 million exceeded the number of credit institutions that failed to meet this criterion and as of January 1, 2007, accounted for 56.9% of total credit institutions (as against 48.0% at the beginning of 2006).

Meanwhile, operation of a large number of medium-sized and small credit institutions (with a capital in the amount of the ruble equivalent of less than €5 million) accounted for the low asset, credit and capital concentration levels in the Russian banking sector. The dynamics of the internationally-accepted Herfindahl-Hirschman Index (HHI)[3] bears this out *(see Chart 1.3).* The asset concentration level declined from 0.085 as of January 1, 2006, to 0.079 as of January 1, 2007, and the concentration of lending to non-financial institutions decreased from 0.118 to 0.115 during the year, remaining at the medium level nevertheless.

Only the household deposit market had a high concentration level, despite the continuous downward trend. As of January 1, 2007, the HHI in this market segment registered 0.287 (as against 0.455 four years earlier). The substantial reduction in the index in the past few years is largely due to Sberbank's decreased share of the household deposit market, caused by competition that became stronger after the enactment of the Federal Law on the Insurance of Household Deposits with Russian Banks and the establishment of the deposit insurance system.

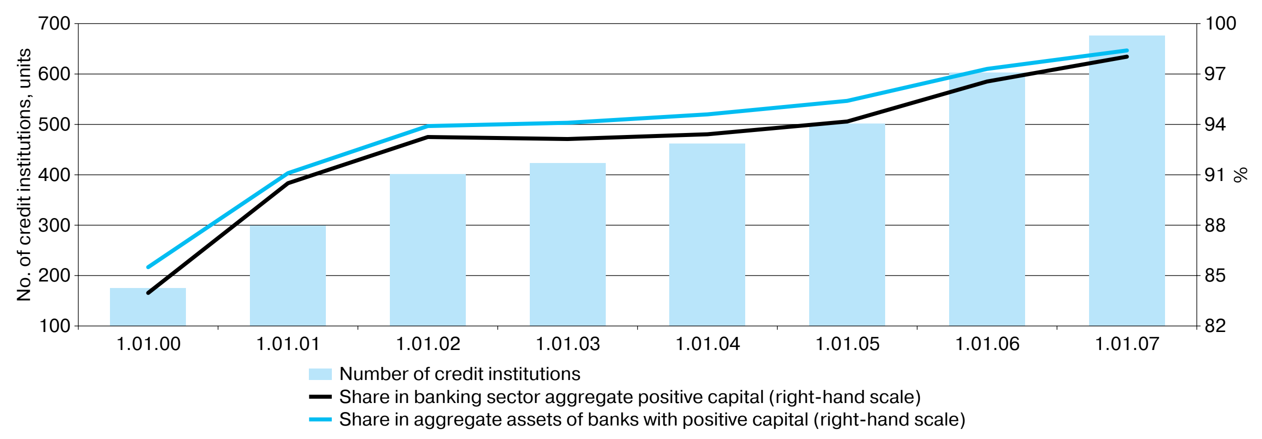
The capital concentration level rose slightly in 2006 and, as in the previous years, remained the lowest banking sector concentration level (0.053).

Substantial regional differences in concentration levels remained on the banking services market in the period under review *(see Chart 1.4).*

The highest asset concentration level in 2006 was registered in the Siberian Federal District, where the HHI increased from 0.088 to 0.264 (a high concentration level). This growth (by 270%) was due to the sharp build-up of assets by a bank operating in that federal district.

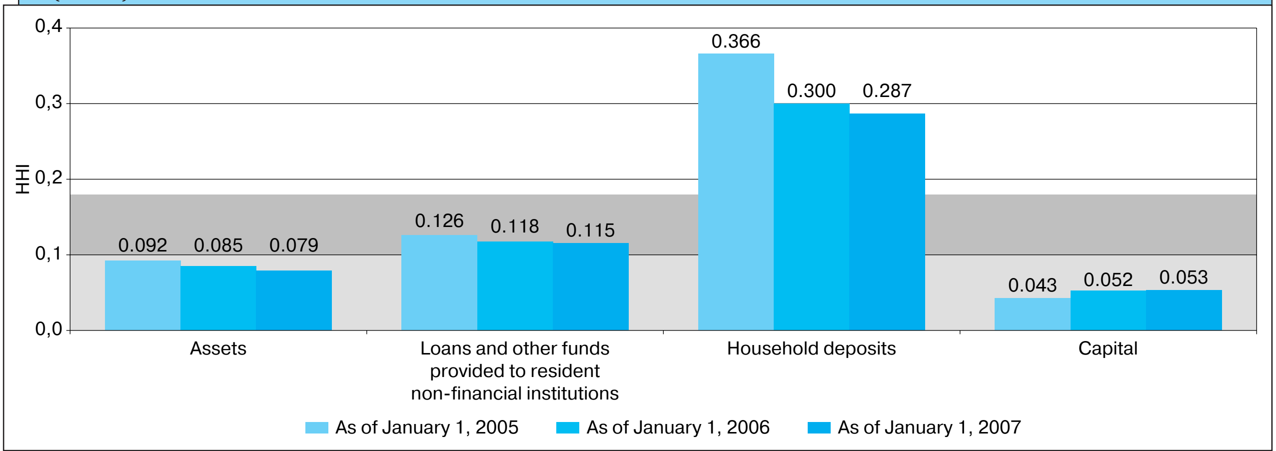
A slight rise in asset concentration levels was also registered in the Southern and Far Eastern Federal Districts. In other federal districts (Central, North-Western, Volga and Ural) the asset concentration levels declined during the year under review. The Central and North-

Number of banks with a capital in the amount of the ruble equivalent of more than €5million and their share in aggregate banking sector capital *CHART 1.2*



[3] The Herfindahl-Hirschman Index is recommended by the Compilation Guide on Financial Soundness Indicators drafted by the IMF as a measure of concentration in the banking sector.

Russian banking sector concentration levels (HHI) *CHART 1.3*

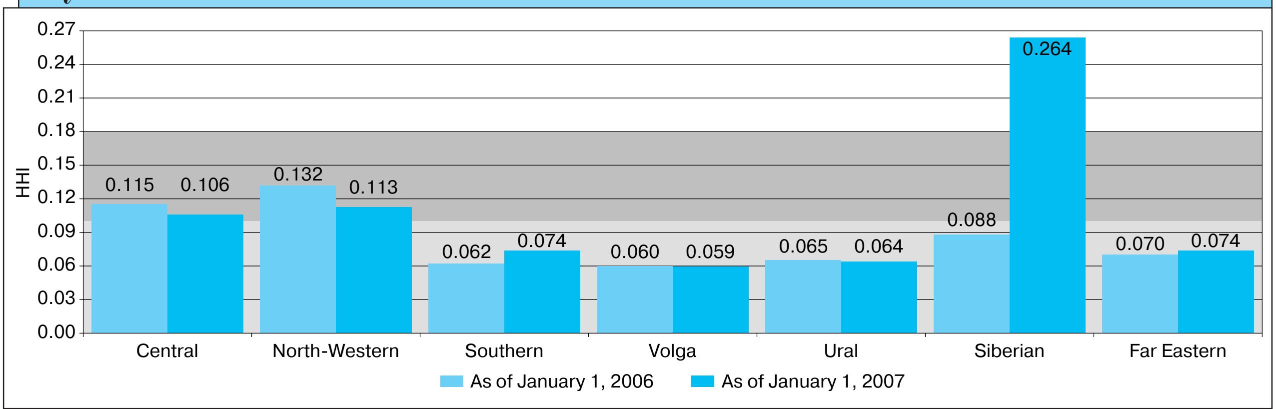


The Herfindahl-Hirschman Index is calculated as a sum of squared unit weights of credit institutions in the banking sector's total volume.

It 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,
over 0.18 a high level of concentration.

Asset concentration by federal district *CHART 1.4*



Western Federal Districts registered a medium asset concentration level, while other federal districts had low asset concentration levels. The lowest asset concentration level was registered in 2006 in the Volga Federal District.

I.2.4. Interaction between banking sector and other segments of the financial market

Macroeconomic stability in Russia, the reduction in the government debt and favourable world market situation led to the rapid expansion of the financial markets, which in 2006 increased their role as financial intermediaries.

Corporate securities market. The Russian *stock market* continued its dynamic growth in 2006. As a result of growth in share prices and a spate of IPOs by Russian issuers, the capitalisation of the Russian stock market exceeded full-year GDP.

The MICEX index gained 68% and by the end of 2006 it reached 1,693.47 points; the RTS index climbed 71% to 1,921.92 points. The aggregate turnover of secondary trade in the shares of Russian issuers on the major national trading floors (the MICEX, St Petersburg and RTS stock exchanges) increased 240% in 2006 and reached 11.1 trillion rubles. The RTS stock market capitalisation grew 190% to $966.0 billion, or 25.4 trillion rubles.

The value of the registered share issues of credit institutions amounted to 231.9 billion rubles in nominal terms in 2006, an increase of 170% on 2005. The shares issued by credit institutions in the period under review accounted for about 6% of the aggregate turnover of the secondary stock trade on the aforementioned stock exchanges.

Although banks' investments in Russian stocks increased 33.5% in 2006, the bank share of investors on the domestic market decreased to 2.0% in 2006.

The *corporate bond* segment increased substantially (by 50%). As a result, the corporate bond market expanded in volume from 7.6% of GDP in 2005 to 9.5% in 2006. Securities denominated in foreign currency accounted for the largest share of the corporate bond market (65.0% as of the end of 2006).

MICEX secondary trade turnover of corporate bonds doubled and reached 1.8 trillion rubles in 2006. Bank bonds accounted for 12% of the aggregate secondary trade turnover of corporate bonds as against 10% in 2005.

The bank share of the ruble-denominated corporate bond market decreased from 52% in 2005 to 50% in 2006. As before, on the corporate bond market banks mostly operated as lead managers, financial consultants, paying agents and underwriters.

Government debt market. With a budget surplus in 2006, Russia implemented the policy of reducing aggregate government debt, which decreased during the year from 14.5% to 9.0% of GDP. Foreign debt contracted to 5.1% of GDP. In the period under review, Russia repaid ahead of schedule its debt to the Paris Club of Creditor Nations to the amount of more than $22.6 billion, or 29.0% of total government foreign debt. The conservative policy pursued by the Ministry of Finance helped maintain domestic debt at a low level (3.9% of GDP) in 2006.

The volume of the ruble and foreign currency-denominated government securities market decreased from 9.4% of GDP in 2005 to 7.7% of GDP in 2006. As the government budget policy was aimed at replacing foreign debt by internal borrowings, the volume of foreign currency-denominated federal government bonds contracted from 5.2% of GDP in 2005 to 3.6% of GDP in 2006.

Federal loan bond (OFZ) market. The OFZ market in 2006 saw a major rise in traders' activity: the total value of transactions on the secondary market increased 23.0% year on year, to 536.4 billion rubles. With the exception of September, October and November, the aggregate monthly OFZ trade volumes on the secondary market in 2006 were considerably larger than in 2005. OFZ yield dynamics in 2006 followed world capital market trends, especially US Treasury bill yield dynamics. In the first half of 2006, the gross yield to redemption of Russian government bonds[4] kept rising, ranging between 6.4% and 6.9% p.a. For most of the second half of the year, yields tended to decline and as a result in 2006 gross yield was down by 0.2 percentage points on the end of 2005 at 6.4% p.a.

Although secondary trade turnovers continued to grow, OFZ market liquidity remained low. As in 2005, OFZ were not particularly attractive to investors because of their small effective yields and a high concentration of individual issues in the portfolios of passive investors who preferred the buy-and-hold strategy. There was a major rise in non-resident activity on the OFZ market in 2006 as Russia liberalised its foreign currency laws (on July 1, it lifted most of the restrictions on the cross-border movement of capital). Although the nominal OFZ portfolio held by non-residents increased by 13 times in 2006, it accounted for a meagre 1.6% of the nominal value of outstanding OFZ bond issues.

Foreign exchange market. In 2006, the situation on the domestic foreign exchange market was characterised by the excess of foreign exchange supply over demand, typical of the previous few years, amid favourable world market prices for major Russian export commodities. The increased capital inflow became an additional source of foreign currency supply on the domestic foreign exchange market.

The quotations of the ruble against the US dollar and the euro were affected by the exchange rate policy pursued by the Bank of Russia and the dynamics of major currencies exchange rates on the world currency market.

The official US dollar/ruble exchange rate tended to decline in the period under review. In 2006, it fell 8.5%. There was no pronounced trend towards the appreciation or depreciation of the ruble against the euro during the year. The official rate of the ruble against the euro gained 1.5% in 2006.

The expansion of export and import operations and massive capital flows kept activity high on the domestic foreign exchange market. As a result, in 2006, the average daily turnover of the interbank spot foreign exchange market increased 30% year on year, from $29.6 billion to $38.4 billion.

Ruble/US dollar transactions dominated the currency structure of the interbank spot market, accounting for 65.0% of its aggregate turnover. In 2006, the volume of euro transactions increased mostly due to the euro/US dollar transactions, which accounted for more than 90.0% of the market's aggregate euro turnover. The euro/ruble transactions accounted for just 6.0% of aggregate euro turnover. Overall, the average volume of interbank spot euro transactions expanded 70.8% in 2006, to $10.4 billion. Growth in euro transaction volumes was accompanied by the expansion of transactions with the Swiss franc, Japanese yen and the British pound.

Non-bank financial institutions

Despite rapid growth in assets (by 43.9%), non-bank financial institutions were still lagging behind the banking sector in terms of the value of assets in 2006 *(see Table 1.1).* Insurance companies grew more slowly than other non-bank financial institutions.

Insurance companies[5]*.* As a result of the revocation of licences, the number of insurance companies decreased 14.6% in 2006 and stood at 918. The reduction in the number of insurance companies was also due to the tightening of the minimum authorised capital requirements. Among other contributing factors were the measures taken by the Federal Insurance Supervision Service to combat the so-called 'salary schemes' in life insurance and 'grey schemes' in financial risk insurance, the increased competition on the insurance market, which

[4] Gross yield to redemption of Russian government bonds (RGBY) is an OFZ-yield indicator calculated by the MICEX.
[5] According to data provided by the Federal Insurance Supervision Service.

Financial institutions' assets — *TABLE 1.1*

	2005	2006	% growth in 2006	% of GDP
Banking sector, billion rubles	9,750.3	14,045.6	44.1	52.4
Non-bank financial institutions, billion rubles	1,076.7	1,549.3	43.96	5.8
of which:				
Unit investment funds (ANA*)	234.0	420.5	79.7	1.6
General bank management funds (ANA)	7.8	16.8	115.5	0.1
Non-government pension funds (property)	344.3	509.9	48.0	1.9
Insurance companies (premiums)	490.6	602.1	22.7	2.2

** Aggregate net assets.*

Source: Bank of Russia, Rosstat, Federal Insurance Supervision Service (FSSN), National Managers League (NLU), Federal Financial Markets Service, Cbonds.ru news agency, Tsentr razvitiya (Centre for Development).

stimulated mergers and acquisitions, and the enforcement of new insurance reserve placement rules in 2005.

The aggregate authorised capital of insurance companies increased 9.5% to 153.4 billion rubles as of January 1, 2007. The dynamics of insurance premiums and indemnities improved compared to 2005: premiums rose 22.7% to 602.1 billion rubles and indemnities 25.8% to 345.2 billion rubles. The highest rates of growth in premiums were registered in compulsory health insurance and property insurance (38.9% and 22.8% respectively). The worst dynamics were demonstrated by life insurance, where premiums fell 36.9% and indemnities 33.6% as a result of the suppression of fraudulent business schemes.

Unit investment funds[6]. The number of unit investment funds (PIFs) increased by 246 in 2006 to 641 as of January 1, 2007, and their aggregate net assets grew 79.7% to 420.5 billion rubles. The total net inflow of funds to the PIFs amounted to 95.7 billion rubles, ensuring 51.3% of growth in ANA (25.0% in 2005). Closed-end PIFs accounted for 51.4% of total net funds raised by PIFs and open-end PIFs 44.1%. Slower growth in closed-end PIFs' ANA (from 127.3% in 2005 to 64.1% in 2006) and the decrease in their ANA share (from 70.3% as of January 1, 2006, to 64.1% as of January 1, 2007) testify to the increased accessibility of the collective investment market for the public. Stock PIFs account for almost half of ANA and in 2006 their ANA increased 64.4%, ensuring 41.5% of total inflow of funds to PIFs.

Non-government pension funds[7]. The growth of non-government pension funds (NPFs) slowed down in 2006. The total value of 289 NPFs' own property rose 48.0% in 2006 and as of January 1, 2007, it reached 509.9 billion rubles, while their pension reserves grew 48.4% to 411.6 billion rubles. One factor of the worsened dynamics of these indicators was slower growth in members (from 10.9% in 2005 to 4.9% in 2006) as NPFs were not particularly popular with corporate entities and private individuals. Accelerated growth in the number of people receiving a non-government pension (by 41.7% to 1 million as of January 1, 2007), as compared with growth in NPF members, was a brake on the expansion of their financial potential.

General bank management funds[8]. The general bank management fund (OFBU) market continued to develop successfully in 2006. The value of OFBU net assets increased by 9 billion rubles to 16.8 billion rubles. In the period under review, the rates of ANA growth remained almost unchanged on 2005 (115.5% and 116.7% respectively).

By the end of 2006, the number of OFBU had reached 138, an increase of 40, or 40%, as compared with 2005 when 61 new OFBU were set up, and their funds doubled. Thirty-two Russian banks are active on the OFBU market.

Although the sector is still characterised by high concentration, there was some progress towards greater diversification of the market in the period under review and the number of major players increased. In 2006, the 10 largest OFBU by ANA controlled 81% of the market (94% in 2005) and the top five controlled almost 68% (85%) of the market.

Despite the rapid expansion of the OFBU market, it has yet played a small role in the banking business. In 2006, OFBU aggregate net assets accounted for a little over 0.1% of aggregate banking sector assets. The ratio of OFBU aggregate net assets to household bank deposits stood at 0.4% at the end of 2006 as against 0.3% at the end of 2005.

The process of mutual penetration of banks and non-bank financial institutions continued in 2006. At the end of 2006, 27 credit institutions out of Russia's 50 largest banks participated in various associations with non-bank financial institutions.

Financial associations in which non-bank financial institutions play a major role demonstrate the same rates of growth as large bank holding companies. In some groups banks and non-bank financial institutions account for roughly the same share of assets and capital. The associations in this group operate like a 'financial supermarket'.

The analysis of the 32 largest financial associations, which account for about two-thirds of aggregate banking sector assets, shows that highly diversified groups accounted for 22% of assets, while the financial associa-

[6] According to data provided by Sbonds.ru. news agency.
[7] According to data provided by the Federal Financial Markets Service.
[8] Information compiled by OOO Tsentr razvitiya was used in preparing this segment of the Report.

Financial institutions' share of major markets at end of 2006 (% of market volume) *TABLE 1.2*

	Market volume, billion rubles	Banks	Non-bank financial institutions[9]	Other investors
Ruble-denominated government bonds	876	53.3	18.0	28.7
Foreign currency-denominated government bonds	958	10.8	3.3	85.9
Regional bonds[10]	216	48.5	6.8	44.7
Ruble-denominated corporate bonds	902	50.1	18.5	31.4
Foreign currency-denominated bonds	1,660	9.7	5.7	84.6
Stocks	3,402	9.1	47.4	43.5

Note.
Capitalisation of traded stocks is given allowing for the 15% evaluation of the stocks' share.
Source: Tsentr razvitiya.

tions in which non-bank financial institutions play a negligible role accounted for 55% of assets. Twenty-two percent of associations comprised one large bank and several small non-bank financial institutions whose business was secondary to the group. The share of the groups in which there are no large banks remains small, accounting for about 1% of assets, and this fact serves to show that in Russia it is impossible to create a large financial holding company without banking capital.

Therefore, banks play a leading role in most of the financial groups. Banks also hold positions of command in the major segments of the financial market *(see Table 1.2).*

[9] Non-government pension funds (NPF), insurance companies, unit investment funds (PIFs) and general bank management funds (OFBU).
[10] Regional government bonds are the bonds issued by regional and municipal authorities.

I.3. Banking Operations

I.3.1. The dynamics and structure of borrowed funds

Credit institutions in 2006 continued to consolidate their resource base and this process was accompanied by structural changes in banking sector liabilities *(see Chart 1.5).*

The balances in customer accounts[11] increased 45.5% in 2006 to 8,467.3 billion rubles and their share in aggregate banking sector liabilities expanded from 59.7% to 60.3%.

In the positive economic situation the principal source of credit institutions' resources in 2006, as in 2005, were funds raised from organisations[12], which grew 54.8% as against 48.7% in 2005 *(see Chart 1.6).* Their share in aggregate banking sector liabilities expanded from 30.3% to 32.5%. Funds raised from organisations accounted for 37.7% of overall growth in banking sector liabilities.

The balances in settlement and current accounts (short-term resources) accounted for almost 52.0% of the funds raised from organisations. They increased 41.0% and accounted for 16.8% of banking sector liabilities (this ratio remained almost unchanged on January 1, 2006).

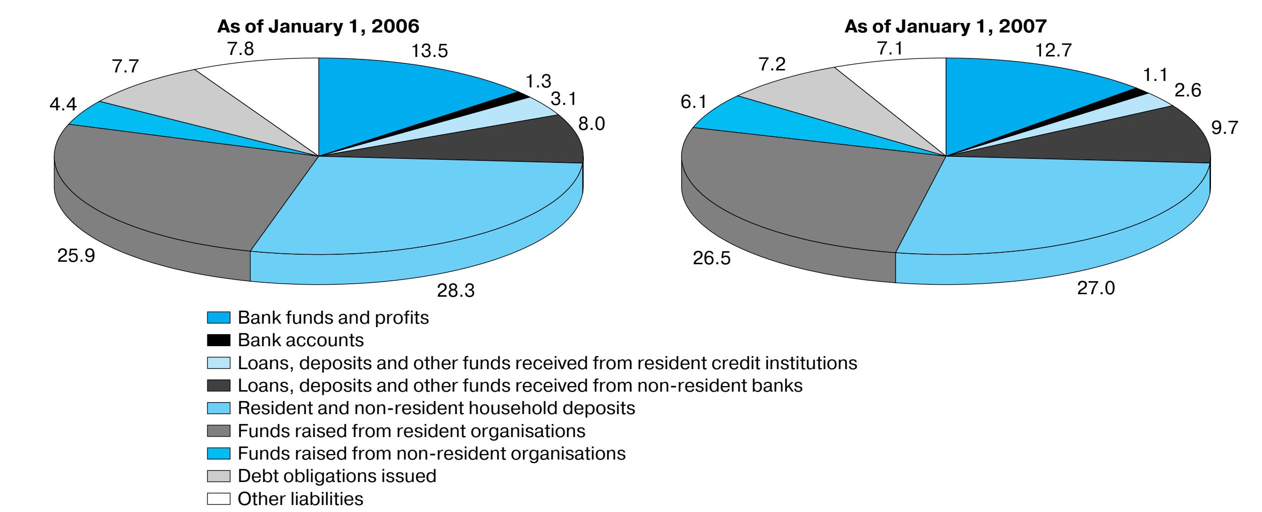
The balances in settlement and current accounts in small and medium-sized banks based in Moscow and the Moscow Region and other regions accounted for the largest share of the funds raised from organisations (83.5% and 73.4% respectively). This is attributable to the specific category of customers serviced by these banks: these are mostly small and medium-sized businesses whose accounts accumulate temporarily excess of their funds. As a rule, these businesses put these financial resources in operation rather than deposit them with banks. The share of the balances in settlement and current accounts in the liabilities of these banks as of January 1, 2007, stood at 37.6% and 24.5% respectively, while the banking sector average ratio was 16.8%.

At the same time, the bulk of the funds accumulated by the banking sector in settlement and current accounts were the funds held with large private (43.6%) and state-controlled banks (29.6%).

Deposits were the fastest growing component of the funds raised from organisations. In 2006, *organisations' deposits* increased 64.8% as against 66.0% in 2005 and their share in aggregate banking sector liabilities expanded from 9.6% to 11.0%. Deposits with maturities from 31 days up to one year grew 72.4% and deposits with maturities in excess of one year 70.1% and as of January 1, 2007, they accounted for 56.3% and 29.7% of total deposits respectively.

The fastest growth in organisations' deposits was registered in banks controlled by foreign capital

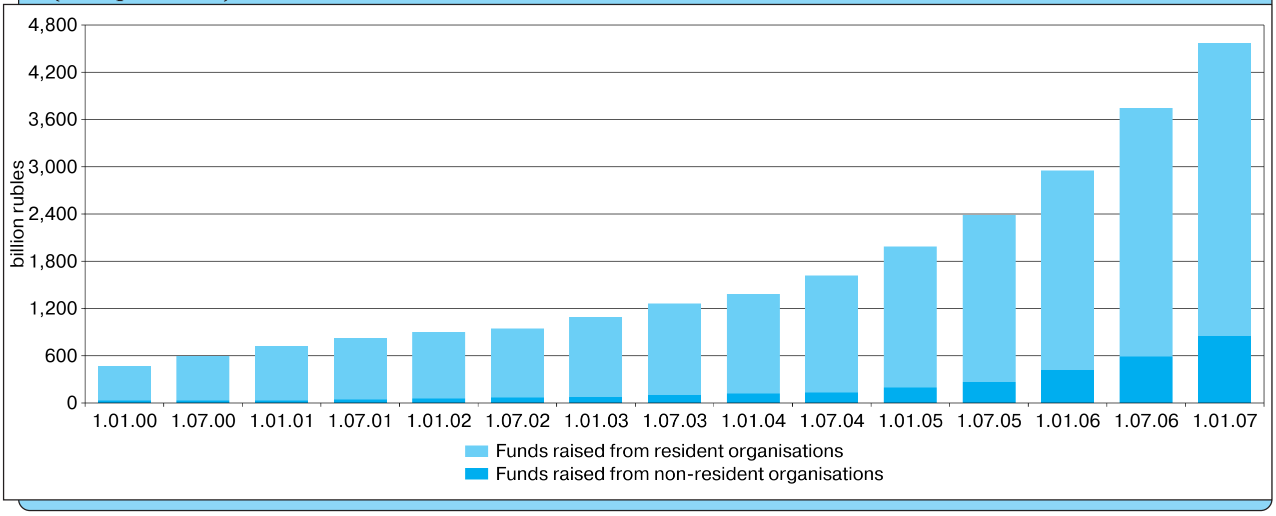
Structure of banking sector liabilities (%) CHART 1.5



[11] Balances in organisations' accounts, including all-level budgetary and government extra-budgetary funds, household funds, float,factoring and forfeiting balances and funds written down from customer accounts but not entered in a credit institution's correspondent account.
[12] Except resident credit institutions and non-resident banks.

Raising funds from organisations (except banks)

CHART 1.6



(these increased 130%[13] and accounted for 17.3% of liabilities) and large private banks (these grew 60% and accounted for 13.1% of liabilities). The major factors of growth were customer confidence in large banks and a wide range of services they provide. These banks accumulate 68.0% of corporate deposits taken by the banking sector.

Other funds raised by banks doubled in 2006, but their share in banking sector liabilities remained small (4.1% as of January 1, 2007, as against 2.9% as of January 1, 2006). Funds raised from non-resident corporate entities accounted for 93.5% of other funds raised and in 2006 they increased 120%. Most of these funds (94.4%) were raised for a term in excess of one year.

At the same time, 86.6% of other funds, mostly loans raised on the international markets, were borrowed by state-controlled banks and large private banks whose credit ratings are high enough to get access to international capital markets.

Household deposits remained a major source of bank resources. In 2006, they grew more slowly than in 2005: having increased 37.7% (as against 39.3% in 2005), they reached 3,793.5 billion rubles. Their share in aggregate banking sector liabilities slightly decreased, from 28.3% to 27.0%. At the same time, these funds accounted for 24.0% of growth in banking sector liabilities. Slower growth in household deposits in 2006 was due to the expansion of unit investment funds and the purchase of large companies' stocks by private individuals.

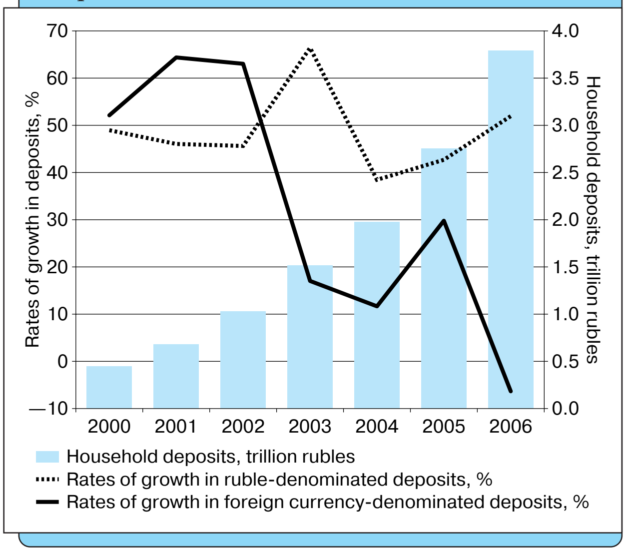
From 2003, ruble-denominated household deposits have grown much faster than foreign currency-denominated deposits *(see Chart 1.7)*. Ruble-denominated household deposits increased 51.9% in 2006, whereas foreign currency-denominated deposits (in ruble terms) decreased by 6.3%. This is the result of the ruble's appreciation against the US dollar, economic stability inside the country and sustained public confidence in the national currency. As a result, in 2006 the share of ruble-denominated bank deposits expanded from 75.6% to 83.4% of total household deposits.

Household deposits with maturities in excess of one year increased 41.0% in the period under review and their share in total household deposits expanded from 59.5% to 61.0%.

Competition increased on the household deposit market. Household deposits with banks, excluding Sberbank, grew 41.1% in 2006, whereas household deposits with Sberbank increased 34.8% and its share of the household deposit market decreased from 54.4% to 53.3% (in 2005, Sberbank's share of this market contracted by 5.5 percentage points). Sberbank stabilised its position on the household deposit market largely by raising interest rates.

Raising household deposits

CHART 1.7



[13] The transfer of three banks in the group of the 30 largest banks by assets under foreign control had a major effect on indicators for foreign-controlled banks.

Household deposits grew at the most rapid rates with foreign-controlled banks (by 150%) and in large private banks (by 42.8%). The share of deposits in foreign-controlled banks' liabilities expanded from 11.8% to 14.0% in 2006, whereas in large private banks' liabilities it remained almost unchanged at 17.6%. Household deposits grew more slowly with state-controlled banks (by 29.6% in 2006 as against 34.6% in 2005), but this kind of deposits accounted for 42.5% of liabilities of these banks.

Household deposits taken by small and medium-sized regional banks increased 38.7% and accounted for 35.0% of their liabilities, 8 percentage points higher than the banking sector average. Household deposits with small and medium-sized banks based in the Moscow Region increased 33.9% in 2006 and their share in these banks' liabilities expanded from 12.3% to 13.7%.

The funds raised by credit institutions by issuing debt obligations grew 35.9% in 2006 as against 16.3% in 2005, and reached 1,018.1 billion rubles. As of January 1, 2007, these obligations accounted for 7.2% of banking sector liabilities (7.7% as of January 1, 2006).

As before, most of the debt obligations issued by banks were promissory notes, which accounted for 77.6% as of January 1, 2007, as against 82.0% as of January 1, 2006, and whose value increased 28.6% to 790.5 billion rubles in the period under review. At the same time, their share in banking sector liabilities decreased from 6.3% as of January 1, 2006, to 5.6% as of January 1, 2007. The value of bonds issued by banks increased 150% and savings certificates 140%, but their share in banking sector liabilities remained small at 1.3% (0.8% as of January 1, 2006).

Obligations on interbank loans[14] increased 59.3% in 2006 as against 47.4% in 2005, and aggregated 1,730.5 billion rubles, while their share in banking sector liabilities expanded from 11.1% to 12.3%.

Russian credit institutions continued to actively raise funds on the international interbank market. Their loan debt to non-resident banks increased 74.1% in 2006 as against 52.4% in 2005. As a result, loans taken from non-resident banks to total interbank loans grew from 72.2% to 78.9% *(see Chart 1.8)* and as of January 1, 2007, this source of funds accounted for 9.7% of banking sector liabilities (as against 8.0% as of January 1, 2006). About two-thirds of loans were taken on the international interbank market with maturities in excess of one year: 64.3% as of January 1, 2007, as against 68.9% as of January 1, 2006.

The most active borrowers of non-resident banks were foreign-controlled banks (the value of their loans doubled), large private banks (the value of their loans increased 63.5%) and state-controlled banks (the value of their loans grew 69.1%). These three groups of banks accounted for almost the entire volume of loans raised on the international interbank market.

The balances of funds raised on the domestic interbank market increased 20.9% in 2006 and their share in banking sector liabilities remained almost unchanged at 2.6%.

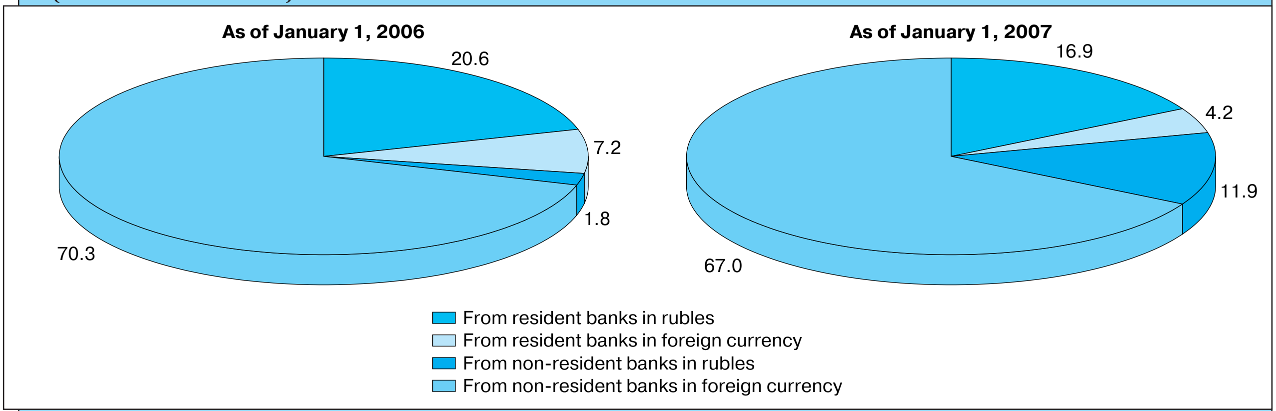
I.3.2. Asset dynamics and structure

In 2006, the Russian banking sector demonstrated the most rapid rates of growth in assets in recent years — 44.1% as against 36.6% in 2005 and 27.4% in 2004. As of January 1, 2007, aggregate banking sector assets amounted to 14,045.6 billion rubles and their ratio to GDP expanded from 45.1% as of January 1, 2006, to 52.8% as of January 1, 2007.

Foreign-controlled banks registered the fastest growth in assets (110.9%) and their share in banking sector assets expanded from 8.3% to 12.1%.

As before, large private banks accounted for the largest share of aggregate banking sector assets (41.0% as of January 1, 2007). They were followed by the state-controlled banks, which accounted for 37.8% of banking sector assets. Medium-sized and small banks based in the Moscow Region accounted for just 4.5% of banking sector assets, whereas medium-sized and small regional banks accounted for 4.1%.

Loans, deposits and other funds raised on international markets (as % of total value) *CHART 1.8*



[14] Loans, deposits and other funds placed or raised on the interbank market.

The expansion of lending to non-financial institutions and households accounted for 60.0% of asset growth.

Total loans extended to non-financial institutions and households increased 47.3% in 2006 to 8,031.4 billion rubles, and their share in banking sector assets rose from 55.9% to 57.2% *(see Chart 1.9)* and relative to GDP it grew from 25.2% to 30.2%.

The share of claims on non-financial institutions and households in the bank asset structure was the largest in the state-controlled banks (64.3%), the smallest in the medium-sized and small banks based in the Moscow region (40.7%).

Loans extended by banks to non-financial institutions continued to make up the largest part of the banking sector credit portfolio. The value of these loans increased 39.6% (30.8% in 2005) and as of January 1, 2007, it reached 5,966.2 billion rubles. However, their share in banking sector assets decreased, from 43.8% to 42.5%. Seventy-one percent of credit institutions expanded lending to non-financial institutions in 2006. Most of these loans (72.0%) were extended in rubles. A major factor of growth in lending to non-financial institutions was the continued improvement of their financial standing.

Data reported by credit institutions show that bank lending to resident borrowers increased most rapidly in agriculture, hunting and forestry (by 79.1%), the mining sector (66.3%) and construction (58.2%).

At the same time, as of January 1, 2007, the manufacturing sector accounted for 19.8% of total loan debt, construction 6.7%, mining 5.3%, agriculture, hunting and forestry 4.9%, wholesale and retail trade and car, motorcycle and household appliances repair services 26.6%.

The share of loans with maturities in excess of one year expanded from 43.7% of total lending to non-financial institutions as of January 1, 2006, to 45.9% as of January 1, 2007. These loans continued to grow faster than total lending to non-financial institutions (46.5% as against 39.6%), a process testifying to the growing role of the banking sector in maintaining investment activity in the economy.

Loans extended to non-financial institutions by foreign-controlled and large private banks grew most rapidly (by 87.1% and 45.4% respectively).

At the same time, long-term loans (loans with maturities in excess of one year) are mainly extended by state-controlled and large private banks (more than 80.0% of loans extended to non-financial institutions for a term in excess of one year).

Banks continued to actively expand household lending, although growth in such loans slowed down slightly (75.1% in 2006 as against 90.6% in 2005). At the same time, their share in banking sector assets expanded from 12.1% as of January 1, 2006, to 14.7% as of January 1, 2007, and in total bank loans from 18.5% to 21.9%. Household loans were extended by banks mostly in rubles (85.0% of total loans of this kind).

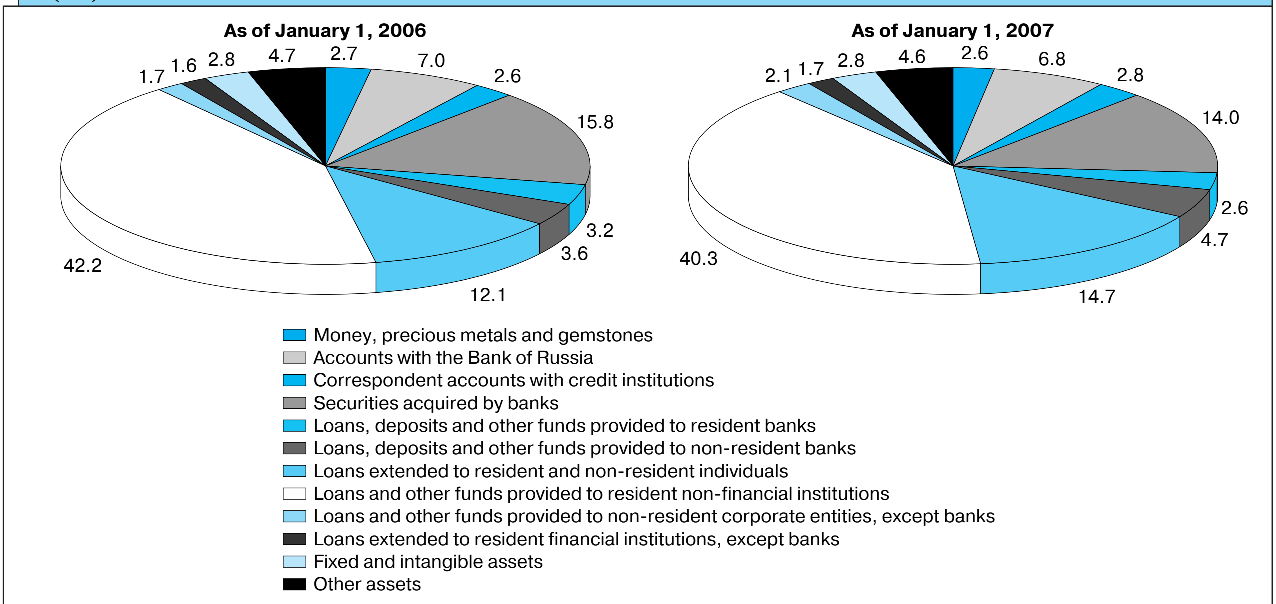
State-controlled and large private banks dominate the household lending market, accounting respectively for 43.3% and 34.8% of the banking sector's total household lending.

As for the structure of the banking sector credit portfolio, medium-sized and small regional banks account for the largest share of household loans (31.9% as of January 1, 2007). Next down the list are foreign-controlled banks (24.9%), state-controlled banks (23.4%), large private banks (18.9%) and medium-sized and small banks based in the Moscow Region (16.6%).

Mortgage loans grew rapidly in 2006. Mortgage loan indebtedness increased 340%. Despite substantial growth in the share of mortgage housing loans in total

Banking sector asset structure
(%)

CHART 1.9



household loans[15] (from 5.0% to 12.5%), their share in assets remained small (1.7% as of January 1, 2007). Most of the mortgage loans (61.9%) were extended in rubles.

Most of the mortgage loans were extended in 2006 by large private banks (40.5%) and state-controlled banks (37.7%). The share of mortgage loans in total loans extended by these two groups of banks stood at 2.5% and 2.3% respectively and in total household loans 13.2% and 9.9%.

In 2006, credit institutions stepped down their activities on the securities market. Bank financial investments in securities increased 27.4% last year as against 41.6% in 2005 and as of January 1, 2007, they aggregated 1,961.4 billion rubles, but their share in banking sector assets decreased from 15.8% to 14.0%. The lower growth of investment in securities was due to the increased price volatility on the securities market. Price fluctuations especially affected growth of investments in stocks and Russian government debt obligations.

The most active financial investors in 2006 were medium-sized and small banks based in the Moscow Region (securities accounted for 16.5% of their assets as of January 1, 2007), the least active were medium-sized and small regional banks (securities accounted for 8.5% of their assets).

The share of investments in debt obligations in credit institutions' securities portfolios expanded from 67.3% to 68.4% in 2006 and in equities from 19.0% to 19.9%, while the share of discounted promissory notes decreased from 13.6% to 11.7% *(see Chart 1.10)*.

In 2006, investments in debt obligations grew most rapidly in medium-sized and small regional banks (by 86.1%), but as of January 1, 2007, they owned just 2.0% of all debt obligations in the Russian banks' portfolio. The major holders of debt obligations as of the beginning of 2007 were state-controlled and large private banks, which held 44.0% and 34.8% of debt obligations acquired by the banking sector respectively.

In the structure of investments in debt obligations the most rapid rates of growth were registered in investments in resident corporate debt obligations (bonds), which increased 81.6% to 402.3 billion rubles, while their share in total investment in debt obligations expanded from 21.4% to 30.0% and their share in banking sector assets rose from 2.3% to 2.9%. Investments in resident credit institutions' debt obligations also increased rapidly (by 60.3%), although their share in total investment in debt obligations remained small (3.7% as of January 1, 2007). Investments in Russian government debt obligations increased 9.2% to 537.2 billion rubles, but their share in total debt obligations decreased from 47.5% to 40.1% and in banking sector assets also fell from 5.0% to 3.8%.

Investments in stocks and shares increased 33.5% in the period under review (in 2005, they grew 110%) and stood at 391.0 billion rubles, whereas their share in banking sector assets decreased from 3.0% to 2.8%.

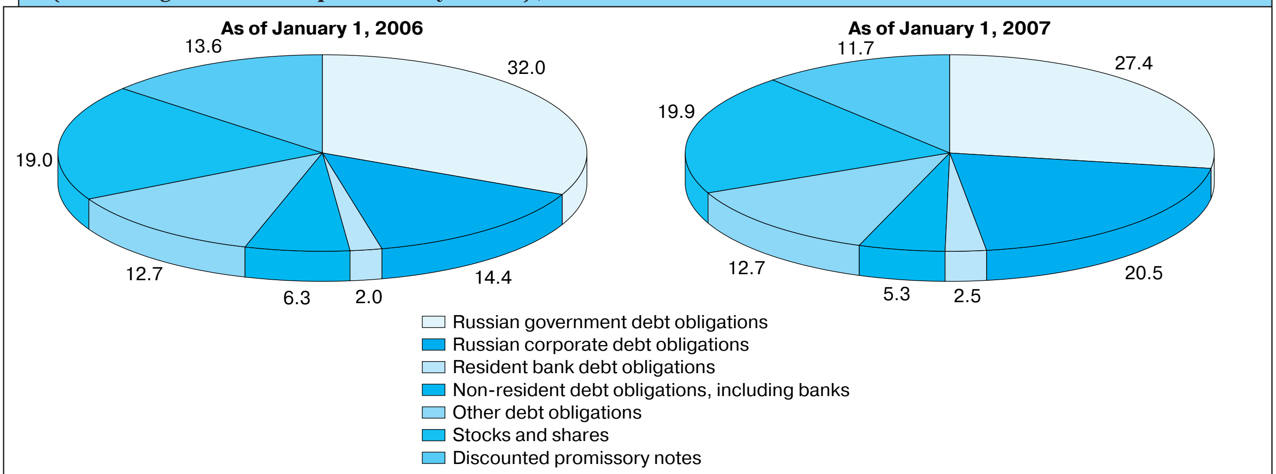
The portfolio of promissory notes discounted by banks expanded 9.1% in 2006, whereas the share of these notes in banking sector assets decreased from 2.2% to 1.6%. Discounted notes of Russian banks accounted for 72.9% of the discounted note portfolio (67.9% as of January 1, 2006) and their value increased 17.2% to 167.2 billion rubles. Investments in promissory notes of other Russian enterprises decreased 9.0% and their share in total discounted notes continued to decline (from 30.6% to 25.4% in the period under review).

Medium-sized and small banks based in the Moscow Region remained the most active note market participants, although the share of discounted notes in their assets decreased from 9.3% as of January 1, 2006, to 8.5% as of January 1, 2007.

The biggest growth (by 55.1%) was registered in securities acquired by credit institutions in their trading books to derive current income. Growth in securities in the majority interest portfolio was slower at 23.0%. The volume of the investment portfolio remained almost unchanged.

Structure of bank financial investments (including discounted promissory notes), %

CHART 1.10



[15] Household loans are loans extended to resident individuals, excluding self-employed entrepreneurs.

In 2006, interbank loans increased 55.0% as against 56.9% in 2005, to 1,035.6 billion rubles, while their share in banking sector assets expanded from 6.9% to 7.4%. As in the previous year, growth was due to the funds placed with non-resident banks: they increased 88.9% in volume, while their share in banking sector assets expanded from 3.6% to 4.7%. The share of loans with a maturity of one year and more expanded from 13.9% in total lending to non-resident banks as of January 1, 2006, to 19.7% as of January 1, 2007. Of the total volume of interbank loans extended for one year and more, 78% were placed with non-resident banks.

Large private and state-controlled banks were the most active participants on international financial markets. At the same time, state-controlled banks demonstrated the most rapid rates of growth in lending to non-resident banks, which increased three times over. Total loans placed by these banks abroad reached 495.7 billion rubles, or 74.6% of the banking sector's loans placed with non-resident banks.

The share of loans with maturities in excess of one year extended to non-resident banks by state controlled banks stood at 26.9% and large private banks 18.6%.

Growth in loans placed on the domestic interbank market slowed from 37.6% in 2005, to 17.4% and its share in banking sector assets decreased from 3.2% to 2.6%.

I.4. Financial Performance of Credit Institutions

I.4.1. Financial results

Banking sector profits continued to increase at rapid rates in 2006 (by 41.8% as against 47.3% in 2005).

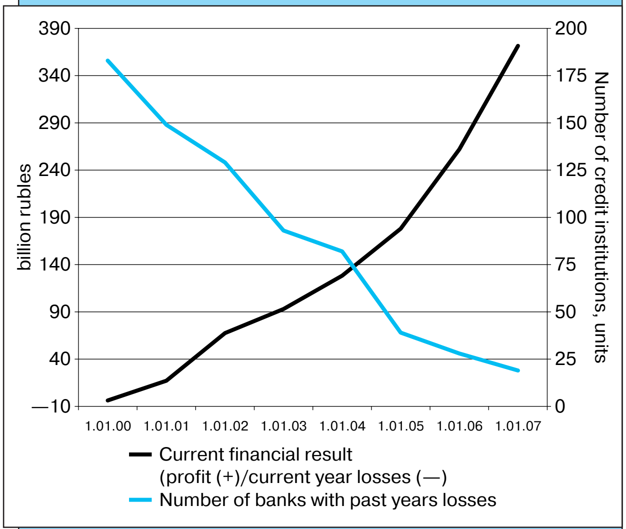
All groups of banks registered rapid growth in profits, but banks controlled by foreign capital and state-controlled banks had higher profit growth rates than the banking sector average — 105.4% and 49.1% respectively.

In 2006, operating credit institutions made profits of 371.5 billion rubles *(see Chart 1.11)* and taking into account the financial results of the previous years, 444.7 billion rubles (262.1 billion rubles and 304.5 billion rubles in 2005).

The share of profit-making credit institutions decreased from 98.9% to 98.4% of total credit institutions, while the number of loss-making credit institutions increased from 14 to 18 (or from 1.1% to 1.5% of total credit institutions). Credit institutions' losses fell from 7.9 billion rubles in 2005 to 800 million rubles in 2006.

The position of the individual groups of banks from the standpoint of their contribution to the aggregate financial result on the whole corresponds to their place in the banking sector in terms of assets. The largest contribution to the financial result (41.5%) was made by the state-controlled banks, which accounted for 37.8% of banking sector assets, large private banks (40.9%), which accounted for 41.0% of banking sector assets, and foreign-controlled banks (10.8%), which accounted for 12.1% of banking sector assets.

Banking sector financial results *CHART 1.11*



The return on assets of credit institutions remained unchanged on 2005 at 3.2%, whereas the return on capital increased from 24.2% to 26.3%[16]. These figures show that the banking sector became increasingly attractive to investors. Growth in asset profitability in 2006 was registered by 531 banks, or 44.7% of total credit institutions, whereas increase in capital profitability was registered by 666 banks, or 56.0% of total credit institutions.

In 2006, state-controlled banks improved their profitability indicators: the return on their assets increased from 3.1% in 2005 to 3.5% and the return on capital grew from 28.5% to 33.1%. In 2006, this group of banks showed the best profitability indicators in the Russian banking sector.

The profitability indicators of large private banks (return on assets at 3.3% and return on capital 26.3%) and banks controlled by foreign capital (3.0% and 23.5% respectively) are close to the banking sector averages.

Medium-sized and small regional banks remain more profitable than medium-sized and small banks based in the Moscow Region. The return on capital of medium and small regional banks in 2006 was 17.9% and return on assets 2.9% as against 16.6% and 3.0% in 2005.

The return on capital of medium-sized and small banks based in the Moscow Region rose from 8.5% to 9.8%, whereas return on assets remained unchanged on 2005 at 2.1%. However, banks in this group remained the least profitable.

I.4.2. Income and expense structure

Incomes from foreign currency operations dominated the structure of credit institutions' *gross income,* accounting for 39.3% in 2006 as against 45.1% in 2005. However, in the net current income structure of credit institutions the share of net income (incomes net of expenses) from foreign currency operations remained small.

The decrease in the share of income from foreign currency operations in the gross and net current income structure is attributable, among other things, to slower growth in income from foreign currency operations amid

[16] 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 are calculated as annual (chronological) averages for the period under review.

the ruble's appreciation against the US dollar and the euro[17].

The recovery of money from funds and reserves (this indicator remained unchanged on 2005) accounted for a large part (27.0%) of gross income in 2006. The share of interest income received expanded from 13.1% as of January 1, 2006, to 14.2% as of January 1, 2007, and the share of income from securities trading increased from 6.4% to 7.6%.

Expenses involved in foreign currency operations played a major role in the gross expense structure in 2006, although their share decreased from 46.9% to 41.1% during the year. The same applies to deductions to funds and reserves, whose share expanded from 30.8% in 2005 to 31.0% in 2006. The share of expenses involved in securities trading expanded from 3.9% to 5.4% during the year and the share of expenses on interest payments for borrowed funds increased from 5.6% to 6.5%. Administrative expenses increased slightly in 2006 (from 4.2% to 4.5%).

Net current income of credit institutions[18] is an important indicator for analysis purposes. In 2006, it stood at 917.3 billion rubles, an increase of 38.0% on 2005. Its structure *(see Chart 1.12)* was largely affected by the expansion of bank credit investments, increased banking commissions and the scaling down of activity on the securities market.

Net interest income is the key element of credit institutions' net current income. However, its share in net income decreased from 63.0% in 2005 to 59.9% in 2006. The reduction in the interest margin on bank lending and deposit operations had a major effect on the contraction of the share of net interest income. The margin on operations with households decreased substantially as interest rates on most ruble loans were cut[19].

The share of interest income decreased in all groups of banks, especially medium-sized and small banks based in the Moscow Region (from 65.8% to 61.5%), medium-sized and small regional banks (from 58.7% to 55.0%) and state-controlled banks (from 73.7% to 70.9%). Net interest income accounted for the smallest share in net current income in large private banks (53.3%) and banks controlled by foreign capital (53.4%).

The trend towards growth in net commission income and the expansion of its share in credit institutions' net income continued and one reason for this was growth in the retail services provided by banks. The share of net commission income in net income expanded from 23.2% as of January 1, 2006, to 27.6% as of January 1, 2007. Net commission income is second in importance to interest income.

All groups of banks registered growth in net commission income. Slower growth in interest income because of the reduction in interest rates on ruble loans to households increased the importance of commission income for many banks actively operating on the household lending market. As a result, the share of net commission interest rose particularly in large private banks (from 21.3% to 27.0%), medium-sized and small regional banks (from 30.3% to 35.9%) and foreign-controlled banks (from 26.0% to 31.1%).

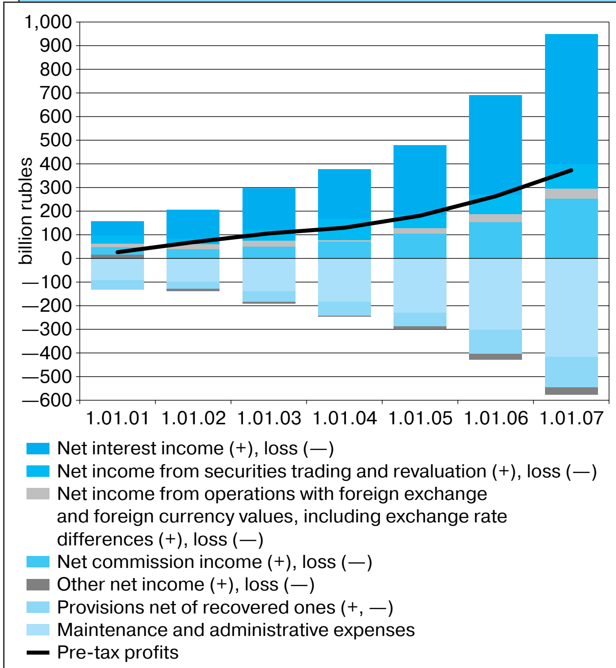
The share of net income from securities trading and revaluation contracted in 2006. It accounted for 11.3% of net current income as against 12.4% in 2005. This was largely due to slower growth in financial investment because of increased price volatility in 2006.

The contraction in the share of net income from securities trading and revaluation in net current income in 2006 mostly affected large private banks (from 20.9% to 18.0%) and medium-sized and small regional banks (from 5.3% to 4.9%). In the medium-sized and small banks based in the Moscow Region the share of net income from securities trading expanded from 10.0% to 13.4% and in foreign-controlled banks from 0.4% to 0.9%. In the state-controlled banks this ratio remained almost unchanged (7.3% in 2006 as against 7.2% in 2005).

The share of net income received by credit institutions from operations with foreign exchange and foreign

Structure of current financial result (net income and profits) of credit institutions

CHART 1.12



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[17] The fall (by more than half compared to 2005) in aggregate net sales of foreign exchange to households is another contributing factor.

[18] Net income is the financial result before making (recovering) provisions net of the maintenance and administrative expenses. Calculated in accordance with the Profit and Loss Statement of Credit Institutions (0409102 form code).

[19] Bank interest margin on lending and deposit operations with non-financial institutions in 2006 was 4.1% (in 2005, it was 6.3%) and on operations with households 6.9% (9.6% in 2005).

currency values, including exchange rate differences, stood at 4.5% in 2006 as against 5.1% in 2005.

This source of income was especially important for the banks controlled by foreign capital, although in this group of banks the share of income from foreign currency operations underwent the largest decrease in 2006 (from 19.1% to 12.2%). The role of income from foreign currency operations in the net current income of foreign-controlled banks changed dramatically: its share in net income of this group of banks contracted from 5.3% in 2005 to 2.2% in 2006. At the same time, the share of income from foreign currency operations in large foreign banks expanded from 1.8% of net current income in 2005 to 3.9% in 2006.

The maintenance and administrative expenses of credit institutions rose 37.5% in 2006 as against 31.9% in 2005 but their ratio to net current income remained almost unchanged at 45.4% as against 45.5% in 2005.

The size and dynamics of maintenance and administrative expenses share differed by group of banks in 2006. Medium-sized and small regional banks had the highest maintenance and administrative expenses (60.4% of net current income). In this group of banks their share decreased by 2 percentage points. State-controlled banks and large private banks also cut the share of these expenses slightly (from 45.2% to 44.7% and from 41.8% to 41.2% respectively). The other groups of banks increased the share of their maintenance and administrative expenses: foreign-controlled banks from 46.9% to 50.3% and medium-sized and small banks based in the Moscow Region from 55.7% to 58.7%.

The value of provisions made by credit institutions in 2006 (net of recovered provisions) increased 29.2% in 2006 to 129.2 billion rubles. At the same time, the share of net income used for provisioning fell from 15.0% to 14.1%, because provisions (net of recovered ones) grew more slowly than net current income. As a result, pre-tax profits to net income rose to 40.5% as against 39.4% at the end of 2005.

This trend was particularly obvious in the state-controlled banks, in which profits grew due to a substantial reduction in provisions (the ratio of provisions to net income declined from 15.2% in 2005 to 7.4% in 2006).

The ratio of provisions to net income in foreign-controlled banks decreased from 15.4% to 12.6%[20].

At the same time, the ratio of provisions to net income in large private banks was up from 15.1% to 20.0% and in medium-sized and small regional banks from 10.1% to 12.2%. The provisions growth testified to some extent to increased lending by these groups of banks and corresponding higher credit risk.

The period under review saw a slight re-distribution of credit institution groups by financial soundness. The number of credit institutions without shortcomings in activities fell from 218 to 194 and the number of credit institutions with few minor flaws in their performance declined from 986 to 932. Overall, the share of financially sound credit institutions decreased from 96.1% as of January 1, 2006, to 94.7%. At the same time, the ratio of financially sound credit institutions in aggregate banking sector assets remained high at 99.6%.

[20] Banks controlled by foreign capital showed the highest rates of growth in net current income in 2006 in the Russian banking sector. During the year, it increased 110%. Provisions made by this group of banks (net of recovered provisions) grew 70%.

II

Banking Sector Risks

II.1. Credit Risk

II.1.1. Loan portfolio quality

According to credit institutions' data, credit risk for the Russian banking system as a whole remains moderate. Overdue debt in total loan debt increased slightly in 2006, from 1.2% to 1.3%. While loans and other placements grew 48.2%, overdue loan debt expanded 58.5% and as of January 1, 2007, it stood at 121.1 billion rubles. Banking sector credit risk increased mainly because overdue debt on household loans grew faster (by 140%) than the amount of such loans (by 80%).

In 2006, medium-sized and small regional banks registered a decrease in the share of overdue debt in their loan portfolio (from 1.6% as of January 1, 2006, to 1.3% as of January 1, 2007). The share of overdue debt in other groups of banks expanded slightly. It increased especially fast in foreign-controlled banks (from 1.1% as of January 1, 2006, to 1.4% as of January 1, 2007), which was partly the result of substantial growth of total loan debt in this group of banks. The largest share of overdue debt in total loan debt was registered in the medium-sized and small banks based in the Moscow Region (1.7% as of January 1, 2007, as against 1.6% as of January 1, 2006).

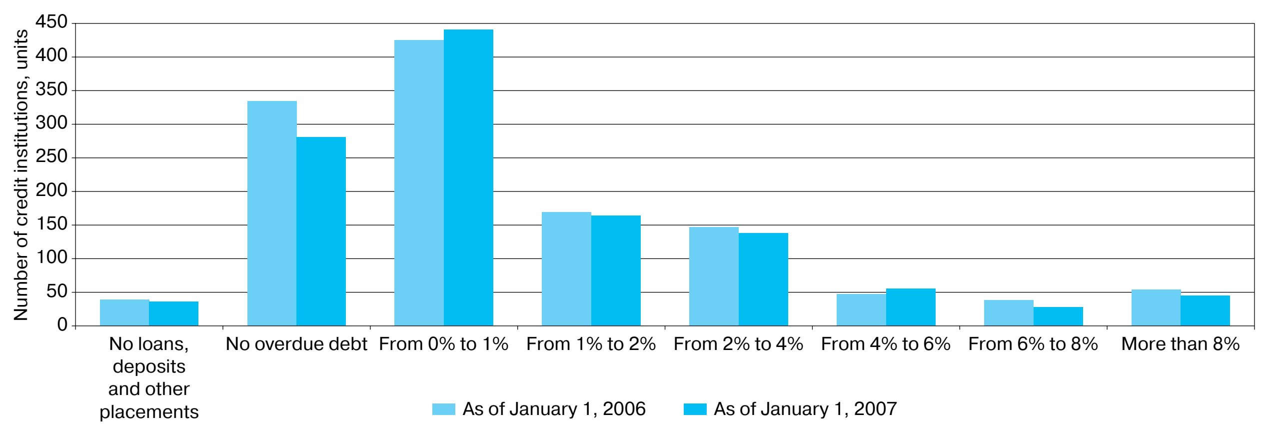
Overdue debt of most of the credit institutions with overdue debt in their loan portfolio was no more than 4.0% *(see Chart 2.1)*. The number of these credit institutions remained almost unchanged at 743 as of January 1, 2007, as compared with 741 as of January 1, 2006, and they accounted for 92.0% of banking sector assets as against 91.2% in the previous year. Of these, the number of credit institutions with an overdue loan debt of no more than 1.0% rose from 425 to 441, while the number of credit institutions with an overdue loan debt of 1.0% to 4.0% fell from 316 to 302.

There was also a contraction (from 54 to 45) in the number of credit institutions with a high level (over 8.0%) of overdue loan debt. As of January 1, 2007, they accounted for 0.7% of aggregate banking sector assets. At the same time, most of them had loan loss provisions and collateral that almost equalled overdue debt.

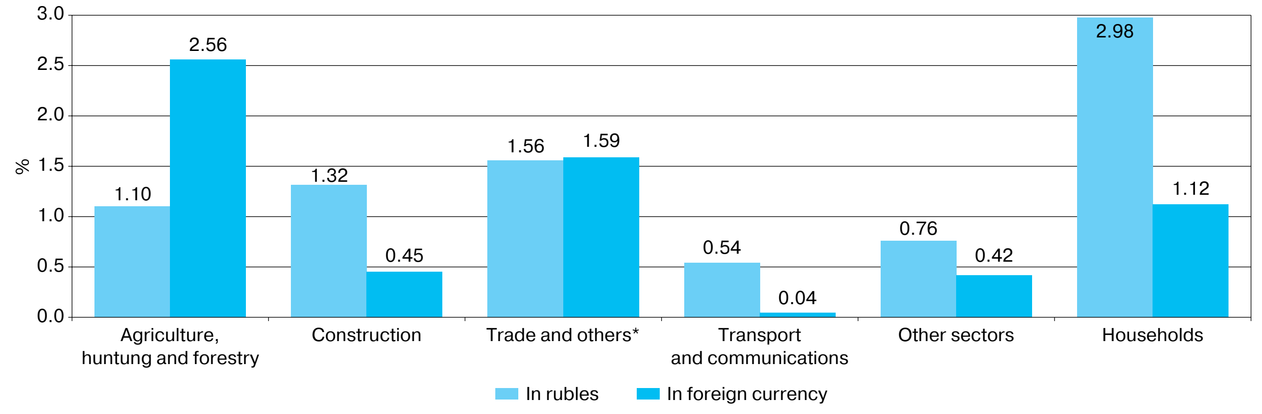
The level of credit risk of Russian banks is still primarily determined by the quality of lending to non-financial institutions, which accounted for 63.2% of total loans extended as of January 1, 2007. In loans to non-financial institutions, the share of overdue debt decreased from 1.3% as of January 1, 2006, to 1.1% as of January 1, 2007. As for ruble-denominated loans, this share contracted from 1.5% as of January 1, 2006, to 1.3% as of January 1, 2007, and as for foreign currency loans, it shrank from 0.7% to 0.6%.

Broken down by activity category, in 2006 the largest share of overdue debt on ruble loans *(see Chart 2.2)* was registered in the manufacturing sector (unchanged on 2005 at 2.2%), wholesale and retail trade and car, motorcycle, household appliances and personal goods repairs services (1.6% as against 1.7% in 2005) and construction (1.3% as against 1.8% in 2005). In 2006, as in the previous year, the largest share of debt on foreign currency loans was registered in agriculture, hunting and forestry (2.6% as against 2.3% in 2005), wholesale and retail trade and car, motorcycle and household appliances and personal goods repairs services (1.6% as against 1.1%).

Credit institutions by share of overdue debt in loan portfolio *CHART 2.1*



Share of overdue debt in loan debt by borrowers' activity category as of January 1, 2007 (%) CHART 2.2



** Wholesale and retail trade and car, motorcycle and household appliances and personal goods repairs services.*

The monitoring of non-financial institution credit risk[21] as of January 1, 2007, revealed 11 banks with a potentially high level of credit risk[22], which accounted for 1.3% of aggregate banking sector assets. In seven banks, the share of loans to financially unsound borrower enterprises in total classified loans exceeded the banking sector average.

Overdue debt on loans to households grew rapidly and its share in total loans of this kind expanded from 1.9% as of January 1, 2006, to 2.6% as of January 1, 2007. At the same time, the share of overdue debt on ruble loans to households increased from 2.0% as of January 1, 2006, to 2.9% as of January 1, 2007, whereas the share of overdue debt on foreign currency-denominated loans decreased from 1.3% to 1.2%.

The monitoring of household credit risk[23] revealed 15 banks with a potentially high risk level[24] as of January 1, 2007, which accounted for 2.1% of aggregate banking sector assets. In all of these banks the share of household loans was over 10.0% of assets and overdue debt to capital exceeded 5.0%.

Standard loans accounted for 51.6% of banking sector loan debt as of January 1, 2007, problems loans 1.2% and bad loans 1.5% (as of January 1, 2006, 48.2%, 1.5% and 1.7% respectively). This was nowhere near the credit risk level that might provoke a bad debt crisis[25] *(see Chart 2.3)*.

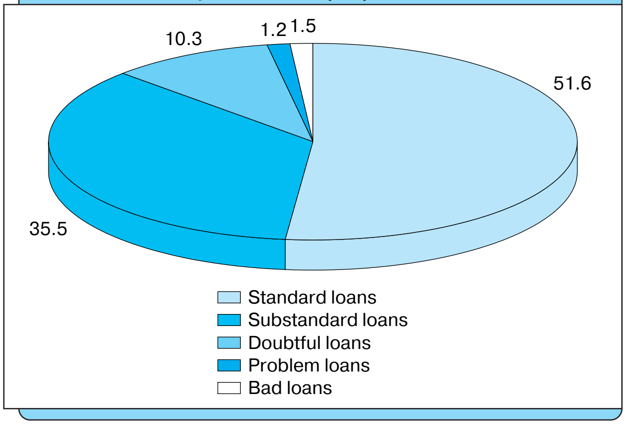
As of January 1, 2007, the largest share of standard loans (59.8%) was registered in the banks controlled by foreign capital; problem and bad loans accounted for 0.6% of their loan portfolio. The largest share of problem and bad loans was in the loan portfolio of medium-sized and small banks based in the Moscow Region (2.2% and 2.0% of total loans extended respectively).

In 2006, the number of credit institutions whose loan portfolios comprised more than half of standard loans decreased from 480 to 459. However, the share of these banks in aggregate banking sector assets almost doubled and stood at 62.9% as of January 1, 2007.

Almost in all groups of banks with a share of standard loans in excess of 50.0% made up more than a third. Such banks prevailed in the group of foreign-controlled banks, accounting for 70.3% of total banks in the group.

Loan loss provisioning by credit institutions remained at a high level during 2006. Almost on all reporting dates

Quality of banking sector loan portfolio as of January 1, 2007 (%) CHART 2.3



[21] The methodology of monitoring non-financial institutions' credit risk is described in the Appendix *(Section IV.I. of Developing the Banking Sector Stability Monitoring System)*.
[22] Banks whose borrowers'default on overdue debt can lead to a reduction in capital adequacy to dangerously low levels (no more than 11%) and this reduction is caused by credit risk. This group does not comprise banks with initially low capital adequacy levels.
[23] The methodology of monitoring household credit risk is described in the Appendix *(Section IV.I. of Developing the Banking Sector Stability Monitoring System)*.
[24] As is the case with monitoring the risk of lending to non-financial institutions, this group comprises the banks whose borrowers' default on overdue debt to individuals can lead to a reduction in capital adequacy levels to 11% at the outside and this reduction is caused by credit risk. This group does not comprise banks with initially low capital adequacy levels.
[25] According to international banking supervision practices, credit risk is considered high if non-performing loans exceed 10% of the total loan portfolio.

the loan loss provisions of most banks met the required minimum[26]. As of January 1, 2007, the number of banks whose loan loss provisions fully met the required level adjusted for the collateral factor stood at 1,118 and these banks accounted for 98.8% of banking sector assets (1,186 banks and 98.4% in the previous year respectively).

On the whole, the loan loss provisions as of January 1, 2007, accounted for 4.1% of the actual loan debt, including 37.1% of problem loans[27] and 82.9% of bad loans[28] (the values as of January 1, 2006, were 5.0%, 44.5% and 81.9% respectively).

II.1.2. Credit risk concentration

According to reported data, the number of credit institutions that violated the N6 ratio (maximum risk per borrower or a group of related borrowers) declined from 13 to eight in 2006, but their share in aggregate banking sector assets expanded from 5.3% in 2005 to 8.2%.

No credit institution violated the N7 ratio in 2006 (maximum large credit risk)[29].

The value of large credit claims (credit risks) in the banking sector increased 36.7% in the period under review, to 4,072.4 billion rubles, while total loan debt grew by a total of 48.2%. As a result, the share of large loans in banking sector assets decreased from 30.5% to 29.0% in 2006.

The highest ratio of large credit risks in bank assets was registered in the medium-sized and small banks based in the Moscow Region (45.6%), the smallest in the state-controlled banks (21.1%).

II.1.3. Shareholder and insider credit risks

As of January 1, 2007, the N9.1 ratio (maximum amount of loans, bank guarantees and sureties provided by a credit institution (banking group) to its members (shareholders)) was calculated by 492 credit institutions (479 as of January 1, 2006). Five credit institutions violated this ratio (its threshold value is 50%) during the year under review (eleven in 2005).

The N10.1 ratio, which sets a limit on total loans extended by a credit institution to insiders and on guarantees and sureties issued to them, was calculated by 928 credit institutions as of January 1, 2007, (936 as of January 1, 2006). In 2006, this ratio was violated by eleven credit institutions (16 in 2005).

II.1.4. Risks connected with finances of corporate borrowers

The financial standing of the borrower enterprises monitored by the Bank of Russia was satisfactory in 2006, by and large, but worse than in 2005. On the whole, the finances of enterprises deteriorated in 2006. Industrial and communications enterprises were better off than others in the year under review, whereas enterprises in other economic activity categories were plagued by serious problems.

In 2006, corporate aggregate capital[30] increased and was balanced by borrowing and lending terms. Enterprises had enough investment resources[31] to create investment assets[32] and only construction, transport and communications enterprises were short of investment resources to finance investment assets.

The actual level of self-financing of enterprises[33], which reflected the capital ratio of enterprises, allowing for the accumulated volume of liabilities, was rather high, but it declined slightly in 2006 (to 53.8%). Only industrial and agricultural enterprises had sufficient capital for investment.

The debt burden on enterprise capital[34] increased slightly and remained rather high in 2006 (0.86 rubles per 1 ruble of capital). Substantial growth in the debt burden on enterprises was registered in wholesale and retail trade, construction and transport. Industrial and agricultural enterprises as a whole had an acceptable level of the debt burden at the end of the period under review. Other enterprises had a significant debt burden in 2006. Capital of transport and communications enterprises covered only 87.7% of their liabilities. The latter exceeded capital of enterprises in wholesale and retail trade by 270% and construction enterprises 210%.

Raising mostly long-term resources, including bank loans, allowed enterprises to use their own funds to ensure growth in investment assets and also to finance current operations. Own working assets expanded 13.0% in 2006, but since working assets grew more rapidly (by 16.5%), the share of working assets created from own funds decreased from 31.3% to 30.5%. Construction, transport and communications enterprises had no working assets of their own.

In 2006, enterprise float improved due to the reduction in overdue receivables, which decreased at enterprises in the major economic activity categories, except construction, transport and communications. As a result,

[26] Beginning from the statements as of September 1, 2004, Bank of Russia Regulation No. 254-P, dated March 26, 2004, “On the Procedure for Making by Credit Institutions Provisions for Possible Losses on Loans, Loan and Similar Debts”, requires banks to determine the minimum provision by adjusting the imputed provision for collateral.

[27] Allowing for the collateral factor and the imputed provision for problem loans, which accounted for 51% to 100% of the principal amount of debt, depending on the extent of the loan depreciation.

[28] Allowing for the collateral factor.

[29] Under Article 65 of the Federal Law on the Central Bank of the Russian Federation (Bank of Russia) a large credit risk is a sum of loans, guarantees and sureties provided to one customer in excess of 5% of a bank’s capital.

[30] Balance sheet total.

[31] Total capital and long-term liabilities.

[32] Fixed assets.

[33] The share of net assets in the enterprise balance sheet total.

[34] The ratio of total liabilities to capital.

Indicators characterising corporate borrowers' finances (%)

TABLE 2.1

Indicator	2006	
	beginning of period	end of period
Self-financing ratio*	54.7	54.3
Debt burden on capital**	0.84	0.86
Liabilities to banks in enterprise total liabilities	34.0	37.9
Absolute liquidity ratio	6.3	5.0
Current liquidity ratio	139.8	139.5
Return on assets***	16.9	
Return on capital***	31.4	

** Capital to assets.*
*** Liabilities to capital.*
**** Full year.*

while short-term receivables increased, the share of overdue receivables in them contracted from 10.5% to 7.5% in the period under review. There was a drop in overdue receivables at enterprises in all economic activity categories, except transport.

At the same time, the short-term net debtor position[35] of enterprises in settlements, which reflected the diversion of funds from production, increased in the period under review, especially at industrial and transport enterprises.

As a result of enterprise capital management, the earnings received by enterprises from the sale of goods, works and services increased 27.3% in 2006 as against 21.2% in 2005. This growth was not enough to cover all enterprise expenses and this resulted in the net outflow of funds in 2006. Net outflow of enterprise funds accounted for 0.11% of earnings and this led to the reduction of cash reserves by 6.9%. Net outflow of funds was registered in industrial, transport and communications enterprises, whereas enterprises in other economic activity categories increased their cash reserves due to the net inflow of funds.

The coverage of enterprise current (short-term) liabilities by working assets (net of overdue receivables) deteriorated a little. In the year under review, it decreased to 139.5%, whereas at the beginning of 2006 it was 139.8%. Only construction, transport and communications enterprises did not have enough working assets (net of overdue receivables) to cover their current (short-term) liabilities. Communications enterprises had the lowest coverage ratio (64.1%) in respect to current (short-term) liabilities.

In 2006, the coverage of current (short-term) liabilities by cash decreased as a result of a reduction in cash reserves from 6.3% to 5.0%.

Profits (the financial result of enterprise activities before taxation) in the period under review increased 60.0% year on year (24.1% in 2005). Only agricultural and transport enterprises registered a fall in profits.

The enterprise return on assets[36], calculated in terms of profits before taxation, rose from 10.3% in 2005 to 16.9% in 2006 and the return on capital increased from 14.8% to 31.4%.

[35] The excess of receivables over payables.
[36] Pre-tax profits to average annual value of assets.

II.2. Market Risk

II.2.1. General characteristics of market risk

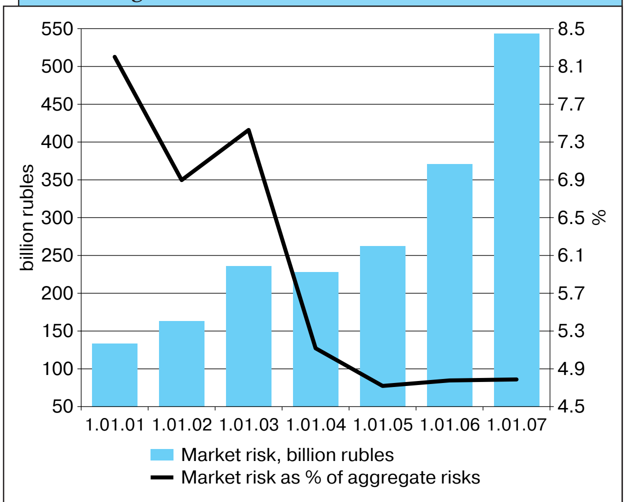
The number of credit institutions calculating market risk[37] decreased slightly (from 772 to 747) in 2006 but their share in banking sector assets decreased substantially (from 91.6% to 67.4%).

As of January 1, 2007, 617 banks took currency risk into account when calculating capital adequacy. These banks accounted for 61.6% of banking sector assets (677 banks accounting for 84.5% of banking sector assets in 2005). In comparison, 185 banks with a 37% share in banking sector assets calculated stock market risk and 305 banks with a 46% share in banking sector assets calculated interest rate risk as of January 1, 2007. The number of banks which played an important role in all segments of the financial market and, consequently, should include all three groups of risk into calculation was relatively small — 115 (83 as of January 1, 2006) and they accounted for 33.4% of banking sector assets (21.2% as of January 1, 2006).

As a result of considerable growth in credit institutions' investments in securities (the balance-sheet trading book increased 55.1% in 2006 as against 39.7% in 2005) and the continued expansion of bank operations on the futures markets, banking sector market risk increased 46.5% to 543.8 billion rubles as of January 1, 2007. The ratio of market risk to capital of the market risk-calculating banks also increased: from 33.6% to 45.1%. However, the share of market risk in aggregate banking sector risks remained small: less than 5.0% as of January 1, 2007 *(see Chart 2.4).*

Market risk and its share in aggregate banking sector risks

CHART 2.4



Although at the beginning of 2006, debt obligations made up the bulk of the trading book (investments in debt obligations exceed investments in stocks by almost 7 times), ***stock market risk*** accounted for the largest part of market risk (45.2% as of January 1, 2007 as against 42.9% as of January 1, 2006). ***Interest rate risk*** accounted for 42.9% as against 39.8% as of January 1, 2006).

It should be noted that interest rate risk prevailed as of most of the intrayear reporting dates, as credit institutions' interest in corporate debt instruments rose (investments in corporate debt obligations increased 110% in 2006). A major price adjustment in May and June, a downward price trend on the stock market in September and the corresponding decrease in investment on the stock market were also the contributing factors.

The dynamics of the risks reviewed here was affected by the expansion of bank operations on the futures markets: claims for the delivery of securities in futures contracts[38] increased almost 310% in 2006 and obligations 90%. The related growth of market risk was compensated for by increase in banking sector capital: relative to banking sector capital the net position[39] on the delivery of securities under futures contracts decreased from 2.7% as of January 1, 2006, to 0.4% as of January 1, 2007.

Currency risk remained the least important risk and its share in market risk contracted from 17.4% to 11.9% in 2006, although it did not change in absolute terms.

As for the balance sheet positions in foreign currency, there was a contraction in the foreign currency component in 2006 *(see Chart 2.5)* as the ruble appreciated against the US dollar on the domestic market. As of January 1, 2007, foreign currency assets accounted for 24.6% of total assets and foreign currency liabilities accounted for 24.8% of total liabilities (27.7% and 28.2% as of January 1, 2006). The difference between the ratios of the foreign currency components of assets and liabilities stood at 0.2 percentage points.

At the same time, currency futures contracts increased banks' exposure to currency risk. The US dollar

[37] In compliance with the requirements of Bank of Russia Regulation No. 89-P, dated September 24, 1999, "On the Procedure for Calculating Market Risks by Credit Institutions".
[38] Futures contracts in Section D of the Chart of Accounts.
[39] Regardless of the sign of the position.

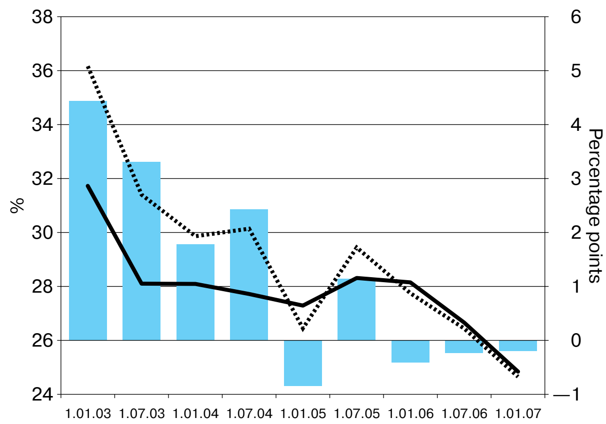
net forward position[40] was long as of December 31, 2006, and in 2005 as a whole and amounted to 24.8 billion rubles, a fourfold increase on December 30, 2005 (6.7 billion rubles). The euro net long forward position stood at 51.8 billion rubles as of December 12, 2006. This represented an increase of 25% on the corresponding long position as of December 30, 2005 (41.3 billion rubles). One factor behind these dynamics was the resumption after a long break of trade in currency futures on the MICEX.

In 2006 as a whole, off-balance sheet claims and obligations in foreign currency[41] increased 60.3% and 34.7% respectively. There was also a rise in the ratio of off-balance sheet and balance sheet foreign currency positions: while at the beginning of 2006 the ratio between off-balance sheet claims and balance sheet assets stood at 54.0%, as of January 1, 2007, it was 67.7%. The ratio between off-balance sheet obligations and balance sheet liabilities in foreign currency had similar dynamics: in the year under review, it increased from 49.3% to 52.2%.

The quarterly average number of credit institutions that violated the limits on the open currency position decreased from 13 in 2005 to 11 in 2006. The share of these banks in assets of the banks holding foreign currency licences fell from 14.3% to 2.4%.

Foreign currency assets and liabilities in aggregate banking sector assets and liabilities (%)

CHART 2.5



Difference between ratios of foreign currency components of assets and liabilities, percentage points (right-hand scale)
Share of foreign currency assets in aggregate assets (%)
Share of foreign currency liabilities in aggregate liabilities (%)

II.2.2. Evaluation of banking sector vulnerability to interest rate risk (trading book)

To determine the banking sector's vulnerability to interest rate risk of the trading book, the Bank of Russia stress tested credit institutions to evaluate 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 price would fall by 30%.

To determine the effect of trading book interest rate risk on the financial state of the Russian banking sector, the Bank of Russia analysed data reported by the credit institutions that had resident enterprises' listed debt obligations in their trading books. For the purposes of analysis, these credit institutions were broken into two groups: the first group comprised the banks that were required to calculate interest rate risk and, consequently, include market risk in the capital adequacy calculation; the second comprised credit institutions that did not calculate interest rate risk[42].

The number of credit institutions in the first group increased 18.0% in 2006 from 172 as of January 1, 2006, to 203 as of January 1, 2007. They accounted for 54.9% of banking sector investments in resident corporate debt obligations and their share in banking sector assets as of January 1, 2007, stood at 41.8% and in banking sector capital 42.6% (32.8% and 32.7% as of January 1, 2006, respectively).

The number of credit institutions in the second group changed slightly and as of January 1, 2007, reached 96 as against 93 as of January 1, 2006. They accounted for the remainder 45.1% of banking sector investments in resident corporate debt obligations and their share in banking sector assets stood at 40.8% as of January 1, 2007, as against 46.4% as of January 1, 2006, and in banking sector capital 34.4% as against 39.1% as of January 1, 2006.

The stress testing of the credit institutions ***required to calculate interest rate risk*** has shown that the vulnerability of the credit institutions in this group to interest rate risk increased in the year under review: as of the beginning of 2007, potential capital loss could be 6.6% as against 5.5% as of the beginning of 2006.

As for the credit institutions that had investments in listed debt instruments of resident enterprises but ***did not calculate interest rate risk,*** their vulnerability to this kind of risk more than doubled in 2006: in the bad-case scenario, at the beginning of 2007 they could lose 6.7% of their capital (39.0 billion rubles) as against 3.8% (18.5 billion rubles) at the beginning of 2006.

II.2.3. Evaluation of banking sector vulnerability to stock market risk

To assess the financial stability of the Russian banking sector against stock market risk, the Bank of Russia

[40] Net currency forward and options positions are calculated on the basis of data in 0409634 Form "Open Currency Positions Statement" for all credit institutions that present this form in ruble terms at the official exchange rates set by the Bank of Russia as of corresponding dates.
[41] Futures contracts in Section D of the Chart of Accounts.
[42] Bank of Russia Regulation No. 89-P, dated September 24, 1999, "On the Procedure for Calculating Market Risks by Credit Institutions', requires interest rate and stock market risks to be calculated when the total balance sheet value of the trading book equals or exceeds 5% of the credit institution's balance sheet assets as of the reporting date. The total balance sheet value of the trading book is determined as the sum of the balance sheet values of the financial instruments with market value and acquired by the credit institution for subsequent resale, repos included.

stress tested credit institutions to evaluate the possible adverse consequences of a fall in the RTS index. A 30% fall in the RTS index was assumed to be the initial event in the stress situation[43].

To determine the effect of stock market risk on the capitalisation of the Russian banking sector, the Bank of Russia analysed data reported by the credit institutions that had listed stocks in their trading books. As in the analysis of interest rate risk, the credit institutions were divided into two groups: the first group comprised banks that were required to calculate stock market risk and, consequently, included stock market risk in the capital adequacy calculation; the second comprised credit institutions that did not calculate stock market risk.

The number of credit institutions in the first group rose from 134 as of January 1, 2006, to 181 as of January 1, 2007, and they accounted for 93.2% of banking sector investments in listed stocks. As of January 1, 2007, this group of banks accounted for 36.3% of banking sector assets and 38.7% of capital (26.0% and 27.6% as of January 1, 2006, respectively).

The number of credit institutions in the second group increased from 125 as of January 1, 2006, to 172 as of January 1, 2007, and these banks accounted for the remaining 6.8% of investments in listed stocks. As of January 1, 2007, this group of banks accounted for 41.2% of banking sector assets and 35.5% of capital (45.8% and 38.7% as of January 1, 2006 respectively).

The analysis has shown that the sensitivity to stock market risk of the group of credit institutions that ***calculated stock market risk*** remained almost unchanged: should the RTS index fall by 30% as of January 1, 2007, losses would account for 4.7% of capital (4.3% as of the beginning of 2006).

As for the credit institutions that had investments in listed stocks but ***did not calculate stock market risk,*** their sensitivity to stock market risk decreased: should developments change for the worse, as of beginning of 2007 losses would account for 0.4% of capital as against 1.0% at the beginning of 2006.

By and large, the stress testing has shown that banking sector vulnerability to stock market risk not high.

II.2.4. Evaluation of banking sector vulnerability to currency risk

To assess the Russian banking sector's vulnerability to currency risk, the Bank of Russia stress tested credit institutions in the context of the ruble's appreciation against the US dollar and the euro separately. A one-time rise in the nominal exchange rate of the ruble by 30% against the US dollar and the euro was modelled as the initial events in the stress situation. To determine the effect of currency risk on the financial state of the Russian banking sector, the Bank of Russia analysed data reported by the credit institutions that were required to calculate currency risk[44] and had net long open positions in the US dollar and in the euro.

The number of credit institutions having net long open positions in the US dollar stood at 346 as of December 31, 2006, as against 402 as of January 1, 2006, and they accounted for 24.9% of aggregate banking sector assets and 23.7% of capital (46.0% and 44.3% respectively as of December 30, 2005). The number of credit institutions having net long open positions in the euro decreased from 396 as of December 30, 2005, to 312 as of December 31, 2006, but their share in aggregate banking sector assets and capital remained almost unchanged at 21.2% and 23.9% respectively (25.4% and 30.2% respectively as of December 30, 2005).

The analysis has shown that by the end of 2006 the long open positions in the US dollar of the first group of banks had increased 50% to $516.2 million and their share in the long open positions in all currencies and precious metals[45] stood at 66.9% on average as of December 31, 2006, as against 71.5% as of December 30, 2005. The long open positions in the euro in the second group of banks increased more, by 80%, to €226.4 million as of December 30, 2005, and their share in the long open positions in all currencies and precious metals[46] averaged 45.8% as of December 31, 2006, as against 30.0% as of December 30, 2005.

The stress testing has shown that an instant and sharp appreciation of the ruble against the US dollar or the euro (by 30%) will not lead to substantial losses: an overwhelming majority of banks would not lose more than 3% of their capital.

The banking sector's vulnerability to a hypothetical sharp appreciation of the ruble against the US dollar is on the decline and is negligible at the moment: in the bad-case scenario, the monitored banks would lose 1.1% of their capital as of December 31, 2006, as against 0.5% as of December 30, 2005. The banking sector's vulnerability to a possible sharp appreciation of the ruble against the euro is also low: in the bad-case scenario, the monitored banks would lose 0.6% of their capital as of December 31, 2006, as against 0.3% as of December 30, 2005.

[43] It was assumed that the RTS index's fall by 30% would lead to a similar decrease in stock prices in trading books.
[44] Currency risk is taken into account in calculating market risks when as of the reporting date the percent ratio between total open currency positions and capital equals or exceeds 2%.
[45] In ruble terms.
[46] In ruble terms.

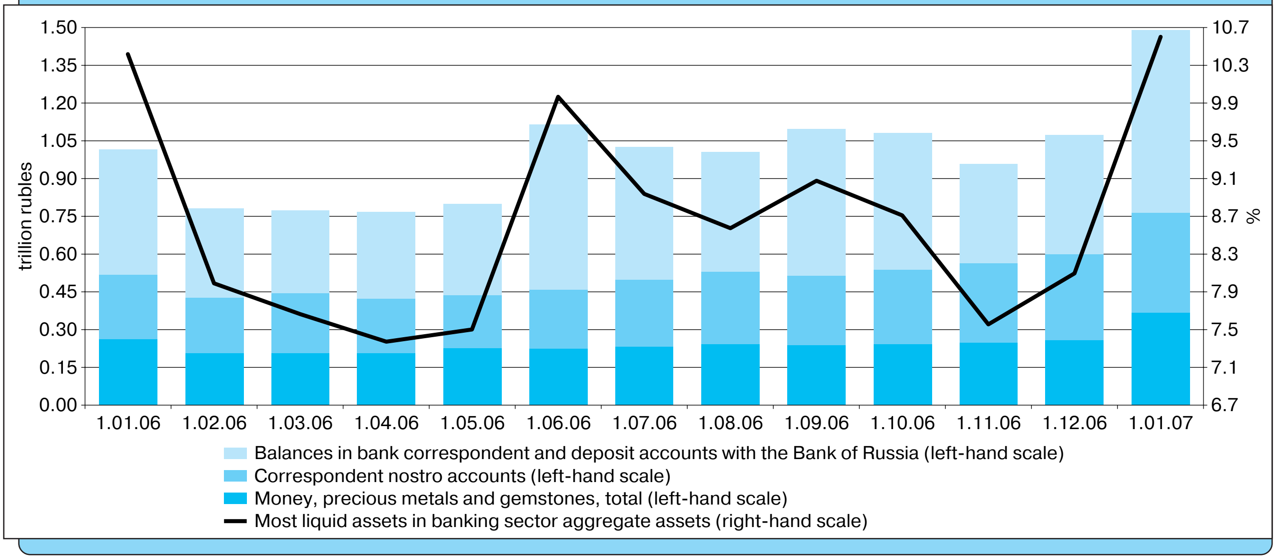
II.3. Liquidity Risk

II.3.1. General characteristics of liquidity risk

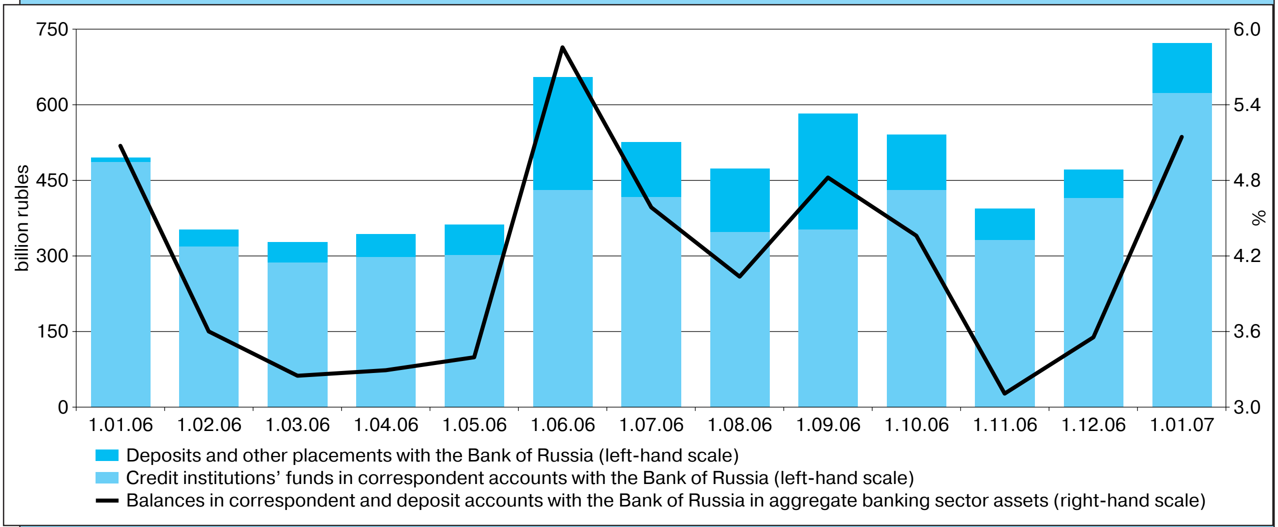
The most liquid assets of the banking sector, such as money, precious metals, gemstones, balances in correspondent nostro accounts and balances in correspondent and deposit accounts with the Bank of Russia, increased in 2006. They grew 46.6% to 1,489.2 billion rubles as of January 1, 2007. At the same time, the share of the most liquid components in aggregate banking sector assets remained relatively stable (10.6% as of January 1, 2007) *(see Chart 2.6)*. This dynamics of the most liquid assets was due to credit institutions' efforts to maintain liquidity at an optimal level necessary to carry out their current obligations and in principle it might reflect the improved quality of the risk management systems in banks.

Banks stepped up their activities in conducting operations in correspondent accounts opened with one another. The value of funds in correspondent nostro accounts increased 54.6% in 2006, of which the balances of corre-

Banking sector's most liquid assets *CHART 2.6*



Balances in credit institutions' correspondent and deposit accounts with the Bank of Russia *CHART 2.7*



spondent nostro accounts with resident credit institutions grew 97.8% and with non-resident banks 32.0%.

The balances of credit institutions' correspondent and deposit accounts with the Bank of Russia showed a slight downward trend in the first half of 2006 but stabilised in the second. As of January 1, 2007, their share in aggregate banking sector assets was the same as in the previous year at 5.1% *(see Chart 2.7).*

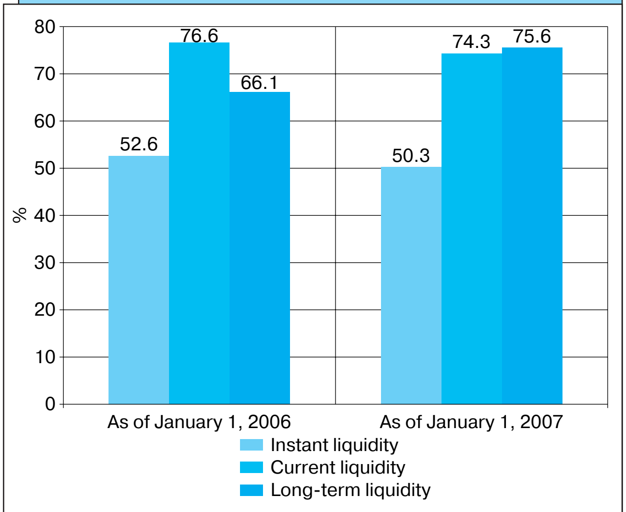
The share of the most liquid assets in aggregate assets by group of banks did not change much either in 2006. There was a slight expansion in the share of the most liquid assets in aggregate assets in foreign-controlled banks (from 8.8% to 10.4%) and large private banks (from 11.6% to 11.8%). The share of the most liquid assets decreased slightly in medium-sized and small banks based in the Moscow Region (from 28.9% to 26.7%) and medium-sized and small regional banks (from 21.3% to 19.9%). The share of the most liquid assets in state-controlled banks remained unchanged at 5.3%.

On average[47] in 2006, the most liquid assets grew more than in 2005 in absolute terms (977.3 billion rubles as against 805.2 billion rubles), but the share of the most liquid assets in aggregate assets[48] contracted by 1.3 percentage points, as compared with 2005, to 8.5%.

II.3.2. Compliance with required liquidity ratios

Throughout the year under review, some credit institutions occasionally failed to meet required liquidity ratios. In 2006, sixty-five credit institutions occasionally violated the instant liquidity (N2) ratio (76 credit institutions in 2005), 94 credit institutions the current liquidity (N3) ratio (88 credit institutions in 2005) and 12 credit institutions violated the long-term liquidity (N4) ratio (11 credit institutions in 2005). As of January 1, 2007, only two credit institutions failed to comply[49] with the instant, current and long-term liquidity ratios.

Banking sector liquidity ratios (chronological annual averages) *CHART 2.8*



In the period under review, the instant liquidity (N2) ratio was violated more than 10 times by seven credit institutions, the current liquidity (N3) ratio by eight credit institutions and the long-term liquidity (N4) ratio by two credit institutions.

On average[50], the liquidity indicators for the banking sector declined slightly in 2006: instant liquidity from 52.6% in 2005 to 50.3% in 2006 and current liquidity from 76.6% to 74.3% *(see Chart 2.8).* As of January 1, 2007, the banking sector instant liquidity ratio stood at 51.4% and current liquidity ratio 76.8%.

The lowest instant liquidity ratio (47.2%) was registered as of the end of 2006 in the group of large private banks. State-controlled banks also had a lower instant liquidity ratio (50.4%) than the banking sector as a whole.

The lowest current liquidity ratio (71.6%) was registered in the group of state-controlled banks. Foreign-controlled banks and medium-sized and small regional banks also had lower current liquidity ratios than the banking sector on average (73.9% and 75.4% respectively).

The average long-term liquidity ratio[51] increased from 66.1% as of January 1, 2006, to 75.6% as of January 1, 2007. The rise resulted from the fact that, first, banking sector liabilities with maturities in excess of one year grew more slowly than long-term lending (in excess of one year) and, second, the expansion of long-term lending (in excess of one year) was considerably faster than growth in banking sector capitalisation (68.9% as against 36.3%).

On the whole, the share of the most liquid assets in aggregate banking sector assets remained stable and in 2006 banking sector liquidity was at an acceptable level, despite a slight fall in instant and current liquidity. This is also confirmed by some indicators, such as the structure of bank assets and liabilities by maturity, the ratio between the deposits taken and loans extended (coverage ratio), interbank lending rates and credit institutions' dependence on the interbank loan market.

II.3.3. Structure of bank assets and liabilities by maturity[52]

The maturity period of the aggregate banking sector loan portfolio increased in 2006. The value of loans with

[47] Calculated as the chronological average for the year.
[48] Calculated as the chronological average for the year.
[49] Non-compliance with a required ratio is the violation of its numerical value for a total of six business days or more within 30 consecutive business days preceding the reporting date.
[50] Calculated as the chronological average for the year.
[51] Bank of Russia Instruction No. 110-I, dated January 16, 2004, "On Banks' Required Ratios" set the limit on this ratio at 120%.
[52] Bank assets and liabilities were analysed by maturity on the basis of data on the distribution of balance sheet assets and liabilities by term.

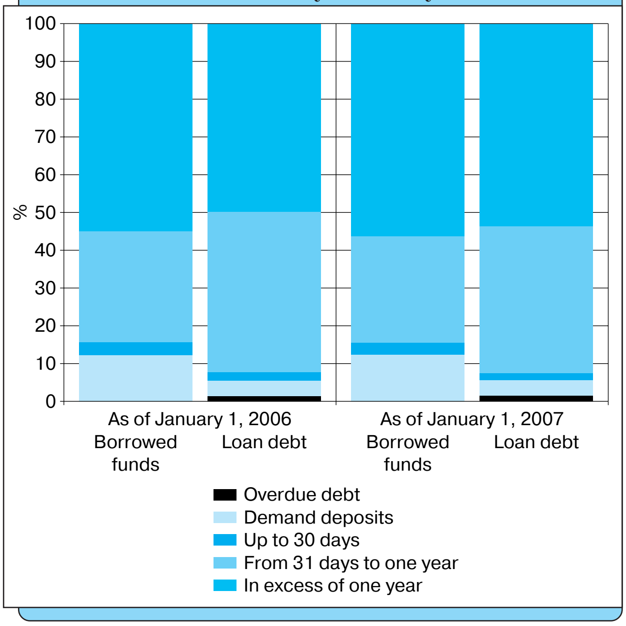
maturities in excess of one year kept growing faster than total loan debt[53] (58.6% as against 47.2%). (In 2005, loans extended for more than one year expanded 60.4%, while total loan debt rose 40.0%).

As a result, the share of medium- and long-term (in excess of one year) components of the loan portfolio continued to expand and as of January 1, 2007, it accounted for 53.5% of total loan debt as against 49.7% as of January 1, 2006. At the same time, there was a contraction in the share of short-term loan debt, including loans with maturities shorter than 30 days: from 6.4% as of January 1, 2006, to 6.0% as of January 1, 2007 *(see Chart 2.9).*

Similar changes took place in the structure of deposits[54] taken by credit institutions. In 2006, deposits with maturities in excess of one year grew faster than customer deposits in general (52.9% as against 49.4%). Deposits with maturities in excess of one year accounted for 56.2% of total deposits as of January 1, 2007, as against 54.9% as of January 1, 2006. Meanwhile, the share of deposits with maturities shorter than 30 days remained almost unchanged (15.6% as of January 1, 2006, and 15.5% as of January 1, 2007).

The expansion of the share of medium- and long-term credit investments and deposits taken was registered in all groups of credit institutions.

Structure of bank loan debt and borrowed funds by maturity — CHART 2.9



The longest maturity period of deposits and loan debt was registered in the group of state-controlled banks: customer deposits with maturities in excess of one year accounted for 71.4% of all deposits taken and loans with the same maturity periods accounted for 63.0%.

In all other groups of credit institutions the share of long-term deposits taken from customers and loans extended to customers was smaller than the banking sector average.

The smallest share of customer deposits with maturities in excess of one year was in the group of banks with foreign interest (32.1%).

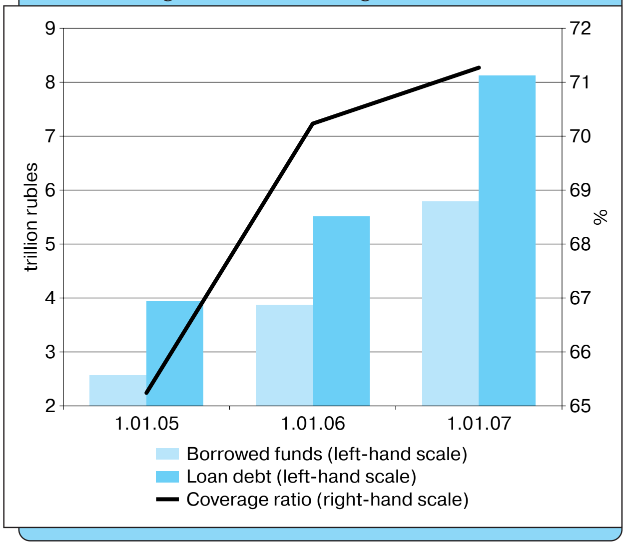
The smallest share of loans with maturities in excess of one year was registered in the medium-sized and small banks based in the Moscow Region (36.9%), which extended nearly half of all loans for a period of from 30 days to one year.

Customer deposits to total loans (coverage ratio)[55]

The coverage ratio continued to gradually increase in 2006. As of January 1, 2007, customer deposits covered by 71.3% the loans extended to customers, which represents a slight increase on a previous year (70.2%). The coverage ratio as of January 1, 2005, was 65.2% *(see Chart 2.10).*

Seventy-nine credit institutions had no corporate and/or household deposits in their resource base, but the

Loan debt to major sources of banking sector financing — CHART 2.10



[53] Loan debt includes loans extended by credit institutions to corporate entities and households, except banks and resident financial institutions, and other funds provided to these categories of resident and non-resident debtors.
[54] These include the deposits taken by credit institutions from legal entities and households, except banks and resident financial institutions, and other funds raised from these categories of resident and non-resident creditors, excluding balances in current and settlement accounts of these categories of customers.
[55] The coverage ratio is calculated as the ratio of deposits taken by credit institutions from corporate entities and households, except banks and resident financial organisations, and other funds provided by these categories of resident and non-resident creditors to loans extended by credit institutions to corporate entities and households, except banks and resident financial institutions, and other funds extended to these categories of resident and non-resident debtors.
The 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 assess banking sector liquidity, as it compares the most 'traditional' and stable sources of resources with their principal investments. The reduction in the coverage ratio is indicative of the increased dependence of the fulfilment of credit institutions' obligations on their ability to quickly access the money or stock market and, consequently, the increased liquidity risk.

assets of these credit institutions accounted for a meagre 0.8% of aggregate banking sector assets.

The highest coverage ratio (79.9%) was registered as of January 1, 2007, in the state-controlled banks and the lowest (48.8%) in the medium-sized and small banks based in the Moscow Region.

The highest coverage ratio, calculated by the medium- and long-term component (for a term in excess of one year) was as of January 1, 2007, in the state-controlled banks (90.6%), the lowest in the banks controlled by foreign capital (35.7%).

As of January 1, 2007, 371 credit institutions had a coverage ratio twice as small as in the banking sector as a whole and these credit institutions accounted for 9.1% of aggregate banking sector assets (422 credit institutions with 12.7% of aggregate banking sector assets as of January 1, 2006). Coverage ratios four times as small as in the banking sector as a whole was registered in 225 credit institutions, which accounted for 3.7% of aggregate banking sector assets (262 credit institutions with 5.7% of aggregate banking sector assets as of January 1, 2006).

II.3.4. Fulfilment of obligations

In 2006, some credit institutions occasionally failed to meet their obligations to creditors and depositors. As of January 1, 2007, only one credit institution failed to fulfil its obligations.

The value of unmet claims (219.7 million rubles) relative to the value of compulsory payments of this credit institution stood at 18.9% as of January 1, 2007, and it accounted for about 0.01% of aggregate banking sector assets.

II.3.5. Dependence on interbank market[56]

Credit institutions' dependence on the interbank market decreased slightly in 2006 from the standpoint of liquidity risk analysis. The following data bear this out.

Credit institutions with the interbank market dependence ratio of no more than 8.0% accounted for the largest share of aggregate banking sector assets, but in 2006 their share contracted from 71.2% to 68.6%. At the same time, the share of credit institutions with the interbank market dependence ratio from 8.0% to 18.0% expanded from 12.4% to 15.7% and the share of credit institutions with the interbank market dependence ratio from 18.0% to 27.0% increased from 10.6% to 12.8%. The share of credit institutions with the interbank market dependence ratio of more than 27% in aggregate banking sector assets decreased from 5.8% to 2.9% in the year under review.

As of January 1, 2007, the interbank market dependence ratio was the highest (15.9%) in the banks with foreign interest (19.9% as of January 1, 2006) due to their close co-operation with their foreign-based parent banks. In this group, 51.9% (52.4% as of January 1, 2006) of banks had the interbank market dependence ratio higher than 18.0%.

The lowest interbank market dependence ratio was in the group of medium-sized and small banks based in the Moscow Region, which placed more funds on the interbank market than raised from it (the interbank market dependence ratio in this group of banks was negative at 3.0%). At the same time, banks with the interbank market dependence ratio higher than 18.0% accounted for 7.5% of the banks in this group as of January 1, 2007 (4.5% as of January 1, 2006).

The interbank loan market has had a major role to play from the standpoint of managing liquidity. A specific characteristic of the Russian interbank loan market was the substantial influence on it by non-resident banks. By the end of 2006, the debt on interbank operations conducted by Russian banks with non-resident banks practically doubled in absolute terms. In the past few years, Russian banks raised from the international interbank market more funds (1,364.8 billion rubles as of January 1, 2007, as against 784.0 billion rubles as of January 1, 2006) than they placed on the market (664.4 billion rubles as against 351.7 billion rubles respectively).

However, it is very important from the standpoint of the long-term prospects for the development of the Russian banking sector that the share of non-resident banks is gradually expanding in total interbank loans taken and extended. In 2006, the share of loans received from non-resident banks expanded by 6.7 percentage points to 78.9% in total interbank loans received, while the share of loans extended to non-resident banks in total interbank loans extended increased by 11.5 percentage points to 64.2%.

The share of the excess of interbank loans received from non-resident banks over loans extended to these banks in aggregate banking sector assets changed slightly in 2006, from 4.4% to 5.0%.

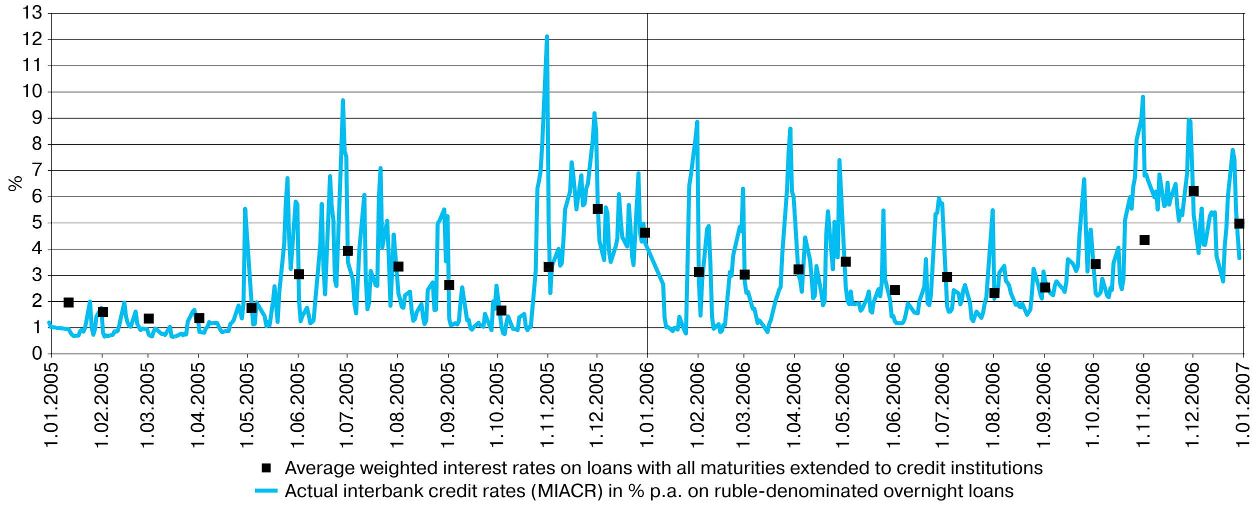
As in the case of January 1, 2006, 174 credit institutions as of January 1, 2007, had loans from non-resident banks and these credit institutions accounted for 83.7% of aggregate banking sector assets (81.5% as of January 1, 2006). Of these, seven credit institutions (five as of January 1, 2006) from the top 20 banks in terms of assets accounted for a half of interbank loans taken from non-resident credit institutions.

As of January 1, 2007, 213 credit institutions extended loans to non-resident banks and they accounted for 85.6% of aggregate banking sector assets (as of January 1, 2006, 202 credit institutions that accounted for 83.7% of aggregate banking sector assets). As in the previous year, six credit institu-

[56] Dependence of credit institutions on the interbank market is calculated as the percent ratio between interbank loans (deposits) taken and placed and borrowed funds. The higher the ratio, the more the credit institution is dependent on the interbank market. The methodology of calculating this ratio is close to that of calculating the PL5 ratio described in Bank of Russia Ordnance No. 1379-U, dated January 16, 2004, "On the Evaluation of Financial Soundness of a Bank for the Purpose of Ascertaining its Sufficiency for Participation in the Deposit Insurance System", which sets its threshold values from 8% to 27% and more.

Ruble interbank credit rate (MIACR)

CHART 2.11



tions from the top 20 banks in terms of assets accounted for a half of all interbank loans placed on the international interbank market.

II.3.6. Interbank market rates

The Moscow Interbank Actual Credit Rate (MIACR) on ruble-denominated overnight loans, the best indicator on the current value of the ruble resources on the interbank market, in 2006 was higher than in 2005. Occasional surges of interest rates on the ruble interbank market in 2006 mostly took place in the periods of tax payments to the budgets of all levels *(see Chart 2.11).*

The annual average weighted interest rate on interbank ruble loans with all maturities increased by 0.7 percentage points year on year, to 3.8% in 2006.

II.4. Capital Adequacy

II.4.1. Banking sector capital dynamics and structure

The banking sector capital reached 1,692.7 billion rubles as of January 1, 2007. In 2006, it grew faster than in the previous year (by 36.3% as against 31.2%). At the same time, growth in banking sector assets was faster than growth in capital; therefore, banking sector capital to assets fell to 12.1%. In the previous three years, this ratio varied from 14.6% to 12.7% *(see Chart 2.12).*

Credit institutions' profits remained the first most important factor of the growth in capital. In 2006, banking sector capital growth by 217.2 billion rubles, or almost a half of its total growth, was due to a rise in profits and the funds from them.

The second most important factor of the growth in banking sector capital was credit institutions' paid-up authorised capital and issue income, which increased by 202.9 billion rubles in 2006 (45% of total growth in own funds (capital)). It became more important because several large credit institutions from the top 20 banks (in terms of assets) increased their authorised capital in 2006 substantially.

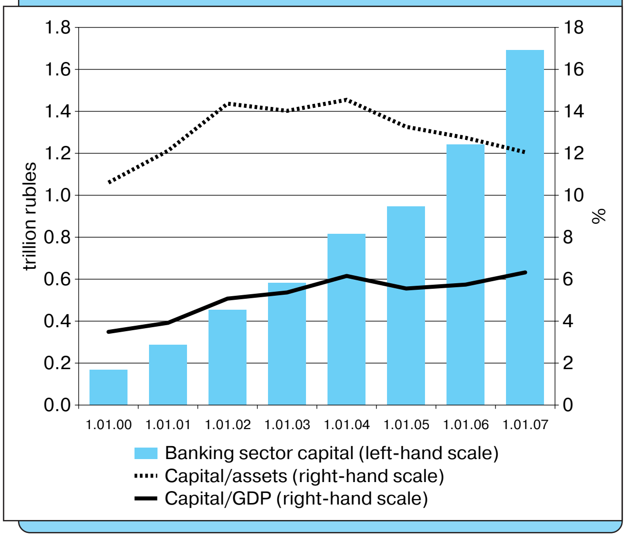
The third most important factor remained the increase in credit institutions' capital due to subordinated loans, which amounted to 63.4 billion rubles, or 14.1% of total growth in capital.

At the same time, the share of authorised capital and issue income in capital continued to decline: in 2006, it fell from 50.5% to 49.1% as against 54.1% in 2004 and 59.0% in 2003. The share of subordinated loans remained almost unchanged at 13.8% in 2006 as against 13.7% in 2005 *(see Chart 2.13).* The share of profits and the funds created from them expanded from 39.6% to 41.9% of aggregate capital in 2006.

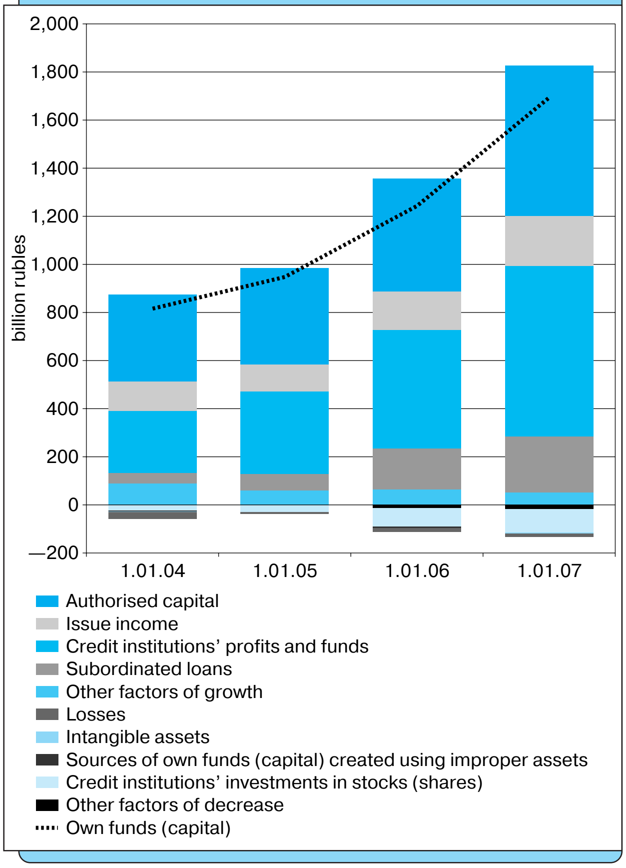
The importance of capital growth factors differed substantially in the various groups of credit institutions. In the state-controlled banks, for example, the increase in capital was largely due to the capitalisation of profits and the funds created from them and growth in authorised capital and issue income (67.4% and 52.9% of capital growth).

In the group of banks controlled by foreign capital, the principal factors of growth in capital were growth in authorised capital and issue income (52.8%), the capitalisation of profits and the funds created from them (32.4%) and subordinated loans (19.0%). The same factors of growth in capitalisation largely prevailed in the group of medium-sized and small regional banks (47.9%, 34.8% and 6.9% respectively).

Banking sector own funds (capital) *CHART 2.12*



Structure of banking sector aggregate own funds (capital) *CHART 2.13*



Large private banks had the most diversified structure of capital growth factors: the capitalisation of profits and the funds created from them accounted for 43.2%, growth in authorised capital and issue income 36.9%, the taking of subordinated loans 21.0%.

Growth in the capital of medium-sized and small banks based in the Moscow Region was mostly due to the capitalisation of profits and the funds created from them (89.5%).

In 2006, 135 credit institutions registered a reduction in own funds (capital) by a total of 2.8 billion rubles as against 134 credit institutions and 10.8 billion rubles in 2005). These credit institutions accounted for 2.2% of banking sector assets as of January 1, 2007 as against 3.9% as of January 1, 2006.

In 2006, most of the banks whose capital decreased were medium-sized and small banks based in the Moscow Region (57 banks) and medium-sized and small regional banks (53 banks). These banks reduced their capital by 1.8 billion rubles and 200 million rubles respectively, and their shares in the capital of the corresponding groups of banks were 11.2% and 5.9% and in aggregate banking sector capital 0.8% and 0.3% respectively.

Eight large private banks saw their own funds (capital) decrease in 2006 and these banks accounted for 2.4% of aggregate banking sector capital, that was more than in other groups of banks.

As in the previous year, there were no credit institutions with negative capital as of January 1, 2007.

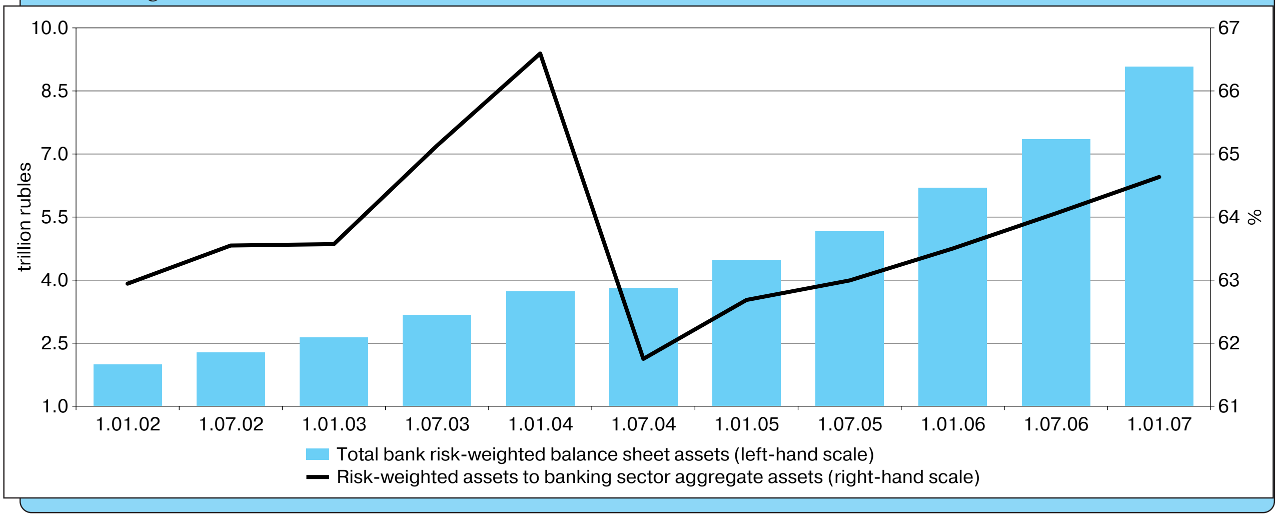
II.4.2. Risk-weighted assets

The ratio of risk-weighted balance sheet assets of credit institutions to aggregate balance sheet assets increased slightly in 2006, from 63.5% to 64.6% *(see Chart 2.14).*

Meanwhile, the structure of risk-weighted balance sheet assets in the year under review remained almost unchanged on 2005. As of January 1, 2007, assets of the

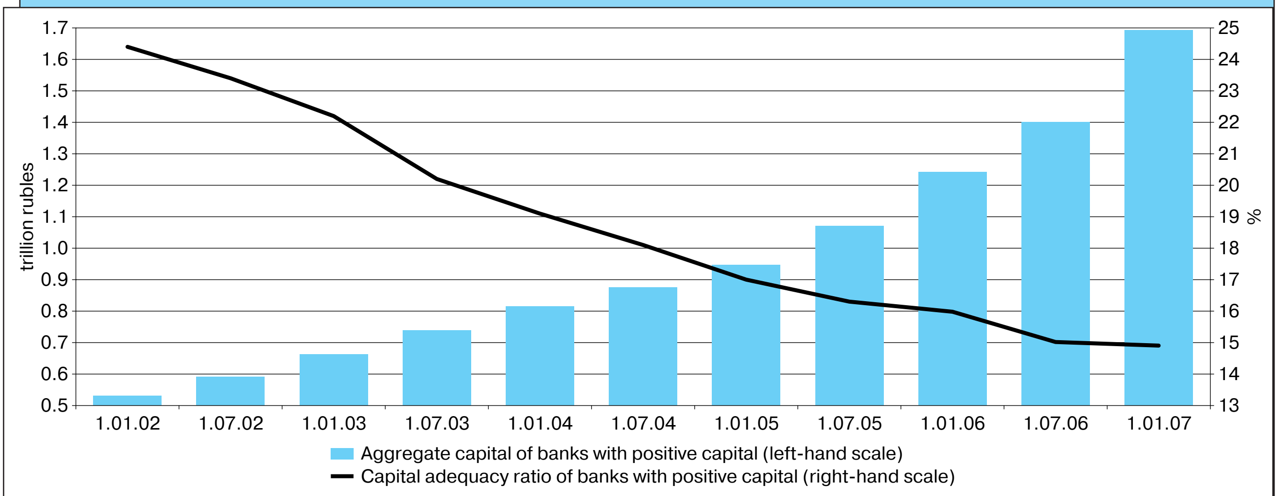
Credit institutions' risk-weighted assets

CHART 2.14



Capital adequacy ratio

CHART 2.15



first, second and third groups accounted for 2.7% and assets of the fourth and fifth groups 97.3% of aggregate assets (3.0% and 97.0% as of January 1, 2006 respectively).

Last year's growth in aggregate risk (by 46.2%) was chiefly due to the increase in credit risk on balance sheet assets[57], which accounted for 84.7% of growth in this risk. The structure of aggregate risk did not change substantially in 2006: credit risk continued to dominate. As of January 1, 2007, credit risk on balance sheet assets accounted for 79.9% of aggregate risk (as against 79.7% as of January 1, 2006), credit risk on contingent credit liabilities 9.8% (as against 9.7% as of January 1, 2006), credit risk on forward transactions 0.5% (unchanged on January 1, 2006) and market risk 4.8% (unchanged on January 1, 2006).

Credit risk dominated the structure of aggregate risk in all groups of banks. The highest ratio of credit risk on balance sheet assets was registered in medium-sized and small regional banks (86.5%) and state-controlled banks (86.3%), the lowest in the banks controlled by foreign capital (74.3%). The highest ratio of market risk was registered as of January 1, 2007, in large private banks (7.4%), the lowest in state-controlled banks (1.6%).

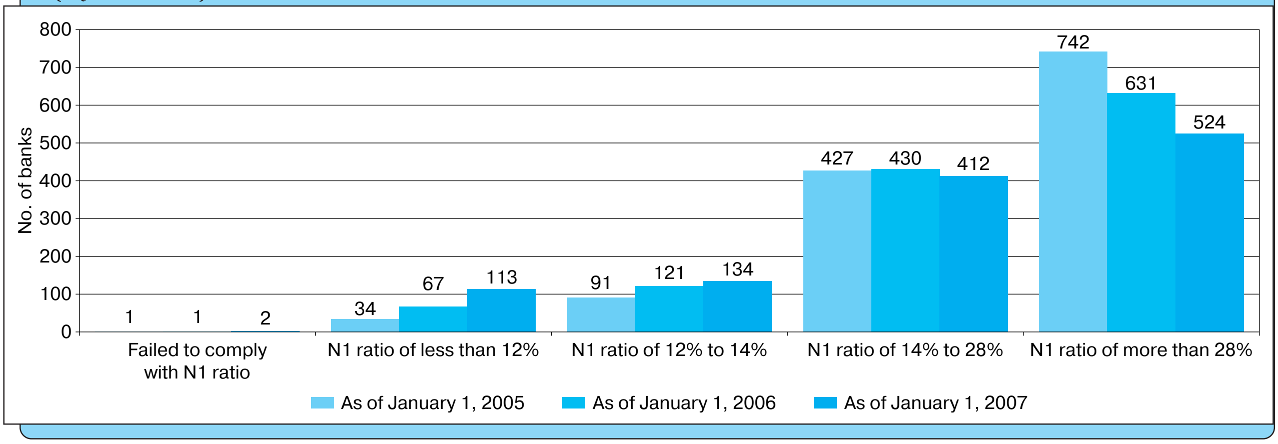
II.4.3. Bank capital adequacy

The trend towards a gradual decline in the average capital adequacy ratio continued as growth in banking sector aggregate assets exceeded growth in banking sector aggregate capital and risks increases. In 2006, the capital adequacy ratio decreased from 16.0% to 14.9% *(see Chart 2.15)*. However, in the second half of the year the capital adequacy ratio stood at 14.4%—14.9%.

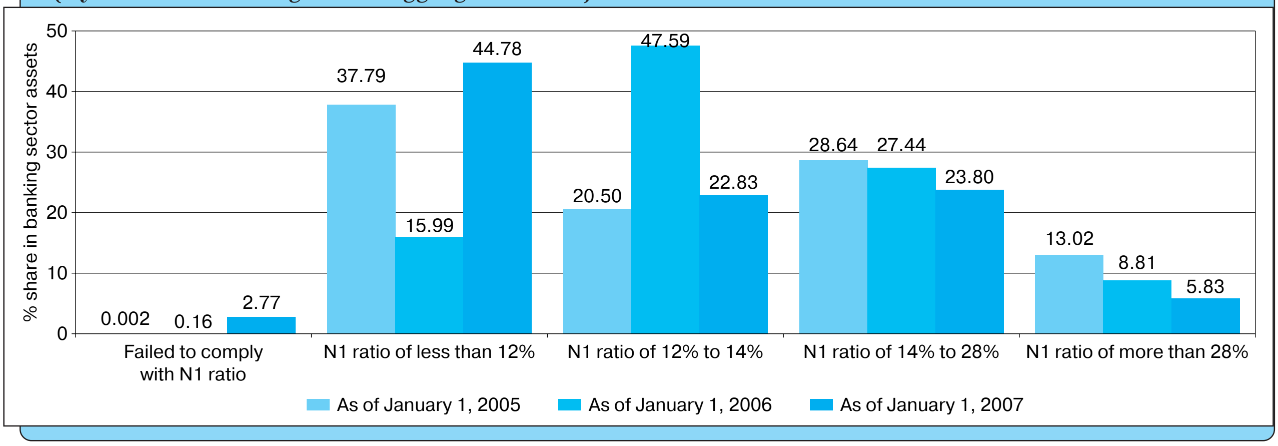
In 2006, risk-weighted banking sector assets increased 46.2% year on year and banking sector capital grew 36.3% during the same period.

All groups of banks registered a fall in the capital adequacy ratios in 2006. It was the highest (29.3%) in the medium-sized and small banks based in the Moscow Region and the lowest in the state-controlled banks (12.7%). The capital adequacy ratios were higher than the banking sector average as of Janu-

Credit institutions grouped by capital adequacy ratio (by number) *CHART 2.16*



Credit institutions grouped by capital adequacy ratio (by share in banking sector aggregate assets) *CHART 2.17*



[57] Taking into account credit institutions' credit risks on claims on counterparty for the reverse (forward) part of transactions, which arise as a result of the acquisition of financial assets with the simultaneous assumption of obligations for their reverse alienation and claims on related persons.

ary 1, 2007, in the group of medium-sized and small regional banks (21.0%) and banks controlled by foreign capital (15.9%) and lower in the large private banks (14.8%).

Eleven credit institutions violated the capital adequacy ratio (N1) in 2006, whereas 19 credit institutions violated this ratio in 2005.

The number of banks with a capital adequacy ratio of no more than 12.0% increased 70% in the year under review, from 67 as of January 1, 2006, to 113 as of January 1, 2007 and their share in aggregate banking sector assets expanded 180% (from 16.0% to 44.8%) due to several large banks in this group.

As of January 1, 2007, 134 credit institutions (121 as of January 1, 2006) had a capital adequacy ratio in the range of from 12.0% to 14.0% and their share in aggregate banking sector assets decreased by more than half, from 47.6% as of January 1, 2006, to 22.8% as of January 1, 2007.

Most of the credit institutions had a capital adequacy ratio of more than 14.0%, but their share in aggregate banking sector assets shrank in 2006 from 36.3% to 29.6% *(see Chart 2.16 and Chart 2.17).*

The capital adequacy ratio of the 20 largest banks in terms of assets stood at 12.8% as of January 1, 2007, as against 13.2% as of January 1, 2006.

II.5. Bank Management Quality

The bank management situation remained stable in 2006, by and large. As in the previous years, the management of most of the credit institutions was competent enough to allow them to comply with Bank of Russia required ratios. Credit institutions paid great attention to the management of banking risks. The measures that have been taken to upgrade governance were a major factor of the positive dynamics of the banking sector financial performance indicators.

The qualification of internal control services' staff and the internal control techniques continued to improve during the year under review.

Credit institutions continued to make their activities more transparent. More than half of all credit institutions in 2006 disclosed information about their activities on the Bank of Russia Internet site and many credit institutions also placed such information on their own web sites.

One favourable change in corporate governance was the improvement of the organisation and activities of the boards of directors (supervisory boards) and the appointment to some credit institutions of independent directors.

Nevertheless, some problems relating to corporate governance remained unresolved.

Specifically, no substantial progress was made in the disclosure of information by credit institutions about their related persons. Some credit institutions failed to clearly separate the functions of the management bodies and as a result related persons continued to meddle in the activities of credit institutions, boards of directors (supervisory boards) interfered too much in the day-to-day management of banks and the powers of executive bodies and their responsibility were too vague.

Credit institutions should make big efforts to ensure compliance with the law and the principles of business ethics. As a result of ineffective internal controls in respect to the prevention of money laundering, the number of banking licence revocations increased in 2006. Credit institutions must improve their performance from the standpoint of disclosing information about the actual price of retail banking services, especially in consumer and mortgage lending. As for the improvements in this sphere, mention should be made of the fact that more than half of the credit institutions inspected by the Bank of Russia in the second, third and fourth quarters of 2006 followed the recommendations for the disclosure of information in extending consumer loans, worked out jointly by the Bank of Russia and the Federal Anti-monopoly Service (FAS) (FAS and Bank of Russia Letter No. IA/7235/77-T, dated May 26, 2005).

II.6. Stress Testing the Banking Sector

To evaluate the stability of credit institutions against possible shocks caused by a crisis, the Bank of Russia stress tested the Russian banking sector. To determine the effect of risk on the banking sector capitalisation, it analysed the data reported by credit institutions for the period from January 1, 2006, to January 1, 2007.

The results of the stress test as of January 1, 2007, indicate that in a baseline scenario total losses may account for 38.7% of banking sector capital, or 2.5% of GDP (35.8%, or 2.1% of GDP, as of January 1, 2006) and in the worst-case scenario 63.1%, or 4.0% of GDP (57.4%, or 3.3% of GDP, as of January 1, 2006). Growth in possible losses as compared with the same period of 2005 was due to several factors, especially the increased non-financial institution credit risk, higher consumer credit risk, the twofold increase in interest rate risk and growth in stock market risk.

The calculations made confirm that credit risk remains the most significant risk for the Russian banking sector. The stress test has shown that possible losses from credit risk may account for 28.8% of capital in the baseline scenario (27.5% as of January 1, 2006) and 42.8% of capital in the worst-case scenario (40.0% as of January 1, 2006).

In credit risk, the risk of lending to non-financial institutions can cause most of the losses, which in all scenarios account for more than 83% of aggregate credit risk losses.

The possible losses from loans to individuals, calculated in the course of stress testing, appear to be small so far. The share of credit institutions whose losses may exceed a quarter of their capital may stand at 4.3% of aggregate banking sector assets in the baseline scenario and 8.0% in the worst-case scenario. One should bear in mind, however, the rapid increase in the risk of lending to households, which may provoke a rise in credit risk in future.

The possible losses of credit institutions from market risk are not yet dangerous for the stability of the banking system as a whole. They vary from 8.4% to 14.1% of aggregate banking sector capital, depending on the scenario. Mention should be made, however, of the substantial growth of interest rate risk as an element of market risk. The possible losses from interest rate risk in 2006 more than doubled as bank investments in resident corporate debt obligations soared. As a result, the share of banking sector losses from interest rate risk in losses from market risk increased, whereas losses from currency and stock market risk seem negligible so far.

Liquidity risk evaluated in the course of the stress test does not pose a serious threat to banking sector stability either. Credit institutions' losses from liquidity risk are estimated at less than 1.5% of aggregate banking sector capital in the baseline scenario but in the worst-case scenario they may rise to 6.2%.

A crisis on the interbank credit market is a large risk for the banking sector (it is calculated separately). If it breaks out, bank losses may amount to 25.3% of banking sector capital. However, the share of credit institutions whose losses may exceed capital is small (about 3.0% of aggregate banking sector assets and capital).

The evaluation of banking sector stability against economic shocks by stress testing shows that the banking sector became more vulnerable in 2006. Over the year, aggregate losses in the baseline and worst-case scenarios increased relative to capital from 35.8% and 57.5% to 38.7% and 63.1% respectively.

Banks became more vulnerable in the year under review mainly due to the low rate of banking sector capitalisation compared to the expansion of the banking business: growth in banking sector aggregate capital was by a quarter slower than growth in banking sector assets (36.3% as against 44.1%). Rapid growth in bank lending gave additional impetus to the expansion of the banking business: total credit to non-financial institutions and households increased 47.3%, whereas loans to households grew 75.3%. In 2006, credit institutions stepped up their activities on the corporate bond market and their corporate bond portfolio expanded 81.6%. The volume of active interbank operations increased 54.9%.

The stress test has shown that a large number of credit institutions may incur potential integral losses in excess of 50.0% of capital: 145 credit institutions (49.3% of assets) in the baseline scenario and 287 credit institutions (62.3% of assets) in the worst-case scenario. This would constitute a threat to the financial stability of the banking sector in either scenario. At the same time, the likelihood of any crisis scenario during one year to come seems low due to substantial economic growth, the improvement of government finance and a favourable world market situation.

III

Banking Regulation and Supervision in Russia

III.1. General Characteristics of Banking Regulation and Supervision

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

The Federal Law on the Central Bank of the Russian Federation (Bank of Russia) stipulates that one of the chief objectives of the Bank of Russia as the banking regulator and supervisor is to maintain the stability of the Russian banking system and protect the interests of depositors and creditors. The tasks for the Bank of Russia in improving banking regulation and supervision are specified in the Russian Banking Sector Development Strategy until 2008 (hereinafter referred to as the Strategy). In accordance with the Strategy, the fundamental principle underlying the banking regulation and supervision system is the introduction of internationally accepted standards and international expertise in Russia, taking into consideration the specific features of the organisation and functioning of the Russian banking services market, and this requires the Bank of Russia to encourage the use of substantive supervision.

Following the Guidelines for the Single State Monetary Policy in 2006, the Bank of Russia implemented the Strategy in three areas:

— it participated in drafting the relevant laws and issued rules and regulations aimed at strengthening financial stability, making Russian credit institutions more competitive, enhancing the protection of investors, creditors and depositors and increasing confidence in the banking sector;

— it continued to implement measures designed to upgrade banking supervision, especially substantive risk-based supervision, and improve the quality of assessment of credit institutions' financial soundness;

— it consistently enforced the law on anti-money laundering and countering the financing of terrorism.

The Bank of Russia priorities in the field of banking regulation and supervision in 2006 were as follows:

— controlling the efficiency of the household deposit insurance system, including ongoing supervision of the compliance by banks with the deposit insurance system requirements and co-ordinating activities with the Deposit Insurance Agency, a state corporation;

— continuing to implement the provisions of the Federal Law on Bank of Russia Payments on Household Deposits with Bankrupt Banks Uncovered by the Compulsory Deposit Insurance System;

— upgrading the system of rules and standards regulating merges and acquisitions, eliminating superfluous administrative procedures and optimising the consolidation processes while ensuring the adequate protection of the rights of creditors and depositors;

— preparing the ground for the introduction of internationally accepted methods of evaluating capital adequacy of credit institutions, recommended by the Basel Committee on Banking Supervision in the 'International Convergence of Capital Measurement and Capital Standards: a Revised Framework (Basel II)', published in June 2004;

— broadening for the purposes of effective supervision the term 'related borrowers' by establishing the economic criteria of relation in addition to the existing legal ones;

— monitoring the financial stability of the banking sector in respect of the major kinds of financial risk (credit, market and liquidity risks) and capital adequacy, including the stress testing for the purpose of detecting credit institutions with increased risk, and compiling and analysing financial soundness indicators;

— taking new approaches to the compiling and analysis of prudential reporting (upon the completion of EU/TACIS Project) and optimising the procedures for collecting, storing and processing reported data;

— specifying the recommendations for compiling financial statements according to the International Financial Reporting Standards (IFRS) and the analysis of these statements and participating in legalising the status of these statements, ensuring their use for banking supervision purposes;

— continuing to implement the banking sector transparency policy, especially the publication of monthly data on the state of the banking sector (macro-prudential indicators) in the Internet, analysing the aggregate banking services concentration indicators for regions and upgrading the methods of determining the banking sector financial stability;

— ensuring the functioning of the Central Catalogue of Credit Histories, which collects and stores the titles of all credit histories collected by credit history bureaux in the Russian Federation;

— drawing special attention of supervisors and inspectors to the quality of the management systems, the efficiency of internal controls and the risk management system, especially in large and multi-branch banks, the transparency of banking operations, the evaluation of the size and adequacy of capital and the assessment of bank asset quality, and the compliance by credit institutions of the law on anti-money laundering and countering the financing of terrorism.

III.1.2. The Bank of Russia's supervisory staff

The Bank of Russia's supervisory divisions have a staff of 4,366 executives and experts, of whom 12.8% work in the head office and 87.2% in regional branches. Most of the experts have specialised higher education (96.1%), are under 50 years of age (80.1%) and have worked in the banking system for more than three years (92.5%).

In 2006, the Bank of Russia continued to implement a number of large-scale retraining programmes for its supervisors, such as Commercial Bank Curator — Bank Manager, Commercial Bank Inspector — Bank Manager and Commercial Bank Receiver — Bank Manager. These programmes, scheduled to take a total of more than 500 hours, were carried out in collaboration with leading Russian institutions of higher education, such as the Russian Government's Academy of National Economy, the Higher School of Economics and the Russian Government's Financial Academy.

Since the start of the project (in the period from 2003 to 2006) 778 supervisors have received vocational retraining, of whom more than 92% are executives and employees with Bank of Russia regional branches. Most of the trainees (over 70%) passed their graduation exams with flying colours.

Those who have successfully finished the basic vocational retraining programmes are recommended for an additional 1,000-hours-plus MBA course and receive an offer to defend an M.A. thesis. As of the end of 2006, 63 Bank of Russia employees were awarded an MBA degree.

In addition to providing advanced training, the Bank of Russia continues to implement the social skill and personal efficiency development programme for credit institution curators and inspectors. Classes are conducted by the Personnel Department, who teach the trainees confident behaviour, partnership, public presentation and partner persuasion, confidence development and the ability to co-operate. More than 30% of the Bank of Russia's supervisors have undergone this course of training.

Vocational retraining and improving social skills of supervisors will continue in 2007.

III.2. Upgrading the Legislative and Regulatory Framework of Banking Activities in Accordance with International Standards

In 2006, the Bank of Russia continued to carry out measures to improve banking supervision in line with the Banking Sector Development Strategy. Special emphasis was made on the legal aspects of banking activities. Specifically, the Bank of Russia made amendments to applicable legislation to facilitate the introduction of new methods and standards of banking regulation and supervision. In doing so, the Bank of Russia was guided by the best international practice, especially the recommendations of the Basel Committee on Banking Supervision.

III.2.1. Household bank deposit insurance

The Bank of Russia drafted in co-operation with the Deposit Insurance Agency a law to amend federal laws for the purpose of improving the criteria and mechanisms to oversee banks' compliance with the requirements for access to the deposit insurance system, specifying the procedures guaranteeing payments to depositors and the functions and powers of the Agency with a view to enhancing the efficiency of the deposit insurance system.

The Bank of Russia and the Deposit Insurance Agency drafted laws designed to increase insurance compensation. In 2006, in pursuance of Federal Law No. 150-FZ, dated July 27, 2006, 'On Amendments to Article 11 of the Federal Law on Insurance of Household Deposits with Russian Banks and Article 6 of the Federal Law on Bank of Russia Payments on Household Deposits with Bankrupt Banks Uncovered by the Deposit Insurance System', insurance compensation was raised from 100,000 rubles to 190,000 rubles[58] along with the simultaneous increase to the same amount of the Bank of Russia payments to depositors of bankrupt banks uncovered by the deposit insurance system.

In 2006, the Bank of Russia continued to upgrade its rules and standards regulating the deposit insurance system. Specifically:

— Bank of Russia Ordinance No. 1655-U, dated February 5, 2006, 'On the Procedure for Considering the Request to Prohibit a Bank Found Unfit to Participate in the Deposit Insurance System from Taking Household Funds on Deposit and Opening Household Accounts', established the procedure for considering by the Bank of Russia the request to impose the prohibition to take household funds on deposit and opening household bank accounts and the procedure for making the decision by the Bank of Russia Banking Supervision Committee on imposing the prohibition and making its decisions known to a bank and Bank of Russia regional branch;

— Bank of Russia Ordinance No. 1724-U, dated September 20, 2006, amended Bank of Russia Ordinance No. 1379-U, dated January 16, 2004, 'On the Evaluation of Financial Soundness of a Bank for the Purpose of Ascertaining its Sufficiency for Participation in the Deposit Insurance System'. The amendment stipulated that from the total number of votes corresponding to the stakes (voting shares) in a bank owned by residents of offshore zones and persons whose decisions the residents of offshore zones may influence substantially, directly or indirectly (through third persons), one should exclude the votes corresponding to the voting shares (stakes) in the bank owned by legal entities (groups of entities) which, in accordance with the procedure for calculating the indicator assessing the openness of the bank's ownership structure are the persons (groups of persons) who exert substantial influence on the decisions taken by the bank management;

— Bank of Russia Letter No. 21-T, dated February 14, 2006, 'On the Clarification of Some Questions Arising in Connection with the Bank of Russia Prohibition to Take Household Funds on Deposit and Open Household Bank Accounts Pursuant to Article 47 of the Federal Law on Household Deposit Insurance', answers the questions most frequently received by the Bank of Russia about the consequences of the ban imposed by the Bank of Russia on the bank declared unfit for admission to the deposit insurance system;

— Bank of Russia Letter No. 158-T, dated December 15, 2006, 'On the Conduct of Credit Card Operations after the Imposition of the Bank of Russia Ban on Taking Household Funds on Deposit and Opening Household Bank Accounts Pursuant to Article 47 and Article 48 of the Federal Law on Household Deposit Insurance', explains the specific features of the issuance of credit cards and the conduct of operations with them after the imposition of the ban.

III.2.2. State registration of credit institutions and bank licensing

In 2006, Russia passed Federal Law No. 246-FZ, dated December 29, 2006, 'On Amending Article 11 and Article 18 of the Federal Law on Banks and Banking Activities and Article 61 of the Federal Law on the Central Bank

[58] In 2007, Federal Law No. 34-FZ, dated March 13, 2007, raised insurance compensation from 190,000 rubles to 400,000 rubles with the commensurate increase in the Bank of Russia payments to depositors of bankrupt banks uncovered by the deposit insurance system.

of the Russian Federation (Bank of Russia)'. The amendments aim to encourage foreign investment in the Russian banking sector by creating a level playing field for residents and non-residents acquiring shares in credit institutions and equalising as much as possible the supervisory requirements made for credit institutions with and without foreign interest. These changes created favourable conditions for the increase of capitalisation of credit institutions, the introduction of advanced banking technologies and, in the final analysis, making Russian credit institutions more competitive. To make the ownership structure in the banking sector more transparent and following the recommendations of the Basel Committee's Core Principles for Effective Banking Supervision, the Bank of Russia lowered from over 5% to over 1% the threshold value of the shares in a credit institution whose acquisition requires that the Bank of Russia should be notified thereof.

Complying with internationally accepted standards, the Bank of Russia issued Regulation No. 290-P, dated July 4, 2006, 'On the Procedure for Issuing Bank of Russia Permits to Credit Institutions to Have Subsidiaries in a Foreign State', which introduced the permit procedure for credit institutions setting up subsidiaries abroad. The requirements set forth in this document are designed to prevent investments in subsidiaries from adversely affecting the parent credit institution from the standpoint of consolidated risk supervision and discourage the Russian banking business from expanding in the countries that are not involved in international co-operation in anti-money laundering and countering the financing of terrorism.

Federal Law No. 60-FZ, dated May 3, 2006, 'On Amending the Federal Law on Banks and Banking Activities and the Federal Law on the Central Bank of the Russian Federation (Bank of Russia)' sets the minimum levels of:

— the authorised capital of a newly-registered credit institution (the amount of the ruble equivalent of €5 million in the case of a bank and €500,000 in the case of a non-bank credit institution);
— capital necessary to obtain a general licence (the amount of the ruble equivalent of €5 million);
— the capital of a non-bank credit institution applying for the status of a bank (the amount of the ruble equivalent of €5 million) and the capital of an operating bank (the amount of the ruble equivalent of €5 million).

At the same time, the law stipulates that a bank that as of January 1, 2007, had a capital of less than the amount of the ruble equivalent of €5 million may continue operating if its capital does not decline from the level reached as of January 1, 2007 (the 'grandfather clause').

At the same time, the law complements the grounds for the obligatory revocation of a licence from a bank by non-compliance with the minimum capital requirement and the failure to file a request for changing the status of a bank into a non-bank credit institution.

Federal Law No. 140-FZ, dated July 27, 2006, 'On Amending the Federal Law on Banks and Banking Activities and Article 37 of the Russian Federation Law on Consumer Protection', grants commercial organisations other than credit institutions the right to take cash from individuals without a Bank of Russia licence as payment for telecommunications, housing and utility services, provided that the following conditions are met:

1. the commercial organisation operates under an agreement with a credit institution whereby the commercial organisation is obliged to accept the aforementioned cash on its behalf but at the credit institution's expense for the purpose of transferring this cash by the credit institution to the bank account of the entity providing services (performing works);
2. the credit institution operates under an agreement with the entity providing services (performing works) whereby the credit institution is obliged for a fee to transfer cash accepted by the commercial organisation from individuals.

In 2006, the Bank of Russia continued to improve its rules and regulations.

On the ground of amendments made to legislation to ease administrative control, the Bank of Russia changed some of its rules and regulations, cancelling the requirement to pay a licence fee by a credit institution seeking to broaden the range of its operations and a non-bank credit institution seeking the status of a bank. The state duty was also cancelled for granting a banking licence to the credit institution acquiring another credit institution (should the former apply for a new banking licence).

Bank of Russia Instruction No. 128-I, dated March 10, 2006, 'On the Rules of Securities Issue and Registration by Credit Institutions in the Russian Federation', drafted pursuant to Paragraph 10 of Article 4 and Article 7 of the Federal Law on the Central Bank of the Russian Federation (Bank of Russia), hereinafter referred to as Instruction No. 128-I, to replace Bank of Russia Instruction No. 102-I, dated July 22, 2002, 'On the Rules of Securities Issue and Registration by Credit Institutions in the Russian Federation', established the procedure for issuing and registering securities by issuer credit institutions, including mortgage securities, in compliance with the requirements of the Federal Law on Mortgage Securities.

Instruction No. 128-I also included new provisions reflecting the changes in the securities issue and registration procedure established by the federal law for the purpose of creating favourable conditions for public offerings and cancelled the requirement for the compulsory signing of the prospectus by a financial consultant. The document established the requirement to pay the state duty for the state registration of securities issues and prohibited paying for securities in foreign currency, except the cases in which the shares of the issuing credit institution, which is an authorised bank, are paid for by another authorised bank on its own behalf and at its own expense.

The following changes were made in Bank of Russia Instruction No. 109-I, dated January 14, 2004, 'On the Procedure for Making the Decision by the Bank of Russia on the State Registration of Credit Institutions and the Issue of a Banking Licence':

— Bank of Russia Ordinance No. 1681-U, dated May 10, 2006, made amendments designed to enhance the efficiency of credit institutions by creating conditions for a more rapid pay-back in respect of the buildings they construct for their offices. For this purpose, a credit institution or its branch is granted the right to move into a building that has been completed but not yet registered on the Single State Real Estate Register;
— Bank of Russia Ordinance No. 1754-U, dated December 11, 2006, made the changes aimed at optimising the administrative control of credit institutions and established the subsequent procedure for monitoring compliance with the Bank of Russia requirements for the offices of credit institutions and their branches where operations with valuables are conducted. The structural units of credit institutions were granted the right to conduct full-scale operations, including the provision of cash services to clients, as soon as they have notified the Bank of Russia of their opening.

Bank of Russia Ordinance No. 1720-U, dated September 13, 2006, made amendments to Bank of Russia Ordinance No. 1548-U, dated February 7, 2005, 'On the Procedure for Opening (Closing) and Managing the Mobile Cash Point of a Bank (Branch)', for the purpose of facilitating the receipt and delivery of cash and valuables by mobile cash points not only in the bank or bank branch that has opened this point, but also in other branches of this bank and its structural divisions.

Bank of Russia Ordinance No. 1763-U, dated December 15, 2006, 'On Amending Bank of Russia Regulation No. 268-P, Dated April 19, 2005, on the Procedure and Criteria for the Evaluation of the Financial Position of the Individual Founders (Members) of a Credit Institution', and Bank of Russia Ordinance No. 1764-U, dated December 15, 2006, 'On Amending Bank of Russia Regulation No. 218-P, Dated March 19, 2003, 'On the Procedure and Criteria for the Evaluation of the Financial Position of the Corporate Founders (Members) of Credit Institutions', eased the regulation of the placement of credit institutions' shares, taking into account the principle of materiality for the purposes of ensuring control of the creation of credit institutions' authorised capital and the financial standing and ownership structure transparency of investors, and simplified the implementation of measures designed to ease the regulatory conditions of credit institutions' share placement and circulation.

The main provisions of these Bank of Russia ordinances:
— reduced the range of the acquirers whose financial position is evaluated when authorised capital is paid in (with the exception of a newly-established credit institution) to the acquirers of shares in a credit institution in the amount exceeding 10 million rubles and/or 1.0% of the authorised capital of a credit institution (previously, 600,000 rubles and/or 0.5%);
— extended the right to evaluate the financial position of persons who may indirectly (through third persons) to exert substantial influence on the decisions taken by the management of a credit institution;
— cancelled the procedure for verifying the correctness of the payment of a credit institution's authorised capital (except a newly-established credit institution) if less than three months have passed between Bank of Russia prior permission and the actual payment of the credit institution's shares.

III.2.3. Regulation of credit institutions and supervision methodologies

Bearing in mind international practices, the Bank of Russia in 2006 sought to improve the regulation of banks mainly by encouraging risk-based supervision, which included the evaluation of credit institutions' performance and supervisory response based on the nature and actual assessment of banking risks and their possible impact on the stability of credit institutions.

Federal Law No. 247-FZ, dated December 29, 2006, 'On Amending Article 50.36 and Article 50.39 of the Federal Law on Insolvency (Bankruptcy) of Credit Institutions and Article 72 of the Federal Law on the Central Bank of the Russian Federation (Bank of Russia)', was passed to diversify the sources of growth in the capital of Russian banks and lift restrictions in respect of the legal interpretation of individual kinds of borrowings, imposed by the applicable Russian laws. The changes made by this Federal Law are designed to help increase the capitalisation of the Russian banking sector by recognising as elements of the own funds (capital) of Russian credit institutions subordinated financial instruments used in international banking supervisory practice and recognised as part of banking capital by the Basel Committee on Banking Supervision and create for Russian credit institutions a level playing field with their foreign competitors on international debt markets.

Federal Law No. 135-FZ, dated July 26, 2006, 'On the Protection of Competition', is expected to help fulfil the tasks set in the Strategy for the development of competition on the banking services market. Elaborated with emphasis on the importance of protecting competition at the current stage of the country's economic development, the law is designed to improve the legal regulation in this field. It governs relations on the commodity and financial markets, takes a new approach to such fundamental concepts of the competition law as the 'commodity,' 'commodity market' and 'group of persons', and broadens the range of concepts used in the law, including in it such a typical form of adverse influence on competition as the co-ordination of the activities of economic entities by a third person to the detriment of competition.

When this law was developed and refined, the Bank of Russia view that it should take part in the legal regulation of credit institution activities in implementing antimonopoly regulation was taken into consideration.

In 2006, the Bank of Russia participated in drafting federal laws and federal law concepts and problem specifications.

To create conditions conducive to greater financial stability of credit institutions and the banking sector as a whole, the Bank of Russia took part in developing the concept and problem specification for the federal law 'On Amending the Federal Law on the Central Bank of the Russian Federation (Bank of Russia)', aimed at building an effective mechanism to regulate risk by credit institutions when lending to related persons and legalise the powers of the Bank of Russia to set requirements in the field of risk regulation.

To improve the trust management system by making it legally possible for credit institutions to set up general bank management funds and determine the powers of the Bank of Russia to regulate them, the Bank of Russia prepared the draft Federal Law 'On Amending Article 5 of the Federal Law on Banks and Banking Activities'.

To improve consolidated supervision, the Bank of Russia continued jointly with the Ministry of Finance to draft federal laws to amend the Federal Law on Banks and Banking Activities and the Federal Law on the Central Bank of the Russian Federation (Bank of Russia) for the purpose of specifying the main provisions on consolidated supervision and the requirements, procedure and time periods for the disclosure of information to interested users by credit institutions, banking groups and bank holding companies. To avoid overlapping, the Bank of Russia and the Ministry of Finance pooled the two documents into a single draft law.

It specifies some terms, such as the 'banking group,' bank holding company' and 'material effect' and the powers of the Bank of Russia to take supervisory decisions in respect of the parent credit institutions in the banking groups, introduces new concepts, such as 'control' and 'related persons', gives the Bank of Russia the powers to supervise bank holding companies and brings the rules and regulations concerning the activities of banking groups and bank holding companies and the disclosure of information by them to interested users into conformity with internationally accepted standards.

To enhance the efficiency of banking supervision and improve co-operation with audit companies, the Bank of Russia sent to the Ministry of Finance the draft federal law 'On Amending the Federal Law on Banks and Banking Activities and Article 8 of the Federal Law on Audit', which requires auditors to provide the Bank of Russia with information received as a result of the audits of credit institutions, along with the drafts of the documents necessary to amend the Federal Law on Banks and Banking Activities and the Federal Law on Audit.

In 2006, the Bank of Russia considered within the framework of the commissions of the Ministry of Finance Audit Council the draft resolution of the Russian Government 'On Amending the Federal Audit Rules (Standards) Approved by Russian Government Resolution No. 696, Dated September 23, 2002, Ministry of Finance Order Invalidating Ministry of Finance Order No. 107n, Dated October 31, 2002', and the Auditor Code of Conduct and Methodological Recommendations, drafted to improve the applicable audit rules (standards), including those related to the audit of credit institutions.

To improve the regulation of credit institutions, the Bank of Russia drafted rules and letters establishing major supervisory standards and practices.

To develop the procedure for making loan loss provisions by credit institutions, the Bank of Russia issued the following documents:

— Regulation No. 283-P, dated March 20, 2006, 'On the Loss Provision Procedure for Credit Institutions' (hereinafter referred to as Regulation No. 283-P);
— Ordinance No. 1671-U, dated March 20, 2006, 'On Amending Bank of Russia Regulation No. 254-P, Dated March 26, 2004, on the Procedure for Making by Credit Institutions Provisions for Possible Losses on Loans, Loan and Similar Debts;'
— Ordinance No. 1672-U, dated March 20, 2006, 'On Amending Bank of Russia Instruction No. 110-I, Dated January 16, 2004, on Banks' Required Ratios'.

These documents change the evaluation of losses on the assets put in trust by a credit institution, methods of portfolio provisioning, the procedure for making loss provisions for contingent credit liabilities, taking into account the collateral, and the requirements for repo transactions, and specify the term 'guarantee deposit'.

To improve the methods of assessing credit risk, the Bank of Russia issued Ordinance No. 1759-U, dated December 12, 2006, 'On Amending Bank of Russia Regulation No. 254-P, Dated March 26, 2004, on the Procedure for Making by Credit Institutions Provisions for Possible Losses on Loans, Loan and Similar Debts', (hereinafter referred to as Regulation No. 254-P), which is to come into force on July 1, 2007. This document extends the general provisioning procedure to the loans extended by banks to pawn offices, consumer co-operatives, small business funds and other financial institutions (for the purpose of implementing Paragraph 52 of the Strategy). It specifies the methods of evaluating the portfolios of similar loans extended to households (specifically, credit institutions may now create the portfolios of depreciated overdue loans allowing for the existence and duration of overdue payments) requires credit institutions to disclose the actual value of loans extended to households, and specifies a collateral list for loans.

In connection with the changes made in Section 5 'The Assessment of Credit Risk for the Purpose of Provisioning for the Portfolio of Similar Loans' of Regulation No. 254-P, the Bank of Russia issued Letter No. 175-T, dated December 29, 2006, 'On Setting an Effective Interest Rate on Loans Extended to Households', which cited examples of calculating an effective interest rate on this kind of loans.

In addition, the Bank of Russia drafted an ordinance to amend Bank of Russia Regulation No. 254-P, which specified the periodicity of loan evaluation and loss provision regulation, introduced the term 'quality information' in respect of information necessary for the evaluation of loans and the quality of collateral, granted to a supervisory authority the right to require that credit institutions should reclassify a loan and/or specify the amount of the provision by a credit institution when using subquality information, and listed other factors of importance for decision-making in respect of the quality of a loan.

To improve the methods of regulating the prudential standards of non-bank settlement credit institutions, the Bank of Russia issued Instruction No. 129-I, dated April 26, 2006, 'On Banking Operations and Other Transactions by Non-bank Settlement Credit Institutions, the Required Ratios for Non-bank Settlement Credit Institutions and the Specifics of Bank of Russia Supervision over their Observance'. To regulate (limit) risks assumed by non-bank settlement credit institutions, this document established for them the permissible combinations of banking operations, required ratios and the methods of calculating them and the specific features of Bank of Russia supervision over their observance. To minimise liquidity and credit risks for non-bank settlement credit institutions, the instruction offered them a list of recommended financial instruments for investment.

In 2006, to develop the methods of calculating capital by credit institutions the Bank of Russia issued:

— pursuant to Federal Law No. 247-FZ, dated December 29, 2006, Ordinance No. 1793-U, dated February 20, 2007, 'On Amending Bank of Russia Regulation No. 215-P, Dated February 10, 2003, on the Methodology of Calculating the Capital of Credit Institutions', which defined the term 'subordinated loan' and established the conditions for including it in the sources of additional capital;
— Ordinance No. 1656-U, dated February 6, 2006, 'On Actions in Response to Detecting the Use of Improper Assets in Creating the Sources of Capital or a Part Thereof' (the new version of Bank of Russia Ordinance No. 1246-U, dated February 10, 2003, 'On Actions in Response to Detecting the Use of Improper Assets in Creating the Sources of Capital or a Part Thereof') to improve the methods of preventing the fictitious capitalisation of banks. This document specifies and describes in greater detail the procedure that the structural units of the Bank of Russia head office and regional branches should follow when detecting the use of improper assets in creating the sources of capital and describes more accurately the methods of eliminating (covering) the risks that arise when a credit institution provides property to investors for the purpose of creating the sources of capital or a part thereof by using improper assets.

To specify the procedure for calculating the open currency position in respect of the inclusion of the issued letters of credit in this calculation, the Bank of Russia published Letter No. 28-T, dated February 22, 2006, 'On the Application of Paragraph 1.9.2 of Bank of Russia Instruction No. 124-I, Dated July 15, 2005, on Setting Limits on Open Currency Positions, the Methodology of Calculating them and the Specifics of Supervision of Their Observance by Credit Institutions'.

Bearing in mind the recommendations of the 15th International Banking Congress "Basel Guidelines: Approaches and Implementation" and the proposals and comments made by the Pillar I working group[59] at the Bank of Russia, the Bank of Russia developed the methodology of calculating required ratios for credit institutions and supervision of compliance with these ratios by specifying the procedure for calculating the capital adequacy ratio (N1), established by Bank of Russia Instruction No. 110-I, dated January 16, 2004, 'On Banks' Required Ratios'.

During the year under review, the Bank of Russia continued to implement the proposals approved by the Bank of Russia Banking Supervision Committee to change the principles of regulating and supervising liquidity risk, which took into consideration the results of EU/TACIS Banking Supervision and Reporting Project. Specifically, the Bank of Russia redrafted its Letter No. 139-T, dated July 27, 2000, 'On Recommendations for the Analysis of Liquidity of Credit Institutions', taking into account the recommendations of the Basel Committee on Banking Supervision and the international supervisory practice of liquidity control. In addition, the Bank of Russia plans to replace the instant liquidity ratio (N2) by the short-term liquidity ratio and calculate it by comparing cash flows.

To improve the calculation of the capital adequacy ratio and liquidity indicators, the Bank of Russia drafted the Ordinance 'On Amending Bank of Russia Instruction No. 110-I, Dated January 16, 2004, on Banks' Required Ratios', which changed the methods of calculating the instant (N2) and current (N3) liquidity ratios. It specified the list of highly liquid and liquid assets and provided for a reduction in the highly liquid and liquid assets involved in the calculation of the N2 and N3 ratios by the amount of an imputed loss provision for these assets, established pursuant to Regulation No. 254-P and Regulation No. 283-P.

In 2006, the Bank of Russia continued to improve the regulation of the credit risk concentration for a related person (a group of related persons) and a group of related debtors. It drafted the Ordinance 'On Amending Bank of Russia Instruction No. 110-I, Dated January 16, 2004, on Banks' Required Ratios', which is to establish the size and methods of calculating maximum risk per related person (per group of related persons) and maximum risk per group of related debtors for the purpose of reducing the risk assumed by credit institutions when conducting credit operations and transactions with such persons and debtors.

In the period under review, the Bank of Russia drafted proposals for amending certain reporting forms and introducing new reporting forms for supervisory purposes (hereinafter referred to as prudential reporting). These proposals are based upon the results of EU/TACIS Banking Supervision and Reporting Project, which ended in December 2005, the best supervisory and reporting practice and some IFRS principles and methods, such as the priority of economic content over legal form, materiality and the IFRS information disclosure requirements. As a result, the Bank of Russia, as the supervisory authority, and credit institutions will have qualitatively new information, both in form and content, about the activities conducted by credit institutions, especially the size of risk they assume.

[59] Pillar I working sub-group "Minimum Capital Requirements".

Most of the prudential reporting forms are to be submitted on a quarterly basis, and whether it is necessary to report on a monthly basis depends on the evaluation of the financial soundness of a credit institution (monthly reporting is to be enforced for problem banks).

The Bank of Russia continued to develop the methods of assessing the banking sector's financial stability, including the stress testing of the banking sector, monitor stability of the banking sector and the soundness of individual credit institutions and compile and analyse the IMF-recommended financial soundness indicators (FSIs) within the framework of the Co-ordinated Compilation Exercise for Financial Soundness Indicators.

To provide the organisational and methodological guidance for the monitoring of enterprises, the Bank of Russia issued Letter No. 40-T, dated March 17, 2006, which made known to the Bank of Russia regional branches recommendations on the practical utilisation of enterprise monitoring results in the interest of the Bank of Russia supervisors and the banking community as a whole.

To provide methodological assistance to its regional branches in analysing the activities of credit institutions, the Bank of Russia:

— drafted and placed on the web site of its supervisory divisions as a guide to be used by the Bank of Russia regional branches in their current work the Methodological Guidebook for the Curator of a Credit Institution, known as the 'Curator's Manual';

— drafted Letter No. 119-T, dated September 7, 2006, 'On Methodological Recommendations for the Analysis of Financial Statements Prepared by Credit Institutions in Accordance with the IFRS', which specified the methods of analysing credit institutions' IFRS-compatible consolidated and unconsolidated statements;

— continued to refine the 2000 recommendations for the analysis of the financial standing of credit institutions and upgrade the computer-based system Analysis of the Financial Standing of a Bank, adjusting it for the methods used by the Bank of Russia in assessing the financial soundness of banks for the purpose of ascertaining its adequacy for access to the deposit insurance system;

— issued Letter No. 106-T, dated August 7, 2006, 'On Recommendations for the Analysis of the Activities of Credit Institutions and the Development of Banking Services in the Region'.

To detect illegal practices by credit institutions and activities endangering the legitimate interests of creditors and depositors, to find evidence of reputation risk and take timely supervisory measures, the Bank of Russia issued Letter No. 99-T, dated July 21, 2006, 'On Monitoring Information Placed by Credit Institutions and Their Branches in the Internet', which contained recommendations for the Bank of Russia regional branches on how they should monitor data placed by credit institutions on web sites.

III.2.4. Inspection

In 2006, the Bank of Russia improved the regulatory and methodological framework for inspection in line with its Plan of Priority Measures to Develop the Russian Banking System, Banking Supervision, the Financial Markets and Payment System, Guidelines for the Single State Monetary Policy in 2006 and the Bank of Russia Plan to Implement the Provisions of the Banking Sector Development Strategy.

During the year under review, the Bank of Russia issued Ordinance No. 1737-U, dated October 27, 2006, 'On Amending Bank of Russia Instruction No. 105-I, Dated August 25, 2003, on the Procedure for Conducting Inspections of Credit Institutions and Their Branches by the Authorised Representatives of the Central Bank of the Russian Federation', and Ordinance No. 1762-U, dated December 15, 2006, 'On Amending 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)'. These documents aim to attain the following objectives:

— to reduce the frequency of inspections of credit institutions and determine their frequency on the basis of the evaluation of the financial soundness of credit institutions;

— to make inspections more comprehensive, especially in credit institutions with many branches and structural units;

— to specify the procedure for co-operation between Bank of Russia structural units in organising and conducting inspections of the banks participating in the deposit insurance system, including inspections with the participation of Deposit Insurance Agency employees.

The Bank of Russia continued to improve the methods of conducting inspections with the objective of working out common tactics in respect of a pre-inspection analysis and preparations. To select the most important problems for inclusion in the inspection assignment, the Bank of Russia issued Letter No. 169-T, dated December 26, 2006, 'The Recommended Methods of Preparing for an Inspection of a Credit Institution (Branch)'.

Having summarised the experience gained by its inspection divisions, which was subsequently analysed by its regional branches, the Bank of Russia sent clarifications on questions arising in the course of organising and conducting inspections of credit institutions and their branches in respect of compliance by credit institutions with required ratios (Bank of Russia Letter No. 62-T, dated May 3, 2006).

The Bank of Russia attached great importance to the improvement of the quality of inspections. Specifically, in respect of the evaluation of the amount and adequacy of capital, including the detection of the use of improper assets in creating credit institutions' capital, the Bank of Russia in 2006 issued methodological recommendations to verify:

— the correctness of authorised capital formation and the calculation of a credit institution's capital;

— the provision of banking services by credit institutions, using automatic teller machines;

— the correctness of the calculation of market risk by credit institutions;

— loans, loan and similar debts;
— operations with precious metals conducted by credit institutions;
— promissory note transactions by credit institutions.

III.2.5. Financial rehabilitation and liquidation of credit institutions

In connection with the coming into force of Federal Law No. 150-FZ, dated July 27, 2006, 'On Amending Article 11 of the Federal Law on Household Deposit Insurance with Russian Banks and Article 6 of the Federal Law on Bank of Russia Payments on Household Deposits with Bankrupt Banks Uncovered by the Deposit Insurance System', the Bank of Russia issued Ordinance No. 1709-U, dated August 8, 2006, 'On Amending Bank of Russia Ordinance No. 1517-U, Dated November 17, 2004, on Bank of Russia Payments on Household Deposits with Bankrupt Banks Uncovered by the Deposit Insurance System and on the Procedure for Co-operation between Agent Banks and the Bank of Russia', which increased the maximum Bank of Russia payment to 190,000 rubles and changed the procedure for calculating compensation payments on household deposits with the bankrupt banks uncovered by the deposit insurance system.

In 2006, the Bank of Russia worked on the draft regulation 'On the Procedure for Preparing and Submitting the Interim Liquidation Balance Sheet and the Liquidation Balance Sheet of a Credit Institution Being Liquidated and their Approval by the Bank of Russia Regional Branch' (issued on January 16, 2007, No. 301-P). This Regulation was drafted pursuant to the Federal Law on Insolvency (Bankruptcy) of Credit Institutions, which requires the Bank of Russia to oversee the liquidation of credit institutions and ensure that the interests of creditors (depositors) are honoured. The credit institution being liquidated must report to the Bank of Russia specific indicators characterising the liquidation process.

Judging by data of an interim liquidation balance sheet, the Bank of Russia regional branches decide if there are signs of insolvency (bankruptcy) of the credit institution in the case of its voluntary or involuntary liquidation.

The liquidation balance sheet and the accompanying documents serve as the grounds to complete the liquidation of the credit institution and to adopt by the Bank of Russia the decision on the liquidation of the credit institution, and to assess the performance of a liquidator.

The interim liquidation balance sheet and liquidation balance sheet are subject to approval by the Bank of Russia regional branch for the purpose of ascertaining that the data contained in them and their attachments comply with the requirements of federal laws and Bank of Russia rules and regulations.

Bank of Russia Regulation No. 301-P, dated January 16, 2007, 'On the Procedure for Preparing and Submitting the Interim Liquidation Balance Sheet and Liquidation Balance Sheet of a Credit Institution Being Liquidated and their Approval by the Bank of Russia Regional Branch',

— takes into account the changes made in federal legislation and the Bank of Russia practice of overseeing the liquidation of credit institutions, including oversight by the Deposit Insurance Agency;
— specifies the content of the attachments to the interim and liquidation balance sheets for the purpose of obtaining concrete indicators on the amount of creditors' satisfied claims, the property (assets) of the credit institution and the results of property (assets) stock-taking and sale and data on the funds received and their spending (the ratio between the funds spent to keep the credit institution operating and the funds used to satisfy creditors' claims);
— provides for a reduction in the number of documents a credit institution is required to submit to the Bank of Russia regional branch along with the interim and liquidation balance sheets (this will help cut slightly the bankruptcy proceedings expenses).

Bank of Russia Ordinance No. 1717-U, dated August 24, 2006, 'On Amending Paragraph 1 of Bank of Russia Ordinance No. 1533-U, Dated December 22, 2004, on the Estimation of the Value of Property (Assets) and Obligations of a Credit Institution', was issued in connection with the change of the procedure for preparing reports as per 0409155 Form 'Information on Loss Provisions', established by Bank of Russia Ordinance No. 1376-U, dated January 16, 2004, 'On the List, Forms and Procedure for Preparing and Submitting Reporting Forms by Credit Institutions to the Central Bank of the Russian Federation'. This change necessitated the correction of references to the indicators of this reporting form, used in evaluating the property (assets) of a credit institution for the purpose of presenting to the arbitration court the Bank of Russia statement about the credit institution's apparent insolvency (bankruptcy).

In connection with the coming into force from January 1, 2007, of Federal Law No. 60-FZ, dated May 3, 2006, 'On Amending the Federal Law on Banks and Banking Activities and the Federal Law on the Central Bank of the Russian Federation (Bank of Russia)', the Bank of Russia issued Ordinance No. 1780-U, dated December 26, 2006, 'On Amending Bank of Russia Ordinance No. 1332-U, Dated October 3, 2003, on the Procedure for Presenting by Bank of Russia Regional Branches the Request to Revoke a Banking Licence from a Credit Institution', and Ordinance No. 1781, dated December 26, 2006, 'On Amending Paragraph 3.3 of Bank of Russia Regulation No. 226-P, Dated May 12, 2003, on the Procedure for Examining by the Bank of Russia Requests to Revoke Banking Licences from Credit Institutions'.

In response to requests, the Bank of Russia issued Letter No. 72-T and Letter No. 73-T, both dated May 24, 2006, which clarified the procedure for filling in 0409350 Form 'On Unsatisfied Claims by Individual Creditors in Relation to Pecuniary Obligations in a Credit Institution and the Failure to Effect Compulsory Payments Due to the Lack or Shortage of Funds in the Credit Institution's Correspondent Accounts'.

III.3. Registration and Expansion of Credit Institutions' Activities

As was the case in the previous years, in 2006 the total number of registered credit institutions continued to decline. Last year, it fell from 1,409 to 1,345, or by 4.5% (in 2005, it decreased from 1,516 to 1,409, or by 7.0%). The number of operating credit institutions with a banking licence also declined, from 1,253 in 2005 to 1,189, of which 46 were non-bank credit institutions as of January 1, 2007 (48 non-bank credit institutions had the licence to conduct individual banking operations as of January 1, 2006).

Seven new credit institutions were registered in the period under review, of which five were banks and two non-bank credit institutions. Nine new credit institutions were registered in 2005 (six banks and three non-bank credit institutions) and three in 2004 (two banks and one non-bank credit institution).

The capitalisation of the banking sector continued to increase in 2006. As a result of re-organisation,

— eight credit institutions were taken over by other credit institutions (14 in 2005);

— two credit institutions were wound up as a result of mergers (there were no mergers of credit institutions in 2005);

— six credit institutions changed their legal status from a limited liability company to a joint-stock company (four in 2005 and five in 2004).

Forty-eight credit institutions, or 4.0% of the total, expanded the range of their operations in 2006 by obtaining additional licences (59 credit institutions, or 4.7%, in 2005). The Bank of Russia in 2006 issued 16 licences to conduct banking operations with foreign currency, 12 licences to take on deposit and place precious metals and seven general licences. In addition, three banks had their licences replaced as restrictions on banking operations were lifted from them.

Ten banks received the licences to take household deposits in 2006. As of January 1, 2007, 934 banks were members of the deposit insurance system.

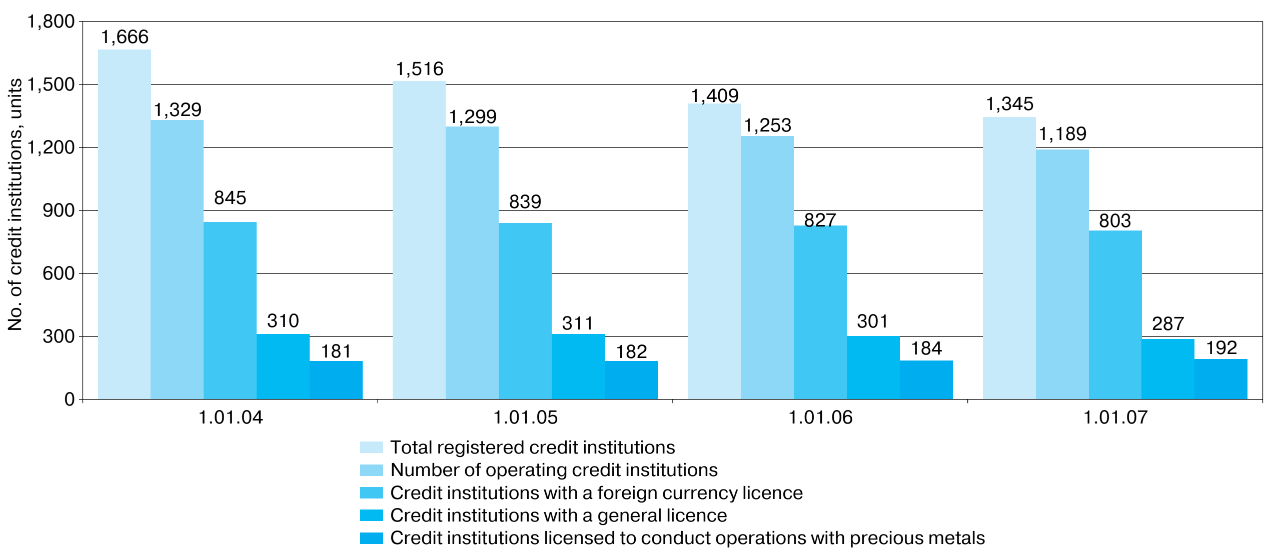
Thirteen credit institutions in 2006 (17 in 2005) were denied additional licences because of violations of law and Bank of Russia rules and regulations. Nine credit institutions were denied licences because they failed to comply with the requirements of the Federal Law on the Insurance of Household Deposits with Russian Banks.

As of January 1, 2007, 921 credit institutions had the licence to take household deposits, 803 credit institutions had the licence to conduct operations in rubles and foreign currency, 287 credit institutions had a general licence and 192 credit institutions had the licence to take on deposit and place precious metals and permission to conduct operations with precious metals *(see Chart 3.1).*

The aggregate registered authorised capital of all operating credit institutions increased by 122.1 billion rubles in 2006 and as of January 1, 2007, it stood at 566.5 billion rubles. In 2006, the authorised capital of credit institutions rose considerably faster than in 2005 (by 27.5% as against 16.8%) *(see Chart 3.2).*

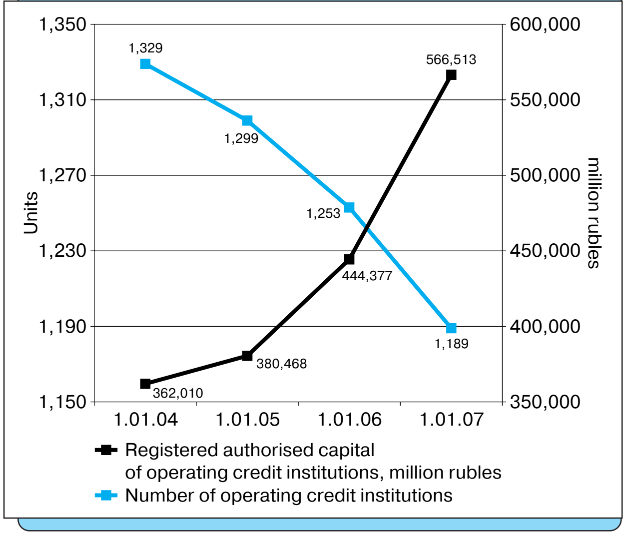
Number of registered operating credit institutions and banking licences granted to them

CHART 3.1



Registered authorised capital of operating credit institutions

CHART 3.2



The number of credit institutions with an authorised capital of more than 175 million rubles (€5 million) had the trend to increase. As of January 1, 2007, it reached 404, or 34.0% of the total number of operating credit institutions (367 credit institutions, or 29.3% of the total, as of January 1, 2006). At the same time, the share of credit institutions with an authorised capital of 60 million rubles and less continues to contract. In 2005, it stood at 46.3%, whereas as of January 1, 2007, it was 40.3% *(see Chart 3.3).*

Foreign investments in Russian credit institutions continued to grow in the period under review. Total foreign investment in the aggregate authorised capital of operating credit institutions in 2006 increased by 81.8%, or 40.5 billion rubles, and as of January 1, 2007, it reached 90.1 billion rubles. The non-resident share in the aggregate authorised capital of Russian credit institutions expanded from 11.2% as of January 1, 2006, to 15.9% as of January 1, 2007. Excluding non-residents controlled by residents, foreign shareholdings in the authorised capital of banks stood at 14.9% as of January 1, 2007.

The number of operating credit institutions with foreign shareholdings increased by 17 to 153 in the year under review as against 136 in the previous year. Of these, the number of wholly foreign-owned credit institutions rose 26.8% to 52.

In view of the equal conditions for the access of Russian and foreign capital to the Russian banking sector, the inflow of foreign investment will increase in 2007.

In 2006, credit institutions continued to reorganise their branch network. Overall, in the year under review the number of branches of operating credit institutions fell slightly: as of January 1, 2007, their number stood at 3,281 as against 3,295 as of January 1, 2006, a decrease of 0.43%. Of the total number of branches of credit institutions in Russia, Sberbank had 859 as of January 1, 2007, a decrease of 150, or 14.9%, on January 1, 2006.

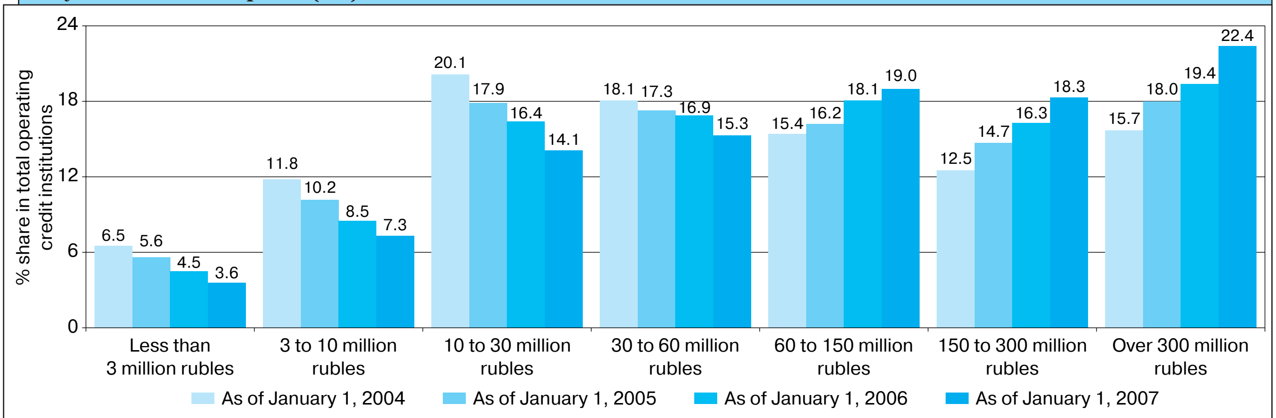
The trend towards growth in the number of structural units of credit institutions and their branches, such as additional and cash and credit offices, continued in 2006. The total number of structural units of credit institutions and their branches increased by 2,254 and as of January 1, 2007, reached 31,888 as against 29,634 as of January 1, 2006. At the same time, the total number of cash departments decreased from 17,662 to 15,885.

Growth in securities issued by credit institutions continued in the year under review.

The value of registered share issues totalled 231.87 billion rubles in 2006, an increase of 170% on the previous year. As a result of growth in the authorised capital of credit institutions in 2006, 286 share issues with a total value of 176.43 billion rubles were registered in 2006. This represents an increase of 96.63 billion rubles, or 120%, on the previous year. Nine share issues to the amount of 1.74 billion rubles were launched when new credit institutions were set up or existing ones merged or turned from limited liability companies into joint-stock companies. Nine share issues worth 53.70 billion rubles were registered in 2006 for the purpose of dilution, consolidation and conversion, an increase of 52.85 billion rubles on 2005, due to the splitting of 52.11 billion rubles of Vneshtorgbank shares. In December 2006, Sberbank

Number of operating credit institutions by authorised capital (%)

CHART 3.3



registered a public offering of 10.5 billion rubles of ordinary shares (at the nominal value of the shares put into circulation).

The value of registered bond issues in 2006 increased by 27.06 billion rubles as compared with 2005 and reached 112.8 billion rubles. In the period under review, 52 bond issues of 43 credit institutions were registered, of which four credit institutions simultaneously registered two bond issues and more with a total value of 36 billion rubles. Bonds were mostly placed on the MICEX Stock Exchange. Banks issued bonds mainly in order to diversify their resources by making wider use of the money market instruments and expanding their public credit history.

III.4. Off-site Supervision

When implementing off-site supervision, the Bank of Russia in 2006 followed the principles of risk-based supervision, which includes the evaluation of credit institutions' performance and the use of supervisory response measures based on the realistic assessment of risk from the standpoint of its possible effect on the soundness of credit institutions (professional judgement). Emphasis was placed on the early detection of problems in credit institutions, the identification of the risks they assume and the evaluation of bank management quality.

One of the principal methods of off-site supervision was the monitoring by the Bank of Russia of the activities of the banks covered by the deposit insurance system for the purpose of ascertaining their compliance with the requirements of Federal Law No. 177-FZ, dated December 23, 2003, 'On the Insurance of Household Deposit with Russian Banks'. In the course of monitoring, the Bank of Russia analysed the reasons why credit institutions occasionally failed to meet the deposit insurance system requirements and supervised the measures taken by the banks to improve their performance. Two credit institutions were prohibited from taking household deposits in 2006 due to non-compliance with the deposit insurance system requirements. The Bank of Russia also closely watched the credit institutions that had the highest permissible financial soundness indicators calculated to determine the bank's compliance with the deposit insurance system access requirements.

The Bank of Russia attached great importance to risk evaluation by banks involved in lending to households, as credit institutions stepped up their activities on this market. Unscheduled inspections were conducted in a number of credit institutions with the sustained trend towards growth in overdue debt on household loans (in unfavourable conditions this might have an adverse effect on their financial soundness) to assess the quality of managing risks involved in consumer lending. Leading credit institutions on the household lending market were suggested to adopt more comprehensible and transparent consumer lending conditions. In addition, when analysing credit institutions' activities on the consumer lending market, the Bank of Russia made sure that banks complied with the information disclosure requirements set in Joint Federal Anti-monopoly Service and Bank of Russia Letter No. 77-T, dated May 26, 2005, 'Recommended Standards for the Disclosure of Information in Extending Consumer Loans'.

In the course of regularly monitoring banking risk[60], in 2006 the Bank of Russia developed new sub-systems, such as market risk monitoring and capital adequacy monitoring. However, emphasis was placed on monitoring the risk involved in lending to households. The Bank of Russia informed its regional branches about credit institutions with unsatisfactory monitoring results in order to reassess the situation in these credit institutions and, if necessary, take supervisory measures.

In 2006, the Bank of Russia constantly examined and responded to appeals by individuals and legal entities, sorting out problems with the credit institutions mentioned in these appeals. At the same time, it used information from these appeals in the course of supervising credit institutions, taking it into account when evaluating legal and reputation risks.

In the period under review, the Bank of Russia continued to identify the instances (signs) of capital formation using improper assets, focusing its attention on the correctness of payment by credit institutions of increased authorised capital and capital sources such as subordinated loans and profits. In 2006, the Bank of Russia evaluated the quality of capital sources of 315 credit institutions. It demanded that five of them readjust their capital to the total amount of 657.7 million rubles and two credit institutions readjusted their capital on their own by the amount of improper assets totalling 123.1 million rubles.

In 2006, the Bank of Russia conducted consolidated supervision of banking groups, regularly analysing the consolidated statements submitted by parent credit institutions and other information available, including inspection results. It placed emphasis on evaluating the completeness of the determination of the consolidation perimeter, the accuracy of prepared consolidated statements, the timeliness of their submission to the supervisory authority, the financial soundness of the group and the compliance by the groups with prudential standards. Whenever the parent credit institutions of (consolidated) banking groups were found guilty of violating banking legislation or Bank of Russia rules and regulations, the Bank of Russia took sanctions against them pursuant to Article 74 of the Federal Law on the Central Bank of the Russian Federation (Bank of Russia).

To make consolidated supervision of credit institutions with subsidiaries in foreign countries more efficient, the Bank of Russia shared information about these credit institutions under the agreements (memorandums of understanding) on cross-border supervision, signed by the Bank of Russia and host country supervisory authorities.

In the period under review, the Bank of Russia continued to improve the analysis of credit institutions' activ-

[60] For more details about the banking risk monitoring system, *see IV.1.1. Regular monitoring.*

ities. Specifically, it determined the methods of analysing their consolidated and unconsolidated statements prepared in accordance with the IFRS. In the course of off-site supervision, the Bank of Russia took into account the results of the analysis of credit institutions' IFRS statements for 2005. When it discovered substantial discrepancies between data contained in statements prepared in accordance with the IFRS and statements prepared in accordance with the Russian accounting standards in respect of the major performance and risk evaluation indicators, it examined the reasons for the discrepancies and, if necessary, urged credit institutions to correct their methods of evaluating assets and liabilities in the future. The Bank of Russia also monitored compliance by credit institutions and banking/consolidated groups with compulsory annual audit requirements.

When performing its supervisory functions, the Bank of Russia continued to focus its attention on improving the performance of its regional branches for the purpose of implementing the common policy, methodology and principles of evaluating the performance of credit institutions. It co-ordinated the activities of its regional branches in order to ensure an adequate level of supervision of credit institutions and banking/consolidated groups with business interests in several Russian regions.

The Bank of Russia analysed the state of off-site supervision in its regional branches and made sure that they took correct and timely decisions. It provided practical assistance to its branches in the field of supervision.

To improve the skills and expertise of off-site supervisors, the Bank of Russia sent to its regional branches the draft Methodological Guidebook for the Curator of a Credit Institution, known as the 'Curator's Manual'.

In 2006, the Bank of Russia Banking Supervision Committee approved the Recommendations for the Practical Application of the Enterprise Monitoring Results by Bank of Russia Supervisors and the Banking Community, which were made known to the Bank of Russia regional branches in Bank of Russia Letter No. 40-T, dated March 17, 2006. The main practical outcome of the Bank of Russia monitoring was the results of the surveys, which involved more than 14,500 enterprises in all regions and economic activity categories in 2006.

The number of requests by supervisory divisions for the enterprise monitoring results and analysis conducted by the Bank of Russia increased from 80 to 450 in 2006, while the total number of analysis materials (forms) prepared by the enterprise monitoring services for the supervisory divisions topped 2,500.

More than 500 banks and 1,000 branches of credit institutions in 2006 received enterprise monitoring analysis materials, aggregated by economic activity category and by region, upon request.

The Bank of Russia has accorded great significance to the transparency of individual credit institutions and the banking sector as a whole. In addition to the annual *Banking Supervision Report,* published in Russian and in English, the Bank of Russia in 2006 issued the online monthly *Russian Banking Sector Review.*

As of January 1, 2007, more than 70% of all credit institutions disclosed information about their activities on the Bank of Russia web site (62% as of January 1, 2006). In addition, as of the beginning of this year 143 credit institutions, or about 12% of the total, agreed to disclose additional information in line with Bank of Russia Letter No. 165-T, dated December 21, 2006, 'On Disclosure of Information by Credit Institutions'. In addition to data on credit institutions' accounts, including the balances and turnovers, information disclosed in compliance with this document contains data on the financial performance of credit institutions.

In 2006, the Bank of Russia expanded the information resources of its corporate intranet portal and intensified the exchange of analytical information among its regional branches by including new thematic web sites in the portal. Information on the activities of credit institutions, disaggregated by bank and region and based on the analysis results for 110 regional mass media and online publications, is posted in the section Banks and Regions of the Bank of Russia's corporate portal.

III.5. On-site Inspection of Credit Institutions

In line with the Summary Plan of Comprehensive and Thematic Inspections of Credit Institutions and their Branches, the authorised representatives of the Bank of Russia conducted 1,421 inspections, of which 813 were conducted in credit institutions, 498 in the branches of credit institutions and 110 in the branches of the Savings Bank (Sberbank).

Inter-regional inspections were conducted in 164 credit institutions and branches of credit institutions, of which 56 in credit institutions, 92 in the branches of credit institutions and 16 in Sberbank branches.

In the course of conducting the scheduled inspections of credit institutions, the Bank of Russia's authorised representatives focused their attention on the evaluation of risk management systems and their quality, the reliability of accounting and reporting and compliance by credit institutions with the requirements of the Federal Law on Countering the Legalisation (Laundering) of Criminally Obtained Incomes and the Financing of Terrorism.

In 2006, the Bank of Russia closely co-operated with the Deposit Insurance Agency in organising and conducting inspections of the banks covered by the deposit insurance system. In all, the Bank of Russia authorised representatives and Deposit Insurance Agency employees jointly conducted 151 inspections to verify bank compliance with the requirements of the Federal Law on the Insurance of Household Deposits with Russian Banks.

In 2006, the Bank of Russia conducted 416 unscheduled inspections of credit institutions and their branches, of which 172 inspections were conducted in line with the decisions taken by the Bank of Russia management pursuant to Paragraph 4.2 of Bank of Russia Instruction No. 108-I 'On Organising Inspections by the Central Bank of the Russian Federation (Bank of Russia)'. The Bank of Russia regional branches conducted 131 inspections; 37 inspections were conducted by the Main Inspectorate for Credit Institutions (some of these inspections were conducted jointly with other Bank of Russia divisions) and four inspections were conducted by the Field Institutions Department.

The unscheduled inspections were conducted mostly for the purpose of verifying credit institutions' compliance with the requirements of the Federal Law on Countering the Legalisation (Laundering) of Criminally Obtained Incomes and the Financing of Terrorism, Bank of Russia rules and regulations on cash operations, cash movement through customer accounts, cash management and settlement and payment dicsipline in credit institutions.

In line with the decisions of the management of the Bank of Russia regional branches, taken pursuant to Paragraph 4.3 of Bank of Russia Instruction 108-I, 244 inspections were conducted in 2006, of which 242 in compliance with the requirements of Bank of Russia Instruction No. 109-I 'On the Bank of Russia Decision-Making Procedure Relating to the State Registration of Credit Institutions and the Licensing of Banking Operations' and two inspections were conducted in connection with the implementation of the bankruptcy (insolvency) prevention measures.

The grounds for appointing unscheduled inspections by the managers of the Bank of Russia regional branches were as follows: the increase of the authorised capital of credit institutions by more than 20% of the previously registered amount, the requests by banks to allow them to expand activities and the implementation by credit institutions of the insolvency (bankruptcy) prevention measures pursuant to Article 4 of the Federal Law on Insolvency (Bankruptcy) of Credit Institutions.

To enhance the efficiency of inspections, the Bank of Russia constantly checked the quality of the inspections of credit institutions and their branches conducted by the inspection divisions of the Bank of Russia regional branches. Having analysed inspection materials, the Bank of Russia sent its statements on the quality of the inspection reports and memos and recommendations on organising inspections and correcting the faults detected.

In 2006, the Bank of Russia completed the test running of the Inspection Division Automated System (ASIP), which made it possible to receive information on inspections online from a single database and improve co-ordination of inspections and ongoing control.

The Bank of Russia continued to organise and co-ordinate supervision and inspection in the Chechen Republic in 2006. In the course of supervision, it collected and analysed the statements of the branches of credit institutions located in that region. During the year under review, the Bank of Russia considered the documents relating to the opening of eight additional offices and cash offices of Rosselkhozbank and conducted several on-site inspections for this purpose. It also conducted thematic inspections of the Chechen branch of Rosselkhozbank and the Vneshtorgbank structural units in the Chechen Republic.

III.6. Supervisory Response

Being a banking regulatory and supervisory authority, the Bank of Russia constantly monitors compliance by credit institutions and banking groups with banking legislation, Bank of Russia rules and regulations and required ratios. When it detects violations or shortcomings in the activity of credit institutions, the Bank of Russia decides whether it is necessary to take supervisory measures and, if so, what specific measures should be taken pursuant to Article 74 of the Federal Law on the Central Bank of the Russian Federation (Bank of Russia) and Bank of Russia rules and regulations and on the basis of the nature of the violations, their reasons and the general financial standing of a credit institution.

As in the previous years, in 2006 the Bank of Russia's supervisory decisions were timely, adequate and consistent. It constantly oversaw the implementation of supervisory decisions by credit institutions. When deciding on the measures that should be taken, the Bank of Russia relied upon the general legal principle of punishment being commensurate with offence. Specifically, Bank of Russia Instruction No. 59-I, dated March 31, 1997, 'On the Corrective Measures Applied to Credit Institutions' (hereinafter referred to as Instruction No. 59-I), states in no vague terms that preventive measures are mainly used when the shortcomings in the work of a credit institution pose no direct threat to the interests of creditors and depositors and describes the violations for which such measures may be used. The same principle applies to the forced measures, except the special cases stipulated by the law.

When a corrective measure is decided upon, the principle of consistency is applied, which means that harsher measures are used in most cases after softer measures have already been tried and failed to make the credit institution correct the flaws detected in its work.

In the past three years, the most common corrective measure has been to provide a credit institution with a memo about the faults discovered in its work. Each year the Bank of Russia sends over 1,000 memos to credit institutions, in which it describes the faults and recommends ways to rectify them. Meetings with the managers of credit institutions and bank owners are now used more frequently as a corrective measure. In 2006, the Bank of Russia regional branches held 503 meetings (as against 392 in 2005 and 373 in 2004) and the rising number of meetings held by the Bank of Russia regional branches with credit institutions on various issues relating to their activities testify to the improved interrelationship between the supervisory authorities and credit institutions.

The choice of the corrective measures, including the forced ones, shows that the aforementioned principle of applying the corrective measures is observed. The most frequently used are the orders given to credit institutions to correct the faults in their work. In 2006, such orders were sent to 861 credit institutions (as against 836 in 2005), of which 56% were connected with violations of the Federal Law on Countering the Legalisation (Laundering) of Criminally Obtained Incomes and the Financing of Terrorism. In 2006, twenty-seven credit institutions were ordered by the Bank of Russia to comply with the required ratios and five to replace their managers.

Fines are widely used as a sanction: 514 credit institutions, or almost 43% of the total, were fined in 2006 (no change on 2005).

Restrictions and bans on individual banking operations were imposed on 156 credit institutions in 2006 and 59 banks had their banking licences revoked (35 banks in 2005).

The improvement of the legal and regulatory framework may also increase the efficiency of the measures applied to credit institutions. The Bank of Russia is currently revising one of its fundamental documents on corrective measures, Instruction No. 59-I, to take into account the substantial changes in applicable legislation and the passage of new laws regulating some activities of credit institutions. In the future, the Bank of Russia is to change the principles of applying corrective measures to credit institutions for shortcomings discovered in the work of the branches of credit institutions with their head offices located in other regions. At present, corrective measures against credit institutions with branches can only be used by the supervisory authorities that oversee the head offices. The corresponding changes are to be made in the Bank of Russia rules and regulations.

III.7. Financial Rehabilitation and Liquidation of Credit Institutions

The number of credit institutions falling under the insolvency (bankruptcy) prevention measures set forth in Article 4 of the Federal Law on Insolvency (Bankruptcy) of Credit Institutions decreased from nine as of January 1, 2006, to seven as of January 1, 2007.

In 2006, the owners and managers of credit institutions took timely and effective measures to rehabilitate their credit institutions financially and this allowed them to avoid being subjected to the bankruptcy prevention measures by the Bank of Russia. The share of such credit institutions in the total number of credit institutions liable to the bankruptcy prevention measures under Article 4 of the Federal Law on Insolvency (Bankruptcy) of Credit Institutions increased from 45% in 2005 to 56% in 2006.

In the period under review, six credit institutions were ordered to take financial rehabilitation measures, of which five credit institutions were ordered to match their authorised capital with own funds (capital).

The Bank of Russia oversaw 68 provisional administrations of credit institutions in 2006. During the year, it discharged 57 provisional administrations, of which 45 were disbanded in connection with the decision of the arbitration court to liquidate the credit institutions and appoint liquidators, 11 provisional administrations were dismissed in connection with the decision of the arbitration court to declare the credit institutions insolvent (bankrupt) and appoint receivers and one provisional administration was discharged by the decision of the arbitration court. Last year, representatives of the Deposit Insurance Agency were included in 20 provisional administrations.

During the year under review, the Bank of Russia made certain that credit institutions complied with the requirements of Federal Law No. 177-FZ on the Insurance of Household Deposits with Russian Banks (hereinafter referred to as Federal Law No. 177-FZ). In 2006, insured events occurred in nine banks covered by the deposit insurance system (these banks had their banking licences revoked)[61]. The provisional administrations appointed by the Bank of Russia in connection with the revocation of banking licences registered the obligations that these banks had to depositors in compliance with the requirements of Federal Law No. 177-FZ, and the Bank of Russia sent the registers of all these banks' obligations to depositors to the Deposit Insurance Agency within seven days, the time period set forth in Federal Law No. 177-FZ. This allowed the Deposit Insurance Agency to begin insurance payments to depositors in time and in many instances ahead of schedule.

In 2006, the Bank of Russia pursuant to Article 48 of Federal Law No. 177-FZ and in line with the decisions of its Banking Supervision Committee, prohibited six banks from taking household deposits and opening personal accounts because of the banks' non-compliance with the deposit insurance system requirements during three consecutive months.

The Bank of Russia continued to co-operate with the Deposit Insurance Agency under the agreements on co-operation, co-ordination of activities and the sharing of information on issues relating to the deposit insurance system, the participation of banks in the deposit insurance system and the payment of insurance premiums and compensation for deposits, the conduct of the Bank of Russia inspections of the banks covered by the deposit insurance system and the use of sanctions against them, and other issues relating to the functioning of the deposit insurance system.

The number of credit institutions whose banking licences were revoked (cancelled) by the Bank of Russia increased in 2006. 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 revoked (cancelled) banking licences from 62 credit institutions (as against 40 credit institutions in 2005), of which three credit institutions had their licences revoked in line with the decision taken by their shareholders (members). Most of the licences were revoked (cancelled) from credit institutions registered in the Moscow Region (54).

The number of banks that had their licences revoked for repeated violations within one year of Articles 6 and 7 (except Paragraph 3 of Article 7) of the Federal Law on Countering the Legalisation (Laundering) of Criminally Obtained Incomes and the Financing of Terrorism (hereinafter referred to as Federal Law No. 115-FZ) increased from 14 in 2005 to 51 in 2006. At the same time, the number of credit institutions that had their licences revoked for failure to satisfy their creditors' claims under pecuniary obligations and/or make compulsory payments decreased from ten in 2005 to two in 2006.

During the year under review, 18 Bank of Russia orders to revoke banking licences from credit institutions were disputed in the course of 76 court sessions. In 15 cases the arbitration courts ruled in favour of the Bank of Russia, while other cases are still in arbitration courts of different instances.

In 2006, the Bank of Russia registered the liquidation of 56 credit institutions, of which 38 credit institutions were

[61] One insured event (the revocation of a banking licence) occurred in 2005.

liquidated by the decision of the arbitration court upon the completion of the bankruptcy proceedings, one credit institution was declared bankrupt and wound up out of court by the decision of its founders (members) and creditors, 15 credit institutions were forcibly liquidated without being declared bankrupt, and two credit institutions were wound up by the decision of their founders (members) on voluntary liquidation.

As of January 1, 2007, liquidation proceedings took place in 144 credit institutions. Of these, 83 credit institutions were declared bankrupt and liquidation proceedings were initiated against them (17 of them in 2006); in respect to 53 credit institutions the arbitration courts ordered their liquidation (43 of them in 2006); eight credit institutions are being wound up voluntarily (the members of three of them decided to liquidate them voluntarily in 2006).

Pursuant to Paragraph 2 of Article 50.11 of the Federal Law on Insolvency (Bankruptcy) of Credit Institutions, in 2006 the Deposit Insurance Agency conducted liquidation proceedings in 109 credit institutions. Ten of them were liquidated in 2006 (seven were wound up by the bankruptcy proceedings and three by forced liquidation) and their liquidation was registered in the same year. As of January 1, 2007, the Deposit Insurance Agency conducted liquidation proceedings in 99 credit institutions.

In 2006, the Bank of Russia conducted 21 inspections of the receivers (liquidators) of credit institutions. As a result of these inspections, receivers were ordered to rectify the faults discovered in their work and information on inspection results was sent to arbitration courts and bank creditor committees.

In 2006, the Bank of Russia accredited 33 receivers of credit institutions declared bankrupt, of whom six had their accreditations extended.

In addition, the Bank of Russia extended the term of 45 receivers' (liquidators') certificates issued before the coming into force of the Federal Law on Amending the Federal Law on Insolvency (Bankruptcy) of Credit Institutions and Invalidating Some Laws (Provisions of Some Laws) of the Russian Federation and refused to extend the term of 10 certificates. As of January 1, 2007, 15 receivers had the receivers' (liquidators') certificates.

Pursuant to the Federal Law on Bank of Russia Payments on Household Deposits with Bankrupt Banks Uncovered by the Deposit Insurance System, the Bank of Russia Board of Directors took the decisions to effect Bank of Russia payments to 13,658 depositors of 10 banks declared bankrupt to the total amount of 656.58 million rubles. In addition, it was decided to allocate 1.06 million rubles on top of that sum to implement the decisions on Bank of Russia payments taken in respect to six banks in 2005.

In line with these decisions, the Bank of Russia paid a total of 649.35 million rubles to 13,332 depositors in 2006.

III.8. Countering the Legalisation (Laundering) of Criminally Obtained Incomes and Terrorist Financing

In 2006, the Bank of Russia continued to perform the functions assigned to it by the Federal Law on Countering the Legalisation (Laundering) of Criminally Obtained Incomes and the Financing of Terrorism (hereinafter referred to as Federal Law No. 115-FZ), placing emphasis on the creation and maintenance of adequate conditions conducive to the efficient implementation by credit institutions of this Law (AML/FT).

The Bank of Russia was actively involved in drafting amendments to Federal Law No. 115-FZ aimed at optimising the requirements for the identification of customers. When the amendments that lifted the requirement to identify the customers who effect social payments to the amount of no more than 30,000 rubles and buy and sell foreign exchange worth no more than 15,000 rubles came into force, the Bank of Russia made the corresponding changes in its own rules and regulations[62].

To provide methodological support to credit institutions when fulfilling the requirements of Federal Law No. 115-FZ, in 2006 the Bank of Russia issued a number of letters recommending the identification procedures to be followed when concluding bank account (deposit) agreements[63] and providing guidance to credit institutions in respect of the changes in the foreign and international regulations on AML/FT[64].

To ensure uniformity in the law enforcement practice, in 2006 the Bank of Russia issued two letters of information clarifying the most urgent issues of application of the Bank of Russia rules and regulations on AML/FT.

When performing its supervisory functions and inspecting 779 credit institutions and/or their branches, the Bank of Russia verified their compliance with the AML/FT laws in 2006. It placed emphasis on the quality and completeness of the customer and beneficiary identification and the accurate evaluation of the risk associated with money laundering and terrorist financing operations conducted by customers.

As a result of the inspections, the Bank of Russia detected various violations of laws and regulations, including Federal Law No. 115-FZ, and used different sanctions against violator credit institutions: preventive measures included making the faults and irregularities known to the management of errant credit institutions and forced measures included orders to take corrective action, fines, restrictions and bans on individual banking operations and the revocation of banking licences.

The analysis of co-operation between credit institutions and the Federal Financial Monitoring Service shows that the banking community has substantially stepped up its activities in AML/FT. The number of reports about operations subject to mandatory control and suspicious operations received by the Service from credit institutions doubled in 2006 (6.1 million reports as against 3.0 million reports in 2005) and the share of the reports about suspicious operations expanded from 50% in 2005 to 63% of total reports received in 2006. The share of reports rejected by the Federal Financial Monitoring Service due to the violation of the Bank of Russia procedure for preparing them gradually decreased throughout the year under review and in December 2006 it stood at less than 1.0%. In all, the Federal Financial Monitoring Service rejected 1.3% of the reports sent by credit institutions in 2006 as against 4.9% in 2005. Fewer late reports were submitted on operations subject to mandatory control. According to the Service's data, 3.0% of the reports about operations subject to mandatory control were sent in violation of the time periods set by Federal Law No. 115-FZ in the second half of 2006 (3.6% in 2006 as a whole) as against 8.8% in the second half of 2005. The progress is due to the improvement of the quality of supervision of credit institutions from the standpoint of their compliance with the requirements of the AML/FT law, more active use by credit institutions of special software and the improvement of personnel training in credit institutions.

In 2006, the Bank of Russia continued to train and retrain employees at its regional branches in AML/FT. Experts with the Bank of Russia, the Ministry of the Interior and the Federal Financial Monitoring Service conducted thirteen courses of training that involved about 600 people in accordance with the Bank of Russia vocational training plan for the staff of Bank of Russia regional branches.

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[62] Bank of Russia Ordinance No. 1721-U, dated September 14, 2006, 'On Amending Bank of Russia Regulation No. 262-P, Dated August 19, 2004, on the Identification of Customers and Beneficiaries by Credit Institutions for the Purpose of Anti-money Laundering and Countering the Financing of Terrorism', and Bank of Russia Ordinance No. 1751-U, dated November 29, 2006, 'On Amending Bank of Russia Instruction No. 113-I, Dated April 28, 2004, on the Procedure for Opening, Closing and Organising the Work of Exchange Offices and the Procedure for Conducting Individual Bank Operations and Other Transactions with Foreign and Russian Currency, Foreign Currency-Denominated Cheques, Including Traveller's Cheques, between the Authorised Banks and Private Individuals'.

[63] Bank of Russia Letter No. 115-T, dated August 30, 2006, 'On the Implementation of the Federal Law on Anti-money Laundering and Countering the Financing of Terrorism in Respect of the Identification of Customers Provided with Electronic Banking Services, Including Internet Banking'.

[64] Bank of Russia Letter No. 81-T, dated June 7, 2006, 'On the Regulation by the US Financial Crime Enforcement Network (Fincen) Establishing Requirements for Opening and Keeping by US Financial Institutions Correspondent Accounts, Non-resident Accounts and Accounts of Politically Exposed Persons', and Bank of Russia Letter No. 105-T, dated August 1, 2006, 'On New Documents of the Wolfsberg Group'.

III.9. Central Catalogue of Credit Histories

Federal Law No. 218-FZ, dated December 30, 2004, 'On Credit Histories', stipulates that the principal objective of the Central Catalogue of Credit Histories (CCCH) is to inform credit history makers and users of credit histories where the credit report of a credit history maker can be received. In March 2006, the CCCH began to receive the titles of credit histories from credit bureaux registered on the state register of credit bureaux and by the end of the year the CCCH had been linked up with 21 credit bureaux.

The modernisation of the Bank of Russia automated CCCH system in 2006 made it possible to process electronic messages and requests from credit bureaux and credit history makers and users within several minutes on average, regardless of the number of messages, on a round-the-clock basis seven days a week.

In 2006, the CCCH kept and, at the request of credit history makers or users, was able to provide information about more than 14 million credit history titles (as against 1 million as of April 2006 and 10 million as of October 2006). Of these, 99.5% are the titles of individual credit histories. In 2006, the CCCH received and processed over 63,000 enquiries about credit bureaux in which credit histories are kept and more than 114,000 requests to create, replace or cancel the code of a credit history marker or create an additional code of a credit history marker.

The analysis of credit history titles (based on the serial numbers of Russian nationals' passports) kept in the CCCH shows that data about credit history makers are collected on the regional level almost throughout the country: the 20 regions with the largest number of individuals with a credit history account for 60% of all credit history titles. At the same time, Moscow and the Moscow Region, the Republic of Bashkortostan and the Sverdlovsk Region account for about 19% of all credit history titles.

In 2006, the CCCH continued to place on the Bank of Russia web site information for credit history makers and users and credit bureaux, such as the register of credit bureaux and Bank of Russia rules and regulations in respect of the CCCH.

III.10. Co-operation with the Russian Banking Community

In 2006, the Bank of Russia continued to actively co-operate with the Russian banking community by holding consultations on how to improve the regulatory framework of banking regulation and supervision.

It continued the practice of discussing its draft regulations and instructions with the banking community before issuing them. For this purpose, in 2006 the Bank of Russia posted several documents on its official web site, including:

— 'The New Approach to the Opening of Structural Units by Credit Institutions and their Branches', a concept developed by the Bank of Russia to encourage the expansion of the banking services market and make banking services accessible to the general public nationwide;

— a list of measures aimed at improving the placement and circulation of stocks and shares for the purpose of assisting credit institutions in increasing their capitalisation by using a simplified share placement procedure;

— the draft Ordinance 'On Amending Bank of Russia Regulation No. 254-P, Dated March 26, 2004, on the Procedure for Making by Credit Institutions Provisions for Possible Losses on Loans, Loan and Similar Debts';

— the draft Letter 'On Self-Appraisal of Legal and Reputation Risk Management in Credit Institutions'.

The Bank of Russia considered the comments and proposals made by the banking community in respect of these documents when it finalised the regulatory documents.

It continued to survey credit institutions (this project began in 2003 with the consent of the credit institutions involved) on issues relating to online banking for the purpose of identifying the risks involved in this banking technique. According to information from the Bank of Russia regional branches, most of the credit institutions surveyed in 2006 had drafted the necessary internal rules and regulations in respect of online banking risk management.

In the period under review, the Bank of Russia worked out jointly with the Association of Russian Banks (ARB) a set of banking quality standards. Specifically, the Bank of Russia proposed a banking quality standard in respect of the outsourcing of information technologies in banks. In 2007, the Bank of Russia plans to develop in collaboration with the ARB a quality standard for the management of operational risk in credit institutions and a quality standard for online banking.

In addition, the Bank of Russia examined and supported the proposals of the Association of Regional Banks "Russia" (Association "Russia") for co-operation between credit institutions and the national post operator Pochta Rossii in providing post office banking services and the proposals by the Ural Banking Union on ways to improve banking practices in Russia.

In 2006, Bank of Russia supervisors took part in the seminars, conferences, roundtables and working meetings organised by the Association "Russia", the ARB, the Russian Microfinancial Centre, the National Monetary Association, the Association for the Protection of the Information Rights of Investors, the National Stock Market Association and the National Public Small and Medium-sized Business Organisation OPORA Rossii on a wide range of issues, such as the conduct of credit operations, repo operations, loan loss provisioning, activities of micro-financial organisations and non-bank deposit and credit institutions, regulation of open currency positions, activities of general bank management funds, transparency and capitalisation of the banking sector and consolidation of credit institutions.

III.11. Co-operation with International Financial Organisations, Foreign Central Banks and Supervisory Authorities

In 2006, Bank of Russia representatives participated in working meetings and in drafting of documents in connection with the projected launching by the **International Monetary Fund** and the **World Bank** of a new Financial Sector Assessment Programme (FSAP) for the Russian Federation, which included the assessment of the banking sector. Specifically, the Bank of Russia prepared a report on the implementation of the recommendations made by IMF and World Bank experts as a result of the previous FSAP (2003).

The Bank of Russia implemented the recommendations made by the Consultative Council for Foreign Investments in Russia (CCFI) and the CCFI working group “Developing the Banking Sector and Financial Markets in Russia” in connection with suggestions offered by foreign investors on major issues of the Russian banking sector development. These recommendations are aimed at enhancing the stability of the banking sector, developing its legal framework, improving the procedures of credit institutions’ mergers, approving their executives and acquisition of large block of credit institutions’ shares, optimising bank reporting, improving supervision on a consolidated basis, etc.

Within the framework of the Co-ordinated Compilation Exercise for Financial Soundness Indicators (FSIs), the Bank of Russia compiled financial soundness indicators and finished the description of metadata on FSIs in 2006. The final version of the FSI data and metadata was sent to the IMF for further posting on the IMF web site[65]. Under this project, a representative of the Bank of Russia took part in the regional meeting of FSI co-ordinators and compilers, held in Austria in May 2006.

The Bank of Russia continued to receive technical assistance from the IMF, which held consultations on international expertise in banking activities and banking supervision.

In response to the World Bank’s request in connection with the compilation of its *Regulation and Supervision of Banks around the World* in 2006, the Bank of Russia provided updated information on the applicable laws and regulations.

The Bank of Russia made proposals and comments on draft documents, presented information and took part in the meetings of the working groups of the **Basel Committee on Banking Supervision** (Core Principles Liaison Group and Capital Task Force) and its **regional groups** (Banking Supervision Group for Central and Eastern Europe and Banking Supervision Group for the Transcaucasus, Central Asia and the Russian Federation). Specifically, the Bank of Russia participated in the discussion and refining of the Basel Committee-proposed new version of the Core Principles for Effective Banking Supervision and the Core Principles Methodology.

Bank of Russia representatives participated in the 19th Conference of the Group of Banking Supervisors from Central and Eastern Europe, which discussed the implementation of the Pillar III of the *International Convergence of Capital Measurement and Capital Standards (Basel II)* and corporate governance at banks (Montenegro, April 9—12, 2006).

In 2006, the Bank of Russia took part in the seminars held by the **Financial Stability Institute** of the Bank for International Settlements and the Basel Committee on the following topics: international accounting and audit in banks, dealing with problem banks, banking capital and international capital standards, core issues of supervision, Basel II and its application, asset and liability management, operational risk at banks, the use of Basel II recommendations in trading activities and the treatment of the double default effects, and risk management.

In 2006, the Bank of Russia examined and specified the details of the Memorandum of Understanding between the Bank for International Settlements and the Bank of Russia on translation into the Russian language and integration of the Russian-language version of FSI Connect, developed by the Financial Stability Institute for the purposes of banking regulation and supervision.

The Bank of Russia drafted and submitted to the **European Commission** office in Russia a report on the implementation of Basel II recommendations under the EU/TACIS *Financial Sector Regulation, Supervision and Governance Project.* It also took part in preparing the manual *Banking Supervision: European Experience and Russian Practice* in English and Russian as part of the EU/TACIS *Central Bank Training — III Project.*

As Russia continued to participate in the effort to create the **Common Economic Space,** the Bank of Russia took part in discussing the draft Agreement to Harmonise Banking Legislation in Compliance with the Basel Principles.

Within the framework of the **Eurasian Economic Community (EurAsEC),** Bank of Russia representatives participated in the conference of EurAsEC central bank experts to discuss the draft documents of the 16th EurAsEC central bankers’ meeting, which was held in Moscow on September 19—21, 2006. The Bank of Russia held a seminar for EurAsEC and CIS central bank experts on ‘The Bank of Russia Enterprise Monitoring Structure and Mechanism’ (Vladimir, May 23—26, 2006).

[65] At *http://www.imf.org/external/np/sta/fsi/eng/cce/index.htm.*

Within the framework of the **Shanghai Co-operation Organisation,** the Bank of Russia took part in the discussion and drafting of proposals on the Kazakhstan-sponsored draft Agreement on the Use of Special Requirements and Procedures for Consolidated Supervision in the Member States of the Shanghai Co-operation Organisation, the sharing of information and co-operation between their financial market regulators and financial supervisors and the draft memorandum (on a bilateral basis) of understanding and the exchange of information between the member states' financial supervisory authorities.

Within the framework of the **Asia-Pacific Economic Co-operation (APEC),** the Bank of Russia participated in drafting materials for the second policy theme of the APEC Finance Ministers' Process in 2006, 'Financial Sector Reform to Attract Capital Flows' for the preparation of the APEC country study.

Bank of Russia representatives also participated:

— in the workshop 'Savings and Capital Market Development Policy', held under the programme to keep the governments of APEC economies informed about possible savings policy readjustment options, including the measures to increase the share of private savings for the purpose of creating a stable capital market contributing to increased economic growth (Voluntary Action Plan for Promoting Freer and More Stable Capital Flows: The Policy Dialogue on Savings and Capital Market Development);

— in the APEC workshop 'Financial Sector Reform: Maintaining Financial Stability Through the Use of Financial Safety Nets' as part of the initiative of the APEC Finance Ministers' Process on Reform of the Financial Sector. The workshop focused on the discussion of the experience gained by APEC economies in building the financial safety nets and the Australia-drafted document 'Financial Sector Reform: Towards a Menu of Policy Options for APEC Economies'.

The Bank of Russia took part in organising and hosting the ***15th International Banking Congress (IBC-2006),*** which was held in St Petersburg on June 7 to 10, 2006, on the topic 'Basel Recommendations: Approaches and Implementation'. Representatives of Russian and foreign business and political circles, international organisations, central (national) banks, foreign supervisory authorities and the banking community participated.

They discussed banking supervision developments, the Basel II implementation, financial soundness of banks and the banking systems, the improving of internal controls and audit in banks and the use of the IFRS in the banking business. After the discussion, the participants in the Congress adopted recommendations for banking sector development in Russia.

Co-operation between the Bank of Russia and Central (National) Banks and Foreign Supervisory Authorities

Within the framework of the **Interbank Currency Council of the Central Bank of the Russian Federation** and the **National Bank of the Republic of Belarus,** the Bank of Russia participated in drafting materials and in discussing them at the meetings of the Interbank Currency Council on the following topics:

— 'The Harmonisation of National Legislation on Banking Supervision with Basel Principles' (23rd meeting, held in Kazan on January 27, 2006);

— 'Progress in Harmonising the Key Elements of the Regulatory Framework of the Central Bank of the Russian Federation and the National Bank of the Republic of Belarus' (24th meeting, held in Mozyr on June 30, 2006);

— 'Progress in Bringing Banking Supervision Legislation of the Russian Federation and the Republic of Belarus in Compliance with Recommendations of the Basel Committee on Banking Supervision' (25th meeting, held in Smolensk on December 1, 2006).

In 2006, the Bank of Russia continued to discuss and sign the agreement on co-operation (memorandums of understanding) in the field of banking supervision with the central (national) banks and banking/financial supervisory authorities of foreign countries.

Guided by the Core Principles for Effective Banking Supervision, the Bank of Russia entered into such agreements with the State Bank of Vietnam and the National Bank of the Republic of Azerbaijan and signed memorandums of understanding with the Superintendency of Banks of Panama, the Central Bank of Brazil, the Financial Supervisory Authority of Norway (in the field of supervision of Norway's DnB NOR Bank ASA and Monchebank), and Germany's Federal Financial Supervisory Authority (Bundesanstalt fur Finanzdienstleistungsaufsicht). The development of relations between the Bank of Russia and foreign supervisory authorities testifies to a certain level of international recognition of banking supervision in Russia. This particularly applies to the relations with members of OECD (Norway and Germany) and of the Basel Committee Group of Ten (Germany).

In 2006, the Bank of Russia continued drafting memorandums of understanding with the Central Bank of Cyprus, the Financial Supervisory Authority of Estonia, the Financial Supervisory Authority of Finland (also during the visit of Finland's representatives to the Bank of Russia on November 1 and 2, 2006), the UK Financial Services Authority, the Republic of Kazakhstan Agency for Regulation and Supervision of Financial Market and Financial Organisations, the National Bank of Bulgaria and the Banking Regulation and Supervision Agency of Turkey.

At the initiative of the Bank of Russia, draft memorandums of understanding were sent to the US Federal Reserve Board and Office of the Comptroller of the Currency, the Administration for the Supervision of Banks and Other Financial Institutions of Venezuela, De Nederlandsche Bank, the Austrian Financial Markets Authority, the Liechtenstein Financial Markets Authority and the Central Bank of Argentina. After the Ukrainian side proposed resuming the negotiations on a draft co-operation agreement, the Bank of Russia sent a new version of the agreement (memorandum of understanding) to the National Bank of Ukraine.

The Bank of Russia's employees took part in the seminars of the Bank of France International Banking and Financial Institute and the seminars on banking supervision organised by the central banks of Indonesia, Turkey, Germany and Poland.

Within the framework of the *Banks/Financial Services Sub-group of the Russian-German Intergovernmental Working Group on the Strategy of Economic and Financial Co-operation (hereinafter referred to as Sub-group),* the seminar on 'Co-operative Credit Institutions and their Regulation, Supervision and Audit: German Experience and its Impact on Russia' was held at the Bank of Russia on June 14 and 15, 2006. Bank of Russia representatives took part in the Sub-group's meeting on Basel II, held at the Federal Ministry of Finance in Berlin on September 13 and 14, 2006.

The Bank of Russia's employees also took part in the seminars organised by the Bank of Russia jointly with the *US Financial Services Volunteer Corps (FSVC)* on the following topics: banking supervision management, anti-money laundering and countering the financing of terrorism, banking supervision and inspection in the field of online banking and technological risk, the banking analysis and inspection school, consolidated supervision, and the methods of organising supervision in connection with the introduction of Pillar II of Basel II.

From December 4 to 7, 2006, the FSVC conducted consultations at the Bank of Russia on the following issues: capital adequacy, the planning of inspections, the quality of inspection control and reports, liquidity risk, and an overview of sanctions against bank employees, including a ban on working in the banking sector.

III.12. Outlook for Banking Regulation and Supervision in Russia

III.12.1. State registration of credit institutions and bank licensing

To accomplish the tasks set out in the Banking Sector Development Strategy, the Bank of Russia will continue to propose amendments to banking legislation with the objective of improving the quality of management in credit institutions and following the Basel recommendations and the best international practice of corporate governance, it will tighten the requirements for the managers and owners of credit institutions.

Given the role played by the board of directors in corporate governance, the Bank of Russia intends to set exacting qualification requirements for the board members, tighten control over compliance by candidates for executive positions in credit institutions, including board members, with the established requirements and ensure that the managers of credit institutions comply with the fitness and propriety requirements during their entire tenure.

The Bank of Russia is also set to tighten requirements for the holders of large blocks of shares in credit institutions, because these people usually determine the decisions taken by the management of the credit institutions. These requirements should also include the fitness and propriety requirements. To ensure that these requirements are complied with, the Bank of Russia should be given the right to dismiss from the management of credit institutions their founders (members) who have failed to meet fitness and propriety or financial position requirements.

To ensure the necessary level of corporate governance in the banking sector, the Bank of Russia will continue to propose amendments to applicable legislation aimed at making the ownership structure of credit institutions more transparent, including the disclosure of information about the beneficial owners of credit institutions.

In 2007, the Bank of Russia plans to complete the drafting of amendments to banking legislation for the purpose of simplifying bank merger, acquisition and reorganisation procedures. The objective of the projected draft law is to create legal conditions for simplifying the procedures for reorganising credit institutions, ensuring their transparency and protecting the interests of the reorganised credit institutions and their creditors.

To make Russian banks more competitive, the Bank of Russia intends to propose amendments to Article 36 of the Federal Law on Banks and Banking Activities, which will give banks the right to take household deposits as soon as they are registered. It is important, however, that the authorised capital of a newly registered bank should be no less than the amount of the ruble equivalent of €100 million. To encourage competition on the financial services market and promote the inflow of household savings to the banking sector, the Bank of Russia is considering the possibility of accessing to the retail banking services market financially sound banks before the expiry of the two-year period from their registration date if their capital is no less than the amount of the ruble equivalent of €100 million.

To implement the Banking Sector Development Strategy, the Bank of Russia plans to participate in drafting the following federal laws:

— a draft federal law to amend Article 22 of the Federal Law on Banks and Banking Activities for the purpose of encouraging the diversification of banking services provided to customers by credit institutions outside their location;

— a draft federal law on the reorganisation of commercial organisations and a draft federal law to amend the Civil Code of the Russian Federation and draft federal laws to amend the federal law on joint-stock companies, federal law on limited liability companies and federal law on the state registration of legal entities and individual entrepreneurs for the purpose of standardising and settling the relations involved in the reorganisation of organisations with different legal statuses and protecting the interests of the creditors of reorganised credit institutions, including the introduction of joint and several liability of the reorganised legal entities;

— draft amendments to the federal law to regulate the opening of individual accounts (deposits) through federal post offices.

To improve its regulatory framework, the Bank of Russia will draft:

— amendments to Bank of Russia Regulation No. 230-P, dated June 4, 2003, ‘On the Reorganisation of Credit Institutions by Merger and Acquisition’, in respect of the licensing of banking activities in case of mergers and acquisitions of the banks that refused to participate in the deposit insurance system or failed to meet the requirements for access to the deposit insurance system;

— a new version of Bank of Russia Ordinance No. 1477-U, dated July 16, 2004, ‘On the Procedure for Invalidating a Bank’s Licence to Take Household Deposits in Rubles and Foreign Currency and a General Licence in Case of the Bank’s Refusal to Participate in the Deposit Insurance System or Failure to Comply with the Requirements for Access to the Deposit Insurance System’, setting up a procedure for making a note in the corresponding licence in connection with the termination of the bank's right to take deposits if the Bank of Russia found it unfit to participate in the deposit insurance system;

— amendments to Bank of Russia Ordinance No. 1548-U, dated February 7, 2005, 'On the Procedure for Opening (Closing) and Managing a Mobile Cash Department of a Bank', to broaden the powers of mobile cash departments by granting them the right to open and close household bank accounts.

III.12.2. Banking regulation and off-site supervision

To improve supervision, abandon formal procedures in favour of the substantive evaluation of the situation in a credit institution and implement the tasks involved in risk-based supervision, the Bank of Russia plans to introduce in 2007:

— new approaches to the evaluation of credit institutions' performance for the purpose of ensuring continuity and uniformity in the methods of assessing the performance of banks by the Bank of Russia in the course of supervising them and the methods used to evaluate compliance by banks with the deposit insurance system requirements, which are described in the draft of the Bank of Russia Ordinance on the Evaluation of the Economic Situation of Banks;

— new approaches to the establishment of the supervision regime and the implementation of supervisory measures (a set of instruments and their application) in regard to credit institutions, taking into account their economic situation;

— the curatorship of credit institutions, which will help improve the relationship between the supervisory authority and credit institutions for the purpose of eliminating unnecessary formalities and making credit institutions more transparent. The curator of a credit institution is to become the main connection between the Bank of Russia and a credit institution, possessing all information about it. This is only possible if a credit institution co-operates with the supervisory authority and willingly provides to the curator all material information about itself. These principles are set out in the draft of the Bank of Russia Regulation 'On the Curator of a Credit Institution', which establishes the powers, duties and responsibility of the curators of credit institutions.

To create more favourable conditions for substantive supervision, the Bank of Russia intends to propose amendments to legislation that will determine the powers of the Bank of Russia to use professional (qualitative) judgement in supervisory practice.

To raise the level of co-operation between the supervisory authority and banks, the Bank of Russia intends to complement its effective rules and regulations on corporate governance, internal controls and legal and reputation risk management by the requirement for credit institutions to make a self-appraisal of their compliance with these rules and regulations and recommendations to the Bank of Russia regional branches on their evaluation.

To upgrade the methods of regulating financial risk by credit institutions, the Bank of Russia has the following plans for 2007:

— to participate in drafting laws on financial risk regulation;

— to improve the methodology of determining the capital of credit institutions;

— to upgrade the methods of calculating credit institutions' required ratios and supervising their observance in respect of the procedure for calculating the capital adequacy and liquidity ratios;

— to upgrade loss provisioning techniques;

— to upgrade the methods of calculating an open currency position.

In connection with the introduction from January 1, 2008, of accrual accounting and the new principles of securities accounting, the Bank of Russia intends to continue to draft amendments to its effective rules regulating financial risk.

For the purpose of adopting the practices recommended by the Basel Committee's document *International Convergence of Capital Measurement and Capital Standards: a Revised Framework (Basel II),* in 2007 the Bank of Russia plans:

— to participate in drafting amendments to applicable legislation to convert the Russian banking practice to Basel II principles;

— to develop methodologies of setting minimum standards for internal risk management and capital adequacy assessment procedures for banks, evaluation of bank capital adequacy assessment procedures and a capital maintenance strategy and the sufficiency of the capital adequacy assessment.

To improve the conditions of consumer lending, the Bank of Russia is currently working out a regulation allowing credit institutions to outsource individual functions connected with consumer lending.

In 2007, the Bank of Russia will continue to build a single information system for banking sector regulation and development in line with its Directive No. 543-R, dated November 3, 2003. Specifically, the process of submitting credit institutions' statements to the Bank of Russia will be automated using the Internet.

In 2006, the Bank of Russia Moscow branch began to install the Extranet Portal data retrieval system, which is to be test run in 2007. One purpose of this system is to facilitate information co-operation with credit institutions. The Extranet Portal will carry materials provided by the Bank of Russia Banking Regulation and Supervision Department, containing answers to the questions frequently asked by credit institutions. The system is expected to solve the problem of collecting statements from credit institutions using a single software package (in standard formats) and to keep the banking community informed on issues relating to the compiling and submitting of statements electronically.

The Bank of Russia will continue to improve the methodology of assessing the financial stability of the banking sector and the soundness of individual credit institutions, including the regular monitoring of banking risk and stress testing in 2007. Plans are afoot to prepare recommendations for the Bank of Russia regional branches on the regular monitoring of risk and the stress testing of credit institutions on the basis of a survey of international best practice in this area.

III.12.3. On-site inspection

To attain the objectives of the Banking Sector Development Strategy, such as dynamics growth of the banking sector, its stability and the competitiveness of credit institutions and the improving of banking regulation and supervision, the Bank of Russia will focus its attention on the following issues when conducting inspections of credit institutions and their branches in 2007:

— the evaluation of risk assumed by credit institutions, including the mandatory assessment of the internal control and risk management services;
— monitoring compliance by credit institutions and their branches with the requirements of the Federal Law on Countering the Legalisation (Laundering) of Criminally Obtained Incomes and the Financing of Terrorism;
— the verification of the sources of credit institutions' authorised capital, especially for the purpose of detecting the instances or signs of authorised capital formation using improper assets and the conformity of the ownership structure transparency indicators of the banks participating in the deposit insurance system to the established requirements;
— compliance with the requirements of the Federal Law on Insolvency (Bankruptcy) of Credit Institutions in respect of the implementation of the bankruptcy prevention measures (such as making certain that the managers and owners of a credit institution comply with the requirements established by the law and Bank of Russia rules and regulations and fulfil their duties, take timely and efficient financial rehabilitation measures and act in good faith to prevent bankruptcy).

The Bank of Russia is determined to do everything to improve the quality of inspections. First of all, it will increase the significance of pre-inspection preparations in order to cut inspection times, enhance the efficiency of supervision and, which is the most important, substantially improve the quality of inspection assignments. Inspectors will be instructed to fulfil specific supervisory tasks rather than register minor faults of no importance for the bank's soundness.

To improve the quality of inspections and increase the responsibility of inspectors, the Bank of Russia will continue the conduct the retrospective analysis of the inspection reports on the credit institutions that had their banking licences revoked.

In the course of risk-based supervision, considerable efforts will be made to identify the most risky areas of the banking business. As high risk concentrations are registered in consumer lending now, it is especially important to evaluate the level of this risk accurately.

The development of the regulatory framework of inspection will proceed along the following lines:

— the powers of the Bank of Russia to take corrective action on the basis of professional (qualitative) judgement passed by Bank of Russia authorised representatives in the course of inspecting credit institutions and their branches will be established by the law;
— the Bank of Russia will issue regulations to describe the specific inspections of the operations offices of credit institutions and their branches for the purpose of implementing the Bank of Russia concept of the change in the principles of opening structural units by credit institutions and their branches;
— the Bank of Russia will amend its regulations to prohibit Bank of Russia and Deposit Insurance Agency employees who have shares (hold stakes) in credit institutions and/or sit on their managerial bodies from participating in inspections in order to preclude any conflict of interest when conducting inspections of credit institutions;
— the Bank of Russia will draft regulations describing the specific organisation and conduct of the inspections of credit institutions by audit firms at the instruction of the Bank of Russia Board of Directors for the purpose of implementing the Bank of Russia concept of enlisting audit firms to the inspection of credit institutions;
— the Bank of Russia will continue to upgrade the inspection methodologies, including the methods of analysing the financial standing of banks before inspecting them and the methods of inspecting bank specific activities.

In view of the importance of management systems for credit institutions and information technologies, especially from the standpoint of risk and information security, the Bank of Russia will continue to build the regulatory framework for inspection in these areas of banking activities.

The Bank of Russia intends to give more weight to interregional inspections and ensure better co-ordination of actions and plans of inspection divisions and the analysis by the interregional inspectorates of the quality of inspection reports and it will continue to provide methodological, organisational and consultative assistance to its regional branches. At the same time, the interregional inspectorates will oversee more closely the activities of inspection divisions.

To raise the professional standard of the heads and employees of the inspection divisions of its regional branches, the Bank of Russia will continue to provide training courses and hold seminars and annual interregional meetings with the heads of the inspection divisions of the Bank of Russia regional branches to discuss key issues relating to inspection, including ways to enhance the efficiency of inspections of credit institutions and improve the quality of inspection reports.

III.12.4. Financial rehabilitation and liquidation of credit institutions

To fulfil the tasks set out in the Banking Sector Development Strategy, the Bank of Russia will continue to improve:

— the measures taken to prevent insolvency (bankruptcy) of credit institutions, including their financial rehabilitation and the appointment of provisional administrations. One way to improve the insolvency (bankruptcy) prevention procedures will be to create a mechanism that will make it possible to quickly prevent bankruptcy of the banks participating in the deposit insurance system and at the same time carry out a set of measures to increase the responsibility of bank owners and managers;

— the procedures for liquidating credit institutions, including the creating of an efficient asset realization mechanism and making the liquidation procedures more transparent for the purpose of meeting to a fuller extent the claims of creditors and depositors.

The Bank of Russia is to participate in drafting amendments to some laws for the purpose of improving the procedure for disputing transactions that violate the rights and legitimate interests of credit institutions and their creditors and to the bankruptcy law with the objective of regulating the responsibility for making a credit institution bankrupt.

To improve the regulatory framework, the Bank of Russia will complete the drafting of the ordinance on the specific features of conducting settlement operations by a credit institution after the revocation of a banking licence and on the accounts used by a receiver (liquidator and liquidation commission).

This document clarifies the application of the laws and regulations on the liquidation of credit institutions, notably, the use of accounts by receivers, liquidators and liquidation commissions, especially when the powers of the receiver (liquidator) are exercised by the Deposit Insurance Agency. It contains a list of the documents that must be submitted to the Bank of Russia and correspondent credit institutions to confirm the right of the liquidation commission, receiver, liquidator and representative of the Deposit Insurance Agency to conduct operations with correspondent accounts of the liquidated credit institution and sets up the procedure for using accounts by the receiver (liquidator and liquidation commission), including opening and closing of foreign currency accounts in the course of liquidating a credit institution, transferring funds to the creditors of the liquidated credit institution and closing correspondent accounts with the Bank of Russia settlement divisions and with correspondent credit institutions.

The Bank of Russia plans to complete the drafting of the Regulation ‘On Conducting Inspections of the Receivers and Liquidators of Credit Institutions by the Bank of Russia’. A new version of Bank of Russia Regulation No. 132-P, dated January 17, 2001, ‘On Inspections of the Receivers of Bankrupt Credit Institutions and Liquidators by the Bank of Russia’, and Bank of Russia Ordinance No. 904-U, dated January 17, 2001, ‘On the Procedure for Conducting Inspections of the Receivers of Bankrupt Credit Institutions and Liquidators by the Bank of Russia’, this document:

— takes into account the amendments to legislation made by Federal Law No. 121-FZ, dated August 20, 2004, ‘On Amending the Federal Law on Insolvency (Bankruptcy) of Credit Institutions and in Invalidating Some Laws (Provisions of Some Laws) of the Russian Federation’, and Federal Law No. 192-FZ, dated December 29, 2004, ‘On Amending Some Laws of the Russian Federation in Connection with the Passage of the Federal Law on Mortgage Securities’, which stipulate that the Deposit Insurance Agency is the receiver (liquidator) of the credit institutions that had the Bank of Russia licence to take household deposits;

— takes into account the practice of conducting inspections of receivers (liquidators), including the Deposit Insurance Agency, by the Bank of Russia;

— specifies the grounds for conducting inspections by the Bank of Russia, the procedure for conducting these inspections and recording the results of the inspections of credit institutions’ receivers (liquidators);

— provides for a new measure to be taken against the receivers (liquidators) who fail to comply with the regulations on the liquidation of credit institutions, including the liquidation of insolvent (bankrupt) credit institutions, such as the sending of an order to correct the flaws discovered in the course of inspection, and specifies the procedure for using other measures in respect of the violations discovered in the course of inspections.

III.12.5. Countering the legalisation (laundering) of criminally obtained incomes and terrorist financing

To continue carrying out the tasks set out in the Banking Sector Development Strategy, especially the task of creating conditions for the prevention of the use of credit institutions for illegal purposes, such as money laundering and terrorist financing, in 2007 the Bank of Russia will continue to propose amendments to federal laws aimed at lifting restrictions on the inspections of credit institutions conducted for the purpose of ensuring their compliance with the AML/FT laws and establishing the instances in which credit institutions may unilaterally terminate bank account (deposit) agreements without recourse to court proceedings.

Further to upgrade the mechanism used by credit institutions to meet the requirements of the AML/FT laws, the Bank of Russia, taking into account the law enforcement practice and the analysis of credit institution inspection results, will take measures to improve the regulatory framework, especially with a view to optimising the requirements made for credit institutions and develop the methodology of controlling by credit institutions the operations with money or property subject to mandatory control and detecting suspicious operations.

The Bank of Russia will focus its attention, especially when supervising credit institutions, on customer identification, the assessment of money laundering and terrorist financing risk associated with customer operations and the evaluation of the conformity of the internal control rules and programmes to the nature of operations conducted by a credit institution and its customers.

III.12.6. Household bank deposit insurance

The Bank of Russia will continue to draft amendments to the federal laws to upgrade the criteria and methods of monitoring the compliance by the banks that participate in the deposit insurance system with the participation requirements, specify the procedures ensuring the effectuation of payments to depositors and the functions and powers of the Deposit Insurance Agency and enhance the efficiency of the deposit insurance system.

In addition, the Bank of Russia will:

— implement the procedures connected with the examination of banks' requests to expand the range of their operations by obtaining the licence to take household deposits;
— constantly monitor compliance by the banks that participate in the deposit insurance system with the participation requirements set in Article 44 of the Federal Law on the Insurance of Household Deposits with Russian Banks;
— impose pursuant to Article 48 of the Federal Law on the Insurance of Household Deposits with Russian Banks a ban on taking hosehold deposits and opening personal accounts by the banks that have failed to comply with the deposit insurance system requirements for three consecutive months;
— control at the onset of an insured event (the revocation of a banking licence from a bank participating in the deposit insurance system) of the formation by temporary administration of a credit institution, appointed by the Bank of Russia, of the register of obligations to depositors and the delivery of this register to the Deposit Insurance Agency within the seven-day period established by the Federal Law on the Insurance of Household Deposits with Russian Banks for the effectuation of payments to depositors.

Annexes

IV

IV.1. Banking Sector Stability Monitoring System

Pursuant to Federal Law No. 86-FZ, dated July 10, 2002, 'On the Central Bank of the Russian Federation (Bank of Russia)' and in line with the Banking Sector Development Strategy, the Bank of Russia focuses on the development and upgrading of the instruments of analysis for the assessment of financial stability. It is currently test-running the banking sector financial monitoring system composed of three interrelated modules: regular risk monitoring, stress testing and the analysis of financial soundness indicators.

IV.1.1. Regular monitoring

In 2006, the Bank of Russia improved a system of banking risk regular monitoring, which comprises three sub-systems:

— monitoring the risk of lending to non-financial institutions,
— monitoring the risk of lending to households, and
— monitoring liquidity.

In the year under review, it completed the development of the market risk monitoring sub-system and was developing the capital adequacy monitoring sub-system.

Regular monitoring is based on the selection of indicators that are the most sensitive to risk accumulation and determining their threshold values, which, if exceeded, may testify to unfavourable developments in the banking sector and credit institutions. In the course of monitoring in 2006, the Bank of Russia analysed statements of the top 200 banks by assets and from January 1, 2007, all operating banks. For the purposes of this analysis, it divided the banks into the following groups: Moscow-based banks, regional banks and banks controlled by foreign capital.

'Major risk zones' are established within each of the aforementioned monitoring sub-systems, and the analysis of a specific bank includes finding out where the 'major risk zones' determined with the help of the monitoring sub-systems intersect.

The results of the regular risk monitoring were promptly made known to the Bank of Russia regional branches, which conducted a more detailed analysis of the situation in the banks responsible for the negative developments in the banking sector as a whole and took remedial supervisory measures whenever necessary.

Monitoring the risk of lending to non-financial institutions

Credit risk monitoring is based on the computation of the *modified capital adequacy indicator* ($N1_{mod}$), which is calculated as capital reduced by possible losses on loans. When the modified capital adequacy indicator is calculated, the following assumptions are made:

— bad loan losses are assumed to be equal to overdue debt on these loans;
— the capital of a bank is reduced by these losses (overdue debt net of the loss provisions made for loans, loan and similar debts).

The capital thus reduced is used to calculate the corrected capital adequacy indicator.

To detect the banks in which default losses may lead to the reduction of capital adequacy to a dangerously low level ($\leq$11.0%), the analysis of the modified capital adequacy indicator ($N1_{mod}$), including the retrospective analysis, is conducted. The reduction in the $N1_{mod}$ indicator to the level indicated above is considered as a characteristic of a 'major risk zone'[66].

The share of loans to borrowers operating in the sectors that have a bad financial situation in the specific region (Group C) is determined as an additional factor of increased non-financial institution credit risk[67].

Non-financial institution credit risk is monitored on a quarterly basis.

Monitoring the risk of lending to households

The *modified capital adequacy indicator* is also calculated for monitoring the risk of lending to households. It is determined using the actual value of overdue debt on loans to households in the same way as the respective indicator is calculated when monitoring non-financial institution credit risk.

It is assummed that banks whose modified capital adequacy indicator is no more than 11.0% operate in a 'major risk zone'. In addition, an *'increased risk zone'* and a *'near increased risk zone'* are established.

It is assummed that credit institutions whose corrected capital adequacy indicator is no more than 10.0% operate in the *'increased risk zone'* if the following conditions are simultaneously fulfilled: the ratio of household loans to assets is more than 10.0%, while the ratio of overdue debt on these loans to capital is more than 5.0%.

In the same way, the *'near increased risk zone'* is when credit institutions have a modified capital adequacy indicator of no more than 10.5% but higher than 10.0% and the two aforementioned conditions are simultaneously fulfilled.

In addition, attention is focused on the credit institutions that operate outside the risk zones described above but re-

[66] Banks that have an intrinsically low capital adequacy level (if the difference between the actual values of N1 and $N1_{cor}$ as of the last reporting date was no more than 0.2 percentage points) are excluded from the analysis.

[67] Loan classification by region and by sector is based on the results of the analysis conducted on the basis of data obtained by monitoring the financial standing of borrower enterprises. Group C comprises the sectors (activity categories) that have a bad financial situation in the specific region.

port a substantial amount of the corresponding loans and an overdue debt that far surpasses the banking sector average and also on the banks with an overdue debt that is considerably smaller than the banking sector average.

The risk of lending to households is monitored on a quarterly basis.

Liquidity monitoring

Liquidity monitoring is based on the analysis of the following core indicators:

— the ratio of funds placed by banks in correspondent and deposit accounts with the Bank of Russia and in correspondent accounts with credit institutions to assets;
— instant liquidity ratio;
— current liquidity ratio.

To detect the banks in the 'major risk zone,' the Bank of Russia has conducted the zoning of indicators. It determined the threshold value of each indicator for each group of banks on the basis of the retrospective analysis of the top 200 banks by assets. The values thus obtained were corrected based on the retrospective analysis of the liquidity indicators of the banks that had had their licences revoked.

The indicator for the 'major risk zone' is a situation when at least two of the three aforementioned indicators of a bank are below the threshold levels.

The following additional factors are taken into account when detecting the banks that the Bank of Russia regional branches must put to scrutiny:

— the deviation of the current value of each of the three indicators from the latest three-month high;
— the outflow of raised funds[68] as the deviation of the current value from the latest three-month high;
— information about the payment documents that had not been passed during the reporting month (based on data compiled by the settlement system of the Moscow Region).

Liquidity monitoring is conducted on a monthly basis.

Market risk monitoring

Market risk monitoring is conducted for the credit institutions covered by Bank of Russia Regulation No. 89-P, dated September 24, 1999, 'On the Procedure for Calculating Market Risk by Credit Institutions'.

The following indicators are evaluated based on market risk and capital data reported by credit institutions:

— the ratio of possible losses from stock market risk to capital;
— the ratio of possible losses from interest rate risk to capital;
— the ratio of possible losses from currency risk to capital;
— total possible losses from market risk to capital.

Possible losses from the corresponding kind of market risk are the corrected value of stock market, interest rate or currency risk, calculated in compliance with Bank of Russia Regulation No. 89-P, dated September 24, 1999, 'On the Procedure for Calculating Market Risk by Credit Institutions'.

The indicator for the 'major risk zone' is a substantial aggregate amount of possible losses from market risk or a low level of market risk diversification (significant exposure to one kind of risk).

Market risk is monitored on a monthly basis.

IV.1.2. Stress testing methodology

Stress testing of the banking sector is a commonly used internationally accepted method of evaluating financial sector stability. Stress testing is the evaluation of vulnerability of the economy as a whole and its individual sectors (macro-level) or individual market participants (micro-level) to stress caused by a substantial deterioration of the situation. The macro-level stress testing is used to identify individual economic agents that are most susceptible to the analysed risks. For some time now, stress testing, as a method of analysing the risks assumed by credit institutions and the banking sector as a whole, has been used to evaluate ***possible losses*** from ***stressful but unlikely*** developments.

The Bank of Russia conducts stress testing of all operating credit institutions. It calculates and analyses losses for each credit institution on the basis of its official statements, which reflect the specific risk nature and profile and the current financial standing of a credit institution.

The trigger for a stressful situation is the slowing or halting of economic growth, which may be caused by a fall in oil prices. Two stress scenarios — ***baseline*** and ***worst-case*** — are considered. They differ in the force of the shock and, consequently, the extent of the losses sustained by credit institutions (they increase when the baseline scenario evolves into the worst-case one).

Given international practice and the state of the Russian banking sector, the Bank of Russia believed it would be meaningful for stress testing purposes to calculate possible capital losses of Russian credit institutions from exposure to credit, market and liquidity risks.

Possible losses from exposure to ***credit risk*** are calculated as the sum of possible losses from credit risk for loans to non-financial institutions and credit risk for loans to households. The calculation of possible losses from credit risk is made on the assumption that if the economic situation changes for the worse, the share of bad loans[69] in the credit portfolio of the banks, uncovered by loss provisions, increases. These losses are compared with the capital of the credit institutions.

Losses from ***liquidity risk*** may be caused by a run on banks and a sharp rise in deposit claims followed by

[68] For the purposes of monitoring, raised funds are customer (corporate and household) funds, loans, deposits and other funds raised from other banks and the Bank of Russia and the funds in correspondent accounts, except the funds raised by issuing securities.

[69] For the purposes of the stress test, bad loans are problem and loss loans (quality category IV and V loans) in accordance with the classification made in Bank of Russia Regulation No. 254-P, dated March 26, 2004, 'On the Procedure for Making by Credit Institutions Provisions for Possible Losses on Loans, Loan and Similar Debts'.

an outflow of corporate deposits from the banks. To cover the subsequent shortage of liquidity, the banks will have to sell a part of their highly liquid and liquid assets and should these prove insufficient, resort to borrowing on the interbank loan market. In this situation, possible losses result from:

- the depreciation of a part of liquid assets held by credit institutions (the securities trading book, for instance);
- the rise in the borrowing price on the interbank market.

In addition, credit institutions have to keep a certain amount of liquid assets as a reserve to conduct operations (to effect current payments, for example). Therefore, a ‘permanent’ ratio of liquid assets that cannot be used to repay debts to depositors and creditors is established.

Possible losses from ***market risk*** are determined as the sum of possible losses from currency, stock market and interest rate risks. Possible losses from ***currency risk*** are calculated on the assumption that in a crisis the national currency will be devalued and, consequently, credit institutions with short open currency positions (currency liabilities exceeding currency assets) will incur losses. Possible losses from ***stock market risk*** are calculated on the assumption that in a crisis investments in listed stocks in the trading book will depreciate. Possible losses from ***interest rate risk*** are calculated on the assumption that listed corporate debt instruments in the trading book will decrease in value.

Besides the baseline and worst-case scenarios, the Bank of Russia calculates losses connected with the need for additional provisioning due to the devaluation of collateral and losses due to the contagion effect on the interbank market.

The trigger event in the calculation of losses incurred by credit institutions because of the need for ***additional provisioning*** is a fall in real estate prices. Spreading to all sectors of the financial market via economic transmission mechanisms, this event leads to a fall in prices of other assets and as a result, the value of collateral accepted on loans extended by banks is depreciated.

The ***contagion effect is*** calculated on the assumption that in a crisis some banks will default on their interbank loan and correspondent account obligations. It is believed that the failure of any group of banks to honour their commitments to other banks may adversely impact, through the interbank market, financial soundness of other credit institutions.

The calculation is made as follows: credit institutions with substantial losses from credit, market and liquidity risks represent the trigger group. Credit institutions that have extended interbank loans to or have funds in the correspondent accounts with the trigger group form the next group. It is assumed that the sum of interbank claims thus calculated is the sum of the losses incurred by the creditors of the trigger group banks. To evaluate the significance of these losses, the Bank of Russia calculates the ratio of this sum to the capital of the creditor bank. Creditor banks with this ratio below the threshold level are considered at this stage stable enough to cushion the shock (make up for the losses), while other credit institutions will not be able to do so and form the so called first-wave group of credit institutions.

The process described above may continue until the iteration where there is no credit institution left whose sum of claims to all credit institutions that have gone bankrupt before does not exceed the threshold value. The aggregate indicators calculated at all iterations illustrate the economic aspect of the problem of interconnection of the banks, calculated on the basis of the contagion effect.

IV.1.3. IMF co-ordinated compilation exercise for financial soundness indicators

In 2006, the Bank of Russia completed, by and large, its part of the IMF Co-ordinated Compilation Exercise for Financial Soundness Indicators.

In April 2006, it prepared as an interim document and sent to the IMF the updated version of FSI metadata and indicators calculated as of December 31, 2005. The final version of FSI metadata was sent to the IMF in August 2006 and in December the sides reached a final agreement on all documents.

Within the framework of the Exercise, a representative of the Bank of Russia took part in the regional meeting of FSI co-ordinators and compilers, held in Austria in May 2006, at which representatives of the participating countries discussed problems involved in using national reporting data for FSI calculation.

The calculation made by the Bank of Russia under the Exercise[70] comprises:

- all the 12 core FSIs (all of them apply to the banking sector only) and nine of the 13 encouraged banking sector FSIs;
- two financial market liquidity (government securities market) indicators and two encouraged real estate market indicators.

The Bank of Russia intends to continue improving the FSI calculation methodology, especially in connection with the Russian banking sector’s transition to the IFRS. In addition, it is going to extend the list of calculated indicators by enlisting other agencies to the Exercise. In September 2007, a seminar is to be held in Tula with the participation of representatives of the Bank of Russia and other agencies on FSI calculation, and IMF experts will be invited to the event.

According to the IMF Statistics Department, which is responsible for the Exercise, in the middle of 2007 the Exercise implementation report is expected be provided to the IMF Executive Board to enable it to take a decision on further steps to be taken by the IMF on FSIs. The IMF Statistics Department is also to provide the results of the FSI-based analysis conducted by its staff and conclusions on FSI use in the work of the IMF.

[70] FSI data and metadata are available on the IMF website at *http://www.inf.org/external/np/sta/fsi/eng/cce/index.htm.*

IV.2. Banking Sector Clustering

To analyse more profoundly the systemic aspects of banking sector development, banking operations and risk in the course of preparing the corresponding sections of the Banking Supervision Report, the Bank of Russia conducted the clustering of the banking sector into the groups of banks with similar characteristics in terms of ownership, quantitative indicators, business model and regional base. The study of such clusters makes it possible to detect and identify trends, factors and causes of the processes that the analysis of banking sector averages cannot reveal.

Some changes were made in the clustering methodology in 2006.

They affected, above all, the concept of captivity[71]. Although the grouping and analysis of credit institutions based on the captivity concept are quite interesting, it is difficult to identify the characteristics that would unquestionably put a credit institution into the 'captive' category under the existing reporting procedure. Therefore, the current practice of classifying a credit institution as 'captive' contains certain bias elements[72].

In addition, the analysis of credit institutions aggregated into 'captive' ('intra-group') banks and 'diversified' banks in the course of compiling the Banking Supervision Reports 2004 and 2005 failed to reveal any substantial distinctions in their practices that would allow one to speak about really different models of behaviour on the market.

In view of the foregoing, the Bank of Russia used the following clustering methodology.

At the ***first stage,*** it put into a separate group the following credit institutions:

— non-bank credit institutions;

— banks in which more than 50% of authorised capital is owned by the government (government structures, federal and regional government-controlled unitary enterprises and the Russian Federal Property Fund and the Bank of Russia);

— banks with a non-resident interest in their authorised capital of more than 50%, including banks whose non-resident owners are controlled by residents.

At the ***second stage,*** banks from the 200 largest banks by assets were analysed, excluding the banks that have not been included in any of the three groups indicated above. Banks in this group were described as 'large private banks'.

At the ***third stage,*** all other banks not included in the four groups indicated above were considered. These are medium-sized and small banks, which, in turn, were divided into two groups by location: medium-sized and small banks based in Moscow and the Moscow Region and medium-sized and small banks based in other regions.

As a result, all credit institutions were divided into the following six groups:

1. Government-controlled banks.
2. Banks controlled by foreign capital.
3. Large private banks.
4. Medium-sized and small banks based in Moscow and the Moscow Region.
5. Medium-sized and small regional banks.
6. Non-bank credit institutions.

The results of the clustering of the banking sector *(see Table 4.1)* indicate that large private banks took

Performance Indicators of Credit Institutions' Groups*

TABLE 4.1

Credit institutions' groups	Number		% share in aggregate banking sector assets		% share in aggregate banking sector capital	
	1.01.06	1.01.07	1.01.06	1.01.07	1.01.06	1.01.07
Government-controlled banks	32	31	40.7	37.8	33.9	32.4
Foreign-controlled banks	51	64	8.3	12.1	9.2	12.7
Large private banks	158	152	40.9	41.0	42.1	42.3
Medium-sized and small banks based in Moscow and the Moscow Region	463	422	5.3	4.5	9.0	7.0
Medium-sized and small regional banks	501	474	4.3	4.1	5.6	5.4
Non-bank credit institutions	48	46	0.5	0.6	0.2	0.2
TOTAL	1,253	1,189	100	100	100	100

** The criteria for dividing credit institutions into groups and the corresponding indicators are used in this Report for the purposes of analysis only.*

[71] The concept of captivity is derived from the term 'captive bank', which means a subsidiary or dependent bank. A member of a financial-industrial group, a captive bank mostly conducts operations with other members of this financial-industrial group and/or operates mostly in its interests.

[72] For more details, see the Banking Supervision Report 2005 *(IV.3. Banking Sector Clustering).*

leading positions in the banking sector in 2006 (they accounted for 41.0% of aggregate banking sector assets and 42.3% of aggregate capital). Banks controlled by foreign capital increased their influence in 2006 (as of January 1, 2007, they accounted for 12.1% of banking sector assets and 12.7% of capital), whereas government-controlled banks lost some weight (they accounted for 37.8% of banking sectors assets and 32.4% of capital).

The largest group of banks, medium-sized and small banks based in Moscow and the Moscow Region and medium-sized and small regional banks, accounted for a small part of banking sector assets and capital, which decreased in 2006.

IV.3. Results of Polling Credit Institutions on Stress Testing Conducted in 2007

Banks increasingly practise stress testing. The results of the Bank of Russia poll of 196 credit institutions on stress testing, conducted in 2007, revealed favourable dynamics in this area: most of the banks (81% of those polled) conducted stress tests (as against 78% in 2005). Several credit institutions, which do not conduct stress tests, are now taking a series of measures to adopt stress testing. More than 90% of the banks polled used the Bank of Russia recommendations when conducting stress tests[73].

In the course of stress testing, 96% of banks evaluated liquidity risk, 89% credit risk and 86% market risk (the respective percentages in 2005 were 92%, 84% and 82%). As in 2005, every other credit institution conducting stress tests evaluated operational risk.

When determining the importance of risks, most of the credit institutions polled put credit risk in first place, liquidity risk in second and market risk in third.

Seventy-three percent of credit institutions wrote down the duty and procedure to conduct stress tests in their internal documents. In all credit institutions conducting stress tests, their results are made known to management and in 99% of credit institutions stress test results are taken into account when developing (adjusting) the risk management policy.

[73] These recommendations are available on the Bank of Russia website at *www.cbr.ru/analytics/bank_system/print.asp?file=stress.htm.*

IV.4. Developing the Central Catalogue of Credit Histories

As the implementation of Federal Law No. 218-FZ, dated December 30, 2004, 'On Credit Histories' continues, the lending market expands and credit institutions increasingly use credit reports, the database of the Central Catalogue of Credit Histories (CCCH) is to grow in volume in 2007.

To improve the regulatory framework of co-operation between the CCCH and credit history makers, in 2007 the Bank of Russia is to enforce the Ordinance 'On the Procedure for Filing Requests and Receiving Information from the Central Catalogue of Credit Histories by Credit History Makers by Applying to Post Offices'.

In addition, it will continue to agree with federal government agencies the draft Ordinance 'On the Procedure for Filing Requests and Receiving Information from the Central Catalogue of Credit Histories by Credit History Makers and Users by Applying through a Notary'.

To establish the procedure for storing, delivering and destroying the credit histories of liquidated credit bureaux (credit bureaux struck off the state register), the Bank of Russia is to complete the drafting of the Ordinance 'On Storing Credit Bureau Databases in the Central Catalogue of Credit Histories'.

To clarify the relationships between credit institutions and the CCCH, the Bank of Russia, building upon the experience gained in 2006, will issue a letter that will explain the most difficult technical aspects of the work of the Bank of Russia's regional branches and credit institutions with the Central Catalogue of Credit Histories automated system.

In 2007, the Bank of Russia is to participate in discussing amendments to the Federal Law on Credit Histories for the purposes of improving it and ensuring more efficient co-operation between credit history makers and users and between credit bureaux and the CCCH.

The Bank of Russia also intends to continue upgrading the CCCH automated system in order to make it more efficient and review the procedures for overseeing its operation. In addition, it is to extend the list of data that characterise the performance of the CCCH.

IV.5. Statistical Appendix

Key macroeconomic indicators in 2002—2006

TABLE 1

Indicator	2002	2003	2004	2005	2006
GDP (in market prices), billion rubles	10,830.5	13,243.2	17,048.1	21,620.1	26,781.1
as % of previous year	104.7	107.3	107.2	106.4	106.7
Federal budget surplus, as % of GDP	1.4	1.7	4.3	7.5	7.4
Industrial output, as % of previous year	103.1	108.9	108.3	104.0	103.9
Agricultural output, as % of previous year	101.5	101.3	103.0	102.4	102.8
Retail trade turnover, as % of previous year	109.3	108.8	113.3	112.8	113.9
Fixed capital investment, as % of previous year	102.8	112.5	113.7	110.9	113.7
Household real disposable income, as % of previous year	111.1	115.0	110.4	111.1	110.2
Unemployment rate, as % of economically active population (average for period)	8.0	8.6	8.2	7.6	7.2
Consumer price index (December as % of December of previous year)	115.1	112.0	111.7	110.9	109.0
Average nominal rate of the US dollar against the ruble for period, rubles to the dollar	31.35	30.68	28.81	28.28	27.18

Russian banking sector macroeconomic indicators

TABLE 2

Indicator	1.01.02	1.01.03	1.01.04	1.01.05	1.01.06	1.01.07
Banking sector assets (liabilities), billion rubles	3,159.7	4,145.3	5,600.7	7,136.9	9,750.3	14,045.6
as % of GDP	35.3	38.3	42.3	41.9	45.1	52.4
Banking sector own funds (capital), billion rubles	453.9	581.3	814.9	946.6	1,241.8	1,692.7
as % of GDP	5.1	5.4	6.2	5.6	5.8	6.3
as % of banking sector assets	14.4	14.0	14.6	13.3	12.7	12.1
Loans and other funds provided to resident non-financial institutions and households, including overdue debt, billion rubles	1,323.6	1,796.2	2,684.7	3,887.6	5,454.0	8,031.4
as % of GDP	14.8	16.6	20.3	22.8	25.2	30.0
as % of banking sector assets	41.9	43.3	47.9	54.5	55.9	57.2
Securities acquired by banks, billion rubles	562.0	779.9	1,002.2	1,086.9	1,539.4	1,961.4
as % of GDP	6.3	7.2	7.6	6.4	7.1	7.3
as % of banking sector assets	17.8	18.8	17.9	15.2	15.8	14.0
Household deposits, billion rubles	678.0	1,029.7	1,517.8	1,977.2	2,754.6	3,793.5
as % of GDP	7.6	9.5	11.5	11.6	12.7	14.3
as % of banking sector liabilities	21.5	24.8	27.1	27.7	28.3	27.0
as % of household income	12.7	15.1	17.1	18.0	20.4	22.5
Funds raised from organisations, billion rubles*	902.6	1,091.4	1,384.8	1,986.1	2,953.1	4,570.9
as % of GDP	10.1	10.1	10.5	11.7	13.7	17.1
as % of banking sector liabilities	28.6	26.3	24.7	27.8	30.3	32.5

** Including 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 customer accounts but not from a credit institution's correspondent account (excluding funds raised from credit institutions).*

Data on the registration and licensing of credit institutions*

TABLE 3

		1.01.06	1.01.07
	Registration of credit institutions		
1.	No. of credit institutions[1] registered by the Bank of Russia or by the Registration Authority pursuant to the Bank of Russia decision, total[2]	1,409	1,345
	of which:		
	— banks	1,356	1,293
	— non-bank credit institutions	53	52
1.1.	Registered wholly foreign-owned credit institutions	42	52
1.2.	Credit institutions that have been registered by the Bank of Russia but have not yet paid up authorised capital and have not received a licence (within the period established by law)	2	1
	of which:		
	— banks	2	1
	— non-bank credit institutions	0	0
2.	Non-bank credit institutions registered by other bodies before July 1, 2002	0	0
	Operating credit institutions		
3.	Credit institutions licensed to conduct banking operations, total[3]	1,253	1,189
	of which:		
	— banks	1,205	1,143
	— non-bank credit institutions	48	46
3.1.	Credit institutions holding licences (permits):		
	— to take household deposits	1,045	921
	— to conduct operations in foreign currency	827	803
	— general licences	301	287
	— to conduct operations with precious metals		
	— permits	4	4
	— licences[4]	180	188
3.2.	Credit institutions with foreign stakes in authorised capital, total	136	153
	of which:		
	— wholly foreign-owned credit institutions	41	52
	— credit institutions with a 50%-plus foreign stake	11	13
3.3.	Credit institutions registered as participants in the deposit insurance system	930	924
4.	Registered authorised capital of operating credit institutions, million rubles	444,377	566,513
5.	Branches of operating credit institutions in Russia, total	3,295	3,281
	of which:		
	— Sberbank branches[5]	1,009	859
	— branches of wholly foreign-owned credit institutions	29	90
6.	Branches of operating credit institutions abroad, total[6]	3	2
7.	Branches of non-resident banks in Russia	0	0
8.	Representative offices of operating Russian credit institutions, total[7]	467	699
	of which:		
	— in Russia	422	657
	— in non-CIS countries	31	29
	— in CIS countries	14	13
9.	Additional offices of credit institutions, total	11,368	15,007
	of which:		
	— Sberbank additional offices	5,564	7,282
10.	Cash departments, total	17,662	15,885
	of which:		
	— Sberbank cash departments	13,841	11,983
11.	Cash and credit offices, total	604	996
	of which:		
	— Sberbank cash and credit offices	1	0

** Including data provided by the Registration Authority as of the reporting date.*

END

	1.01.06	1.01.07
Licence revocation and liquidation of corporate entities		
12. Credit institutions which had their banking licence revoked (cancelled) but were not struck off the State Register[8]	154	155
13. Liquidated credit institutions struck off the State Register, total[9]	1,687	1,758
of which:		
— due to licence revocation (cancellation)	1,305	1,366
— due to reorganisation	381	391
of which:		
— by merger	0	2
— by acquisition	381	389
of which:		
— by being transformed into other banks' branches	337	341
— by being merged with other banks (without establishing a branch)	44	48
— due to an infraction of the law in respect to the payment of authorised capital	1	1

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

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

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

[4] Issued since December 1996 pursuant to Bank of Russia Letter No. 367, dated December 3, 1996.

[5] Sberbank branches put on the State Register of Credit Institutions and assigned serial numbers.

[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 has been notified.

[8] Total number of credit institutions whose banking licences were revoked (annulled) by the Bank of Russia, including credit institutions struck off the State Register, rose from 1,469 as of January 1, 2006, to 1,532 as of January 1, 2007.

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

Operating credit institutions by organisational and legal form structure

TABLE 4

Title	1.01.06		1.01.07	
	Number	% share	Number	% share
Operating credit institutions with licences to conduct banking operations, total	**1,253**	**100.00**	**1,189**	**100.00**
of which:				
— joint-stock companies	799	63.77	772	64.93
— close-end joint-stock companies	330	26.34	319	26.83
— open-end joint-stock companies	469	37.43	453	38.10
— unit trusts	454	36.23	417	35.07
— additional liability companies	—	—	—	—
— limited liability companies	454	36.23	417	35.07

Credit institutions grouped by registered authorised capital as of January 1, 2007

TABLE 5

	Up to 3m rubles	3m to 10m rubles	10m to 30m rubles	30m to 60m rubles	60m to 150m rubles	150m to 300m rubles	300m rubles and over	Total
1	2	3	4	5	6	7	8	9
Russian Federation	**43**	**87**	**168**	**182**	**226**	**217**	**266**	**1,189**
Central Federal District	**13**	**30**	**66**	**96**	**115**	**152**	**201**	**673**
Belgorod Region	0	1	0	2	0	3	0	6
Bryansk Region	0	0	0	1	0	0	0	1
Vladimir Region	0	0	0	1	1	1	0	3
Voronezh Region	0	0	0	1	2	0	1	4
Ivanovo Region	1	0	1	0	3	0	0	5
Kaluga Region	0	0	0	0	3	1	1	5
Kostroma Region	0	0	1	2	0	0	1	4
Kursk Region	0	0	1	0	1	0	0	2
Lipetsk Region	0	0	0	0	0	1	1	2
Orel Region	0	0	0	1	1	0	0	2
Ryazan Region	0	1	0	3	0	0	0	4
Smolensk Region	0	2	0	0	0	1	1	4
Tambov Region	0	0	1	0	1	0	0	2
Tver Region	2	2	1	1	0	1	0	7
Tula Region	0	1	1	2	2	0	0	6
Yaroslavl Region	0	0	2	4	2	1	0	9
Moscow Region (for the record)	*10*	*23*	*58*	*78*	*99*	*143*	*196*	*607*
Moscow	10	22	57	75	97	141	191	593
Moscow Region	0	1	1	3	2	2	5	14
North-Western Federal District	**5**	**10**	**18**	**13**	**14**	**9**	**11**	**80**
Republic of Karelia	0	0	0	0	1	0	0	1
Komi Republic	0	0	2	1	0	0	0	3
Arkhangelsk Region	0	2	0	1	0	0	0	3
of which: Nenets Autonomous Area	0	0	0	0	0	0	0	0
Vologda Region	0	0	4	1	2	0	1	8
Kaliningrad Region	0	0	1	3	4	1	2	11
Leningrad Region	0	0	2	0	0	1	0	3
Murmansk Region	1	0	1	0	0	2	0	4
Novgorod Region	0	1	0	0	0	1	0	2
Pskov Region	0	2	0	0	1	0	0	3
St Petersburg	4	5	8	7	6	4	8	42
Southern Federal District	**15**	**32**	**25**	**16**	**22**	**11**	**3**	**124**
Republic of Adygeya	1	4	0	0	0	0	0	5
Republic of Daghestan	8	12	9	3	3	1	0	36
Republic of Ingushetia	0	2	0	0	0	0	0	2
Kabardino-Balkar Republic	1	1	2	1	1	0	0	6
Republic of Kalmykia	0	0	0	0	2	0	0	2
Karachai-Cherkess Republic	1	1	3	0	0	0	0	5
Republic of North Ossetia — Alania	0	1	2	0	2	1	0	6
Chechen Republic	0	0	0	0	0	0	0	0
Krasnodar Territory	0	2	5	2	6	2	1	18
Stavropol Territory	1	5	0	3	0	0	0	9
Astrakhan Region	0	4	0	0	0	1	0	5
Volgograd Region	0	0	1	2	1	2	0	6
Rostov Region	3	0	3	5	7	4	2	24

END

	Up to 3m rubles	3m to 10m rubles	10m to 30m rubles	30m to 60m rubles	60m to 150m rubles	150m to 300m rubles	300m rubles and over	Total
1	2	3	4	5	6	7	8	9
Volga Federal District	**5**	**4**	**17**	**20**	**41**	**22**	**30**	**139**
Republic of Bashkortostan	0	0	2	0	4	4	1	11
Republic of Marii El	0	0	1	0	0	0	0	1
Republic of Mordovia	0	0	0	0	2	1	0	3
Republic of Tatarstan	1	0	2	1	7	4	11	26
Udmurt Republic	0	1	2	1	3	0	2	9
Chuvash Republic	1	0	0	2	1	1	0	5
Kirov Region	0	0	1	0	0	1	1	3
Nizhny Novgorod Region	1	1	1	4	6	3	3	19
Orenburg Region	0	0	2	3	0	2	2	9
Penza Region	0	0	0	0	1	0	1	2
Perm Region	1	0	2	1	2	0	3	9
Samara Region	1	1	2	1	8	4	5	22
Saratov Region	0	1	1	3	7	2	1	15
Ulyanovsk Region	0	0	1	4	0	0	0	5
Ural Federal District	**2**	**2**	**12**	**11**	**14**	**8**	**16**	**65**
Kurgan Region	0	1	2	1	1	0	0	5
Sverdlovsk Region	2	1	3	3	5	4	7	25
Tyumen Region	0	0	5	5	5	2	6	23
of which: Khanty-Mansi Autonomous Area — Yugra	0	0	1	3	2	2	4	12
Yamalo-Nenets Autonomous Area	0	0	3	1	0	0	0	4
Chelyabinsk Region	0	0	2	2	3	2	3	12
Siberian Federal District	**2**	**6**	**19**	**15**	**13**	**9**	**4**	**68**
Republic of Altai	0	0	3	2	0	0	0	5
Republic of Buryatiya	0	0	0	0	0	1	0	1
Republic of Tyva	0	1	0	1	0	0	0	2
Republic of Khakassia	0	1	0	0	1	1	0	3
Altai Territory	0	1	2	2	2	0	1	8
Krasnoyarsk Territory	0	0	1	1	1	2	0	5
Irkutsk Region	0	0	1	5	2	1	0	9
of which: Ust-Orda Autonomous Area	0	0	0	0	0	0	0	0
Kemerovo Region	0	1	2	1	2	1	1	8
Novosibirsk Region	2	1	6	0	3	1	1	14
Omsk Region	0	1	2	1	1	1	1	7
Tomsk Region	0	0	1	1	1	1	0	4
Chita Region	0	0	1	1	0	0	0	2
of which: Agin-Buryat Autonomous Area	0	0	0	0	0	0	0	0
Far Eastern Federal District	**1**	**3**	**11**	**11**	**7**	**6**	**1**	**40**
Republic of Sakha (Yakutia)	0	1	1	2	1	1	0	6
Primorskiy Territory	1	1	3	0	3	1	0	9
Khabarovsk Territory	0	0	2	2	0	0	1	5
Amur Region	0	1	0	2	0	2	0	5
Kamchatka Region	0	0	4	2	1	0	0	7
of which: Koryak Autonomous Area	0	0	1	0	0	0	0	1
Magadan Region	0	0	0	1	0	1	0	2
Sakhalin Region	0	0	1	2	2	1	0	6
Jewish Autonomous Region	0	0	0	0	0	0	0	0
Chukotka Autonomous Area	0	0	0	0	0	0	0	0

Provision of Russian regions with banking services as of January 1, 2006*

TABLE 6.1

Region	No. of credit institutions, branches and additional offices	Net assets, million rubles	Loans to resident institutions and households, million rubles*	Household deposits, million rubles	Gross Regional Product for 2005, billion rubles (estimate)	Population, thousand (estimate)	Average monthly per capita money income in 2005, rubles	Institutional density of banking services (by population)	Financial density of banking services (by assets)	Financial density of 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
Central Federal District	**5,150**	**6,733,750**	**2,675,359**	**1,331,455**	**5,815**	**37,356**	**10,913**	**1.24**	**2.13**	**1.58**	**1.32**	**1.53**
For the record: Central Federal District without Moscow	*2,221*	*634,012*	*770,219*	*350,581*	*2,317*	*26,931*	*5,504*	*0.74*	*0.50*	*1.14*	*1.00*	*0.81*
Belgorod Region	119	45,960	59,875	20,725	143	1,511	5,279	0.71	0.59	1.44	1.05	0.89
Bryansk Region	76	17,096	18,546	10,626	70	1,331	4,742	0.51	0.45	0.91	0.68	0.62
Vladimir Region	108	26,381	25,456	17,739	95	1,473	4,000	0.66	0.51	0.92	1.22	0.78
Voronezh Region	130	56,758	46,839	31,374	148	2,314	5,039	0.50	0.70	1.09	1.09	0.81
Ivanovo Region	82	15,724	11,615	10,054	55	1,100	3,281	0.67	0.53	0.73	1.13	0.73
Kaluga Region	100	21,147	17,344	12,989	82	1,014	5,333	0,88	0.47	0.73	0.97	0.74
Kostroma Region	67	10,867	10,749	6,970	49	709	4,657	0.85	0.41	0.76	0.85	0.69
Kursk Region	114	34,525	37,223	11,290	105	1,184	5,113	0.86	0.60	1.22	0.75	0.83
Lipetsk Region	79	31,995	29,923	13,778	182	1,181	5,511	0.60	0.32	0.57	0.86	0.55
Moscow Region	619	209,704	328,613	115,862	696	6,628	7,200	0.84	0.55	1.63	0.98	0.93
Orel Region	73	12,714	25,541	7,812	65	834	4,668	0.79	0.36	1.34	0.81	0.74
Ryazan Region	90	23,159	21,771	14,033	101	1,182	4,641	0.68	0.42	0.74	1.04	0.68
Smolensk Region	80	20,869	22,049	11,176	73	1,006	5,364	0.71	0.53	1.04	0.84	0.76
Tambov Region	91	16,866	16,674	9,204	76	1,130	5,144	0.72	0.41	0.75	0.64	0.61
Tver Region	102	19,768	19,688	12,407	111	1,407	5,448	0.65	0.33	0.61	0.66	0.54
Tula Region	172	32,454	29,621	19,806	112	1,600	4,816	0.96	0.54	0.91	1.04	0.84
Yaroslavl Region	119	38,024	48,692	24,737	154	1,328	5,907	0.80	0.45	1.09	1.28	0.84
Moscow	2,929	6,099,738	1,905,140	980,874	3,498	10,425	24,886	2.52	3.21	1.87	1.53	2.19
North-Western Federal District	**1,876**	**744,532**	**522,352**	**307,961**	**1,871**	**13,628**	**8,381**	**1.23**	**0.73**	**0.96**	**1.09**	**0.99**
Republic of Karelia	80	13,198	17,960	7,810	71	698	6,720	1.03	0.34	0.87	0.67	0.67
Komi Republic	104	27,913	22,257	18,687	179	985	10,915	0.95	0.29	0.43	0.70	0.53
Arkhangelsk Region	115	27,188	37,334	16,476	195	1,291	7,584	0.80	0.26	0.66	0.68	0.55
Vologda Region	123	45,819	45,667	19,465	208	1,235	6,486	0.89	0.41	0.76	0.98	0.72
Kaliningrad Region	146	31,585	31,812	16,592	83	940	6,282	1.39	0.70	1.32	1.14	1.10
Leningrad Region	225	27,943	31,958	17,784	221	1,644	4,854	1.23	0.23	0.50	0.90	0.60
Murmansk Region	138	28,039	21,981	19,481	150	865	9,295	1.43	0.34	0.50	0.98	0.70
Novgorod Region	111	9,884	11,183	6,224	60	665	5,086	1.50	0.30	0.64	0.74	0.68
Pskov Region	85	8,876	6,536	5,714	46	725	4,852	1.05	0.35	0.49	0.66	0.59
St Petersburg	749	524,087	295,664	179,730	658	4,581	11,385	1.47	1.47	1.55	1.39	1.47

CONT.

1	2	3	4	5	6	7	8	9	10	11	12	13
Southern Federal District	**2,007**	**357,309**	**332,946**	**187,289**	**1,376**	**22,790**	**4,979**	**0.79**	**0.48**	**0.83**	**0.67**	**0.68**
Republic of Adygeya	41	3,275	3,257	2,257	17	443	3,759	0.83	0.36	0.66	0.55	0.57
Republic of Daghestan	171	9,128	5,289	2,560	96	2,641	4,725	0.58	0.17	0.19	0.08	0.20
Republic of Ingushetia	7	1,049	378	634	8	487	2,457	0.13	0.25	0.17	0.21	0.19
Kabardino-Balkar Republic	62	6,146	5,103	3,409	41	894	4,015	0.62	0.28	0.43	0.38	0.41
Republic of Kalmykia	32	2,256	4,804	744	14	289	2,333	0.99	0.29	1.15	0.45	0.62
Karachai-Cherkess Republic	41	3,637	13,722	1,421	18	431	4,188	0.85	0.36	2.57	0.32	0.71
Republic of North Ossetia — Alania	54	8,275	5,422	5,417	32	702	5,241	0.69	0.47	0.58	0.60	0.58
Krasnodar Territory	501	109,367	107,740	65,160	413	5,097	5,359	0.88	0.49	0.90	0.97	0.78
Stavropol Territory	420	47,979	41,852	27,651	168	2,710	5,119	1.39	0.52	0.86	0.81	0.84
Astrakhan Region	71	18,758	13,584	10,350	79	994	5,443	0.64	0.44	0.59	0.77	0.60
Volgograd Region	167	47,051	42,939	26,125	205	2,636	5,625	0.57	0.42	0.72	0.71	0.59
Rostov Region	427	98,827	88,431	41,087	284	4,304	6,262	0.89	0.64	1.07	0.62	0.78
Volga Federal District	**2,592**	**921,703**	**774,137**	**383,299**	**3,062**	**30,511**	**5,976**	**0.76**	**0.55**	**0.87**	**0.85**	**0.75**
Republic of Bashkortostan	399	112,102	86,381	41,168	427	4,063	6,490	0.88	0.48	0.70	0.63	0.66
Republic of Marii El	46	8,022	6,391	4,143	38	712	3,216	0.58	0.38	0.57	0.73	0.55
Republic of Mordovia	92	15,102	12,293	6,175	66	857	3,998	0.96	0.42	0.64	0.73	0.66
Republic of Tatarstan	371	198,970	147,525	57,628	521	3,762	6,997	0.88	0.70	0.97	0.89	0.86
Udmurt Republic	138	43,742	39,814	15,638	136	1,544	4,462	0.80	0.59	1.01	0.92	0.81
Chuvash Republic	78	19,801	20,583	9,930	79	1,292	3,963	0.54	0.46	0.90	0.78	0.65
Kirov Region	107	22,787	20,957	12,461	93	1,443	4,453	0.67	0.45	0.77	0.78	0.65
Nizhny Novgorod Region	311	114,980	104,091	54,970	336	3,411	5,969	0.82	0.63	1.07	1.09	0.88
Orenburg Region	161	48,887	55,776	20,585	223	2,138	4,932	0.68	0.40	0.86	0.79	0.66
Penza Region	84	19,249	17,240	12,383	79	1,408	4,103	0.54	0.45	0.75	0.87	0.63
Perm Region	250	84,281	78,432	38,414	340	2,748	7,803	0.82	0.46	0.79	0.72	0.68
Samara Region	284	159,564	122,787	68,589	443	3,189	9,057	0.80	0.66	0.95	0.96	0.84
Saratov Region	177	54,619	40,769	29,837	194	2,608	4,827	0.61	0.52	0.72	0.96	0.68
Ulyanovsk Region	94	19,597	21,098	11,378	86	1,336	4,426	0.63	0.42	0.84	0.78	0.64
Ural Federal District	**1,546**	**587,388**	**412,319**	**223,258**	**3,314**	**12,244**	**9,128**	**1.13**	**0.33**	**0.43**	**0.81**	**0.60**
Kurgan Region	80	10,016	12,184	5,324	57	980	4,520	0.73	0.32	0.74	0.49	0.54
Sverdlovsk Region	588	200,559	172,415	73,436	465	4,410	8,360	1.20	0.79	1.28	0.81	0.99
Tyumen Region	478	283,333	140,083	102,128	2,407	3,323	14,337	1.29	0.22	0.20	0.87	0.47
Chelyabinsk Region	400	93,480	87,636	42,369	386	3,531	6,463	1.02	0.45	0.78	0.75	0.72

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Siberian Federal District	**1,895**	**485,803**	**481,320**	**211,004**	**2,148**	**19,676**	**6,525**	**0.86**	**0.42**	**0.77**	**0.66**	**0.66**
Republic of Altai	22	2,578	10,305	814	12	204	4,364	0.97	0.41	3.07	0.37	0.82
Republic of Buryatiya	128	16,554	16,453	5,967	82	963	5,765	1.19	0.37	0.69	0.43	0.60
Republic of Tyva	21	1,586	1,481	765	12	308	4,010	0.61	0.24	0.41	0.25	0.35
Republic of Khakassia	55	8,379	22,304	3,460	43	538	4,914	0.92	0.36	1.78	0.53	0.75
Altai Territory	235	53,906	48,936	18,975	142	2,543	4,472	0.83	0.70	1.19	0.68	0.83
Krasnoyarsk Territory	300	80,042	76,852	37,086	482	2,906	7,550	0.93	0.31	0.55	0.68	0.57
Irkutsk Region	262	54,481	61,799	29,181	266	2,527	7,030	0.93	0.38	0.80	0.66	0.66
Kemerovo Region	206	69,176	72,263	33,653	323	2,839	7,680	0.65	0.39	0.77	0.62	0.59
Novosibirsk Region	291	101,037	76,805	35,790	254	2,650	6,234	0.99	0.73	1.04	0.88	0.90
Omsk Region	147	54,338	48,835	22,788	265	2,035	6,922	0.65	0.38	0.63	0.65	0.56
Tomsk Region	115	30,511	29,149	14,880	186	1,034	7,935	1.00	0.30	0.54	0.73	0.59
Chita Region	113	13,215	16,138	7,645	81	1,128	5,653	0.90	0.30	0.69	0.49	0.55
Far Eastern Federal District	**848**	**199,834**	**163,549**	**108,310**	**868**	**6,547**	**8,545**	**1.16**	**0.42**	**0.65**	**0.78**	**0.71**
Republic of Sakha (Yakutia)	105	26,523	26,394	14,434	208	950	10,750	0.99	0.23	0.44	0.57	0.49
Primorskiy Territory	242	48,175	35,639	27,290	187	2,020	7,007	1.07	0.47	0.66	0.78	0.72
Khabarovsk Territory	173	56,725	51,214	29,673	171	1,412	9,070	1.10	0.61	1.03	0.94	0.90
Amur Region	115	18,350	16,587	7,735	84	881	6,084	1.17	0.40	0.68	0.58	0.66
Kamchatka Region	74	12,981	10,177	8,208	42	349	9,614	1.90	0.57	0.83	0.99	0.97
Magadan Region	42	10,975	6,781	5,093	30	172	10,783	2.20	0.67	0.78	1.11	1.06
Sakhalin Region	67	21,090	10,090	12,560	112	526	12,137	1.14	0.35	0.31	0.80	0.56
Jewish Autonomous Region	13	1,915	1,594	1,369	15	187	6,226	0.63	0.24	0.38	0.48	0.41
Chukchee Autonomous Area	17	3,100	5,072	1,947	19	51	12,997	3.02	0.30	0.91	1.20	1.00
Total**	**15,914**	**10,030,318**	**5,361,982**	**2,752,575**	**18,454**	**142,754**	**7,802**	**1.00**	**1.00**	**1.00**	**1.00**	**1.00**

** Based on credit institutons' statements on 0409302 form, which take into account the borrower's residence (in similar Table of the 2005 Banking Supervision Report the value of loans is based on 0409101 form statements by head offices and branches of credit institutons).*
*** Similar Table of the 2005 Banking Supervision Report did not include data for Moscow and the Moscow Region. The change in the calculation base led to the change in absolute figures in columns 9 to 13.*

Provision of Russian regions with banking services as of January 1, 2007

TABLE 6.2

Region	No. of credit institutions, branches and additional offices	Net assets, million rubles	Loans to resident institutions and households, million rubles	Household deposits, million rubles	Gross Regional Product for 2006, billion rubles (estimate)	Population, thousand	Average monthly per capita money income in 2006, rubles	Institutional density of banking services (by population)	Financial density of banking services (by assets)	Financial density of banking services (by value of loans)	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
Central Federal District	**5,887**	**9,775,446**	**3,711,630**	**1,857,630**	**7,162**	**37,211**	**13,834**	**1.16**	**2.12**	**1.50**	**1.34**	**1.49**
For the record: Central Federal District without Moscow	*2,656*	*931,029*	*1,152,496*	*487,086*	*2,854*	*26,768*	*7,379*	*0.72*	*0.51*	*1.17*	*1.00*	*0.81*
Belgorod Region	134	72,452	139,980	27,262	177	1,513	6,749	0.65	0.64	2.29	0.99	0.98
Bryansk Region	82	24,799	27,310	14,783	88	1,318	6,033	0.45	0.45	0.92	0.69	0.60
Vladimir Region	144	37,573	39,827	24,816	117	1,460	5,034	0.72	0.50	0.99	1.26	0.82
Voronezh Region	165	80,161	66,456	42,130	183	2,293	6,814	0.53	0.68	1.05	1.00	0.78
Ivanovo Region	97	22,318	19,593	14,166	68	1,088	4,310	0.65	0.51	0.84	1.12	0.75
Kaluga Region	116	38,541	27,854	18,688	101	1,008	6,888	0.84	0.59	0.80	1.00	0.79
Kostroma Region	80	16,448	17,680	9,783	60	702	5,594	0.83	0.43	0.86	0.93	0.73
Kursk Region	135	49,409	51,803	15,379	130	1,171	6,499	0.84	0.59	1.15	0.75	0.81
Lipetsk Region	92	50,795	56,399	19,077	224	1,174	7,634	0.57	0.35	0.73	0.79	0.58
Moscow Region	752	290,989	439,136	166,126	857	6,643	10,437	0.83	0.53	1.48	0.89	0.87
Orel Region	87	18,208	30,093	11,127	81	827	5,591	0.77	0.35	1.08	0.90	0.71
Ryazan Region	106	34,404	33,882	18,729	125	1,172	5,796	0.66	0.43	0.78	1.03	0.69
Smolensk Region	102	30,458	31,548	15,175	90	993	6,424	0.75	0.53	1.02	0.88	0.77
Tambov Region	96	22,024	27,643	12,566	94	1,117	6,499	0.63	0.36	0.85	0.64	0.59
Tver Region	124	34,207	30,350	18,216	137	1,390	7,048	0.65	0.39	0.64	0.69	0.58
Tula Region	189	53,314	45,614	26,428	137	1,581	6,156	0.87	0.60	0.96	1.01	0.85
Yaroslavl Region	155	54,926	67,327	32,635	189	1,320	7,839	0.86	0.45	1.03	1.17	0.83
Moscow	3,231	8,844,417	2,559,133	1,370,544	4,308	10,443	30,382	2.26	3.19	1.72	1.61	2.11
North-Western Federal District	**2,224**	**1,083,529**	**802,471**	**424,703**	**2,304**	**13,549**	**10,685**	**1.20**	**0.73**	**1.01**	**1.09**	**0.99**
Republic of Karelia	114	18,495	23,582	11,382	87	693	8,200	1.20	0.33	0.78	0.75	0.69
Komi Republic	120	36,624	35,771	23,588	220	975	12,903	0.90	0.26	0.47	0.70	0.53
Arkhangelsk Region	125	43,863	52,640	22,446	240	1,280	9,267	0.71	0.28	0.63	0.70	0.55
Vologda Region	142	61,251	62,787	26,965	256	1,228	8,303	0.84	0.37	0.71	0.98	0.68
Kaliningrad Region	162	50,079	49,598	23,288	102	937	8,552	1.26	0.76	1.40	1.08	1.10
Leningrad Region	262	36,613	58,413	24,409	272	1,637	8,147	1.17	0.21	0.62	0.68	0.57
Murmansk Region	158	35,766	33,096	24,518	185	857	12,038	1.35	0.30	0.52	0.88	0.66
Novgorod Region	129	15,010	18,212	8,221	74	658	6,911	1.43	0.32	0.72	0.67	0.68
Pskov Region	119	12,020	10,940	7,687	57	713	6,218	1.22	0.33	0.55	0.64	0.61
St Petersburg	893	773,810	457,430	252,198	810	4,571	13,960	1.43	1.48	1.63	1.47	1.50

CONT.

1	2	3	4	5	6	7	8	9	10	11	12	13
Southern Federal District	**2,882**	**544,349**	**548,926**	**257,655**	**1,695**	**22,771**	**6,479**	**0.92**	**0.50**	**0.94**	**0.65**	**0.73**
Republic of Adygeya	58	5,117	6,562	3,089	21	441	4,519	0.96	0.38	0.91	0.58	0.66
Republic of Daghestan	194	13,168	7,834	4,261	119	2,658	7,167	0.53	0.17	0.19	0.08	0.20
Republic of Ingushetia	7	1,654	1,107	562	9	493	2,996	0.10	0.27	0.34	0.14	0.19
Kabardino-Balkar Republic	73	10,742	9,529	4,861	50	891	4,989	0.60	0.33	0.55	0.41	0.46
Republic of Kalmykia	39	3,845	6,433	1,063	18	287	3,324	0.99	0.34	1.05	0.41	0.62
Karachai-Cherkess Republic	45	6,167	15,442	2,053	23	429	5,667	0.77	0.42	1.98	0.31	0.67
Republic of North Ossetia — Alania	60	11,418	10,157	6,244	40	702	6,347	0.62	0.45	0.74	0.52	0.57
Krasnodar Territory	930	176,876	180,706	91,755	509	5,101	6,994	1.33	0.54	1.03	0.96	0.92
Stavropol Territory	447	69,220	68,459	36,427	207	2,700	6,372	1.21	0.52	0.95	0.79	0.83
Astrakhan Region	94	23,971	23,421	13,790	98	990	7,033	0.69	0.38	0.69	0.74	0.61
Volgograd Region	202	63,752	63,505	35,193	252	2,620	8,146	0.56	0.39	0.73	0.61	0.56
Rostov Region	712	154,647	152,662	58,027	350	4,276	7,380	1.22	0.69	1.26	0.68	0.92
Volga Federal District	**3,189**	**1,325,685**	**1,159,904**	**520,961**	**3,771**	**30,342**	**7,727**	**0.77**	**0.55**	**0.89**	**0.83**	**0.75**
Republic of Bashkortostan	480	150,253	130,177	54,987	526	4,051	8,674	0.87	0.44	0.72	0.58	0.63
Republic of Marii El	59	13,962	10,795	5,975	47	707	4,639	0.61	0.46	0.66	0.68	0.59
Republic of Mordovia	113	23,547	22,101	8,918	82	848	4,511	0.97	0.45	0.78	0.87	0.74
Republic of Tatarstan	446	266,819	208,386	77,708	642	3,759	9,247	0.87	0.65	0.94	0.83	0.81
Udmurt Republic	165	66,280	61,896	21,277	167	1,538	5,928	0.78	0.61	1.07	0.87	0.82
Chuvash Republic	98	33,370	36,197	14,364	97	1,286	5,247	0.56	0.54	1.08	0.79	0.71
Kirov Region	130	35,398	33,945	17,563	115	1,427	5,573	0.67	0.48	0.85	0.82	0.69
Nizhny Novgorod Region	379	161,325	150,210	74,733	413	3,381	7,678	0.82	0.61	1.05	1.07	0.86
Orenburg Region	214	64,051	62,199	27,253	275	2,125	6,127	0.74	0.36	0.65	0.78	0.61
Penza Region	113	27,240	25,892	17,180	98	1,396	5,401	0.59	0.43	0.77	0.85	0.64
Perm Region	287	127,187	134,273	52,365	418	2,731	10,609	0.77	0.47	0.93	0.67	0.69
Samara Region	352	252,272	188,286	93,274	545	3,177	11,121	0.81	0.72	1.00	0.98	0.87
Saratov Region	231	73,867	61,583	40,359	239	2,595	5,860	0.65	0.48	0.74	0.99	0.69
Ulyanovsk Region	122	30,115	33,964	15,005	106	1,322	5,760	0.67	0.44	0.92	0.73	0.67
Ural Federal District	**1,758**	**850,187**	**643,872**	**304,947**	**4,082**	**12,223**	**11,800**	**1.05**	**0.32**	**0.46**	**0.79**	**0.59**
Kurgan Region	90	16,578	18,131	7,571	70	969	6,299	0.68	0.37	0.75	0.46	0.54
Sverdlovsk Region	675	327,387	269,848	106,756	572	4,399	10,866	1.12	0.89	1.36	0.83	1.03
Tyumen Region	547	365,629	219,779	132,814	2,964	3,339	18,090	1.20	0.19	0.21	0.82	0.45
Chelyabinsk Region	446	140,593	136,114	57,805	475	3,516	8,511	0.93	0.46	0.83	0.72	0.71

END

1	2	3	4	5	6	7	8	9	10	11	12	13
Siberian Federal District	**2,457**	**775,509**	**754,465**	**282,641**	**2,645**	**19,588**	**8,049**	**0.92**	**0.46**	**0.82**	**0.67**	**0.69**
Republic of Altai	25	4,096	12,434	1,149	14	205	5,418	0.89	0.45	2.52	0.38	0.79
Republic of Buryatiya	191	24,975	28,273	7,704	101	960	6,739	1.45	0.38	0.81	0.44	0.67
Republic of Tyva	28	3,325	3,348	1,117	15	309	4,736	0.66	0.34	0.63	0.28	0.45
Republic of Khakassia	67	12,811	28,272	4,829	53	537	6,014	0.91	0.38	1.54	0.56	0.74
Altai Territory	282	77,539	73,799	25,800	175	2,523	6,114	0.82	0.69	1.22	0.62	0.81
Krasnoyarsk Territory	343	115,562	117,082	48,879	594	2,893	9,076	0.87	0.30	0.57	0.69	0.57
Irkutsk Region	425	87,529	93,274	39,417	327	2,514	8,640	1.23	0.42	0.82	0.68	0.73
Kemerovo Region	235	113,024	126,414	44,726	398	2,826	9,299	0.61	0.44	0.92	0.63	0.63
Novosibirsk Region	331	188,897	131,360	48,450	312	2,640	7,709	0.92	0.94	1.22	0.89	0.98
Omsk Region	177	82,234	72,816	30,903	327	2,025	8,718	0.64	0.39	0.64	0.65	0.57
Tomsk Region	138	44,977	42,576	19,444	229	1,033	9,707	0.98	0.30	0.54	0.72	0.58
Chita Region	215	20,542	24,818	10,223	99	1,122	6,838	1.40	0.32	0.72	0.50	0.63
Far Eastern Federal District	**1,078**	**274,386**	**240,527**	**144,738**	**1,069**	**6,508**	**10,411**	**1.21**	**0.40**	**0.65**	**0.79**	**0.71**
Republic of Sakha (Yakutia)	140	35,078	41,344	17,840	256	949	12,532	1.08	0.21	0.47	0.56	0.49
Primorskiy Territory	324	71,417	53,890	38,285	230	2,006	8,604	1.18	0.48	0.68	0.83	0.75
Khabarovsk Territory	217	75,350	77,850	39,558	211	1,405	11,500	1.13	0.56	1.07	0.91	0.88
Amur Region	157	28,193	24,563	10,692	103	875	6,968	1.31	0.42	0.69	0.65	0.71
Kamchatka Region	79	16,248	12,429	10,634	52	347	11,592	1.66	0.49	0.69	0.98	0.86
Magadan Region	44	12,983	9,428	6,339	37	169	12,569	1.91	0.55	0.74	1.11	0.96
Sakhalin Region	81	28,660	14,821	17,391	138	521	15,451	1.13	0.32	0.31	0.80	0.55
Jewish Autonomous Region	18	2,665	2,707	1,657	18	186	7,346	0.71	0.23	0.44	0.45	0.42
Chukchee Autonomous Area	18	3,792	3,494	2,341	24	50	15,568	2.60	0.25	0.43	1.11	0.74
Total	**19,475**	**14,629,091**	**7,861,796**	**3,793,274**	**22,728**	**142,192**	**9,925**	**1.00**	**1.00**	**1.00**	**1.00**	**1.00**

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

TABLE 7

	1.01.02	1.01.03	1.01.04	1.01.05	1.01.06	1.01.07
Credit institutions with a 50%-plus foreign stake						
Assets	8.8	8.1	7.4	7.6	8.3	12.1
Own funds (capital)	7.7	7.1	6.6	7.8	9.3	12.7
Correspondent accounts with non-resident banks	20.0	22.9	19.7	14.0	10.5	23.1
Loans and other placements with non-financial institutuions, including non-resident corporate entities	7.2	7.1	6.1	6.2	7.4	10.0
Loans, deposits and other placements with banks	31.3	25.9	22.0	15.8	17.1	22.5
Household accounts	2.2	2.2	2.2	2.9	3.4	6.2
of which household deposits	2.3	2.3	2.3	3.0	3.4	6.2
Funds raised from organisations*	11.7	10.4	9.3	9.4	9.6	13.3
of which wholly foreign owned credit institutions						
Assets	5.2	5.6	5.6	5.9	8.0	9.0
Own funds (capital)	5.2	5.4	5.4	6.3	9.0	10.1
Correspondent accounts with non-resident banks	10.5	19.2	16.8	7.7	9.9	8.2
Loans and other funds placed with non-financial institutions, including non-resident corporate entities	5.2	5.5	4.6	4.6	7.3	7.9
Loans, deposits and other placements with banks	20.4	16.3	17.0	11.4	16.8	18.4
Household accounts	1.4	1.5	1.5	2.4	3.3	4.0
of which household deposits	1.5	1.5	1.5	2.4	3.3	4.1
Funds raised from organisations*	5.3	5.5	5.7	6.6	9.4	8.9

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

Credit institutions' assets grouped by kind of investment (billion rubles)

TABLE 8

	Assets	1.01.06	1.04.06	1.07.06	1.10.06	1.01.07
1	Money, precious metals and gemstones, total	263.4	208.8	232.4	244.5	368.5
1.1	of which: money	255.2	201.0	222.5	232.1	356.7
2	Accounts with the Bank of Russia, total	684.1	543.5	733.4	758.2	955.6
	of which:					
2.1	credit institutions' correspondent accounts with the Bank of Russia	487.5	298.8	417.8	431.6	624.5
2.2	credit institutions' required reserves transferred to the Bank of Russia	161.3	172.1	190.0	205.6	220.9
2.3	deposits placed with the Bank of Russia	7.2	44.2	108.0	109.6	98.1
3	Correspondent accounts with credit institutions, total	257.5	216.5	267.0	295.1	398.2
	of which:					
3.1	correspondent accounts with correspondent credit institutions	88.5	75.3	79.2	158.9	175.1
3.2	correspondent accounts with non-resident banks	169.0	141.1	187.7	136.2	223.1
4	Securities acquired by banks, total	1,539.4	1,764.0	1,921.1	1.903.9	1.961.4
	of which:					
4.1	debt obligations	1,036.6	1,206.1	1,316.5	1,325.2	1,341.2
	of which:					
4.1.1	Russian government debt obligations	492.0	512.3	524.7	541.5	537.2
4.2	stocks and shares	292.8	317.7	361.8	343.7	391.0
	of which:					
4.2.1	controlling shareholdings	64.9	68.5	77.6	80.6	79.8
4.3	discounted promissory notes	210.1	240.2	242.7	235.1	229.2
5	Other shareholdings in authorised capital	10.7	11.1	13.0	13.9	18.8
6	Loan debt, total	6,371.1	6,945.1	7,539.8	8,359.5	9,440.5
	of which:					
6.1	loans, deposits and other placements, including overdue debt	6,369.5	6,943.5	7,538.2	8,357.8	9,438.9
	of which overdue debt	76.4	91.2	101.0	112.0	121.1
	of which:					
6.1.1	loans and other placements with non-financial institutions	4,274.8	4,489.3	4,940.9	5,406.6	5,966.2
	of which overdue debt	53.8	60.5	60.6	63.7	66.8
6.1.2	loans, deposits and other placements with banks	668.0	913.7	787.7	835.3	1,035.6
	of which overdue debt	0.2	0.4	0.2	0.2	0.2
6.2	financing of government programmes and capital investment on a repayable basis	1.6	1.6	1.6	1.6	1.6
7	Fixed and intangible assets and inventories	283.4	343.5	357.1	376.4	409.9
8	Disposition of profits	61.2	75.6	48.1	69.4	90.9
9	Other assets, total	279.5	312.9	357.3	386.7	401.8
	of which:					
9.1	float	116.8	131.0	157.3	153.4	154.7
9.2	debtors	38.3	42.6	53.4	64.3	66.9
9.3	overdue interest on loans	0.7	0.8	0.8	0.8	0.8
9.4	deferred expenses	107.7	118.6	123.9	141.7	150.4
Total assets		**9,750.3**	**10,421.0**	**11,469.2**	**12,407.6**	**14,045.6**

Credit institutions' liabilities grouped by source of funds (billion rubles)

TABLE 9

	Liabilities	1.01.06	1.04.06	1.07.06	1.10.06	1.01.07
1	Bank funds and profits, total	1,320.2	1,448.9	1,478.9	1,583.8	1,783.0
	of which:					
1.1	bank funds	1,015.6	1,059.7	1,203.3	1,238.1	1,338.3
1.2	profits (losses), including financial results of previous years	304.5	389.2	275.6	345.7	444.7
	of which:					
1.2.1	reporting year's profits (losses)	262.1	96.0	178.9	273.7	371.5
2	Loans, deposits and other funds received by credit institutions from the Bank of Russia	20.2	20.9	19.7	13.8	13.8
3	Bank accounts, total	126.6	108.3	111.4	139.0	156.6
	of which:					
3.1	correspondent credit institutions' correspondent accounts	71.7	59.9	63.8	79.5	94.8
3.2	non-resident banks' correspondent accounts	14.7	15.2	14.0	15.8	14.1
4	Loans, deposits and other funds received from other banks, total	1,086.4	1,177.2	1,282.3	1,459.7	1,730.5
	of which:					
4.1	overdue debt	0.0	0.1	0.0	0.0	0.0
5	Customers' funds, total	5,818.9	6,167.3	6,964.1	7,442.5	8,467.3
	of which:					
5.1	budget funds in settlement and current accounts	48.6	19.6	15.5	15.5	14.6
5.2	government extra-budgetary funds in settlement and current accounts	17.9	34.0	36.4	36.5	28.0
5.3	corporate funds in settlement, current and other accounts	1,674.1	1,771.0	2,000.7	2,109.1	2,361.2
5.4	customer float	35.6	74.2	99.6	90.1	57.4
5.5	corporate deposits	936.4	985.6	1,182.1	1,309.9	1,543.5
5.6	funds in household accounts	2,817.1	2,962.6	3,200.3	3,415.3	3,881.8
	of which:					
5.6.1	household deposits	2,754.6	2,897.6	3,126.6	3,333.9	3,793.5
5.7	other borrowed funds	280.0	312.7	421.2	457.4	570.2
5.8	customers' funds in factoring and forfeiting operations	8.2	7.4	7.8	8.7	10.4
5.9	funds written down from customer accounts but not entered in a credit institution's correspondent account	0.9	0.1	0.3	0.1	0.2
6	Debt obligations issued, total	749.2	793.0	828.0	932.0	1,018.1
	of which:					
6.1	bonds	67.3	93.8	104.7	133.9	168.3
6.2	certificates of deposit	54.8	61.2	51.5	41.1	33.1
6.3	savings certificates	6.6	8.2	10.8	12.9	16.2
6.4	promissory notes and bank acceptances	614.5	622.6	654.7	735.8	790.5
7	Other liabilities, total	628.9	705.4	784.7	836.7	876.2
	of which:					
7.1	reserves	343.0	368.8	380.7	414.4	452.4
7.2	float	189.6	219.0	253.1	261.3	265.2
7.3	creditors	10.3	15.1	39.8	30.0	21.6
7.4	fixed and intangible asset depreciation	50.0	59.6	64.5	69.9	75.0
7.5	deferred income	11.4	13.1	14.1	18.7	20.9
Total liabilities		**9,750.3**	**10,421.0**	**11,469.2**	**12,407.6**	**14,045.6**

Major characteristics of banking sector lending operations (billion rubles)

TABLE 10

Indicators	Rubles					Foreign exchange					Total				
	1.01.06	1.04.06	1.07.06	1.10.06	1.01.07	1.01.06	1.04.06	1.07.06	1.10.06	1.01.07	1.01.06	1.04.06	1.07.06	1.10.06	1.01.07
1. Loans, deposits and other placements, total	4,362.6	4,722.9	5,266.5	5,884.0	6,720.3	2,006.9	2,220.6	2,271.7	2,473.9	2,718.6	6,369.5	6,943.5	7,538.2	8,357.8	9.438.9
of which overdue debt	64.6	78.7	89.7	98.3	107.1	11.8	12.5	11.3	13.8	14.0	76.4	91.2	101.0	112.0	121.1
1.1. Loans and other placements with resident non-financial institutions	2,904.2	3,137.8	3,434.5	3,777.6	4,259.1	1,206.4	1,177.8	1,290.5	1,344.0	1,405.3	4,110.6	4,315.6	4,725.0	5,121.6	5,664.4
of which overdue debt	44.1	50.6	52.2	53.2	56.3	9.1	9.2	7.7	9.9	9.8	53.2	59.8	59.9	63.0	66.1
1.2. Loans and other placements with non-resident corporate entities, except banks	18.3	19.5	20.8	39.3	39.3	145.8	154.2	195.1	245.6	262.5	164.1	173.7	215.9	285.0	301.8
of which overdue debt	0.2	0.2	0.2	0.3	0.3	0.3	0.4	0.4	0.4	0.4	0.6	0.7	0.7	0.7	0.7
1.3. Loans, deposits and other placements with financial sector	300.9	321.5	357.4	368.6	420.6	102.7	106.2	107.6	112.7	100.8	403.6	427.7	465.0	481.3	521.4
Including overdue debt	0.2	0.3	0.2	0.2	0.3	0.0	0.1	0.0	0.1	0.0	0.2	0.4	0.2	0.2	0.3
of which:															
1.3.1. loans, deposits and other placements with resident credit institutions	230.9	248.6	258.2	250.6	293.4	85.4	87.4	85.8	90.9	77.8	316.3	336.0	344.1	341.5	371.2
of which overdue debt	0.2	0.3	0.1	0.1	0.1	0.0	0.1	0.0	0.0	0.0	0.2	0.4	0.2	0.2	0.2
1.3.2. loans, deposits and other placements with resident financial institutuions of different forms of ownership	70.0	72.9	99.2	118.0	127.2	17.3	18.7	21.7	21.8	23.0	87.3	91.6	120.9	139.8	150.2
of which overdue debt	0.06	0.04	0.04	0.04	0.11	0.01	0.01	0.02	0.03	0.02	0.06	0.06	0.06	0.07	0.14
1.4. Loans, deposits and other placements with non-resident banks	20.0	22.7	30.5	39.5	64.6	331.7	555.0	413.1	454.3	599.8	351.7	577.7	443.6	493.8	664.4
of which overdue debt	0.00	0.00	0.00	0.00	0.00	0.01	0.01	0.01	0.02	0.03	0.02	0.02	0.02	0.02	0.04
1.5. Loans and other funds placed with government financial agencies and extra-budgetary funds	63.6	68.5	65.7	60.8	93.1	1.6	1.5	0.7	0.5	0.9	65.2	70.0	66.4	61.3	94.0
of which overdue debt	0.27	0.05	0.04	0.03	0.01	0.00	0.00	0.00	0.00	0.00	0.27	0.05	0.04	0.03	0.01
1.6. Loans extended to resident individuals	1,000.8	1,093.9	1,285.5	1,512.8	1,754.1	174.1	190.4	231.8	278.9	305.5	1,174.9	1,284.4	1,517.4	1,791.7	2,059.5
of which overdue debt	19.7	27.4	37.0	44.6	50.3	2.1	2.5	2.9	3.2	3.5	21.8	29.9	39.8	47.8	53.7
1.7. Loans extended to non-resident individuals	0.2	0.3	0.3	0.4	0.6	4.1	4.6	4.5	5.4	5.0	4.3	4.9	4.8	5.9	5.7
of which overdue debt	0.01	0.01	0.01	0.01	0.01	0.21	0.22	0.26	0.21	0.22	0.22	0.22	0.26	0.22	0.23
For the record:															
Overdue interest on loans, deposits and other placements with residents	0.7	0.8	0.8	0.8	0.8	0.0	0.0	0.0	0.0	0.0	0.7	0.8	0.8	0.8	0.8
Overdue interest on loans, deposits and other placements with non-residents	0.00	0.00	0.00	0.00	0.00	0.00	0.01	0.00	0.00	0.00	0.00	0.01	0.00	0.00	0.00
Credit institutions' investments in residents' promissory notes	198.5	230.4	235.9	229.4	224.1	9.6	5.0	5.2	4.3	3.9	208.1	235.4	241.1	233.7	228.0
Credit institutions' investments in non-residents' bills	0.0	2.9	0.0	0.0	0.0	2.0	2.0	1.6	1.3	1.3	2.0	4.8	1.6	1.3	1.3

Quantitative and qualitative characteristics of the supervisory staff at the Bank of Russia head office and regional branches (based on form K-1 data as of January 1, 2007)

TABLE 11

Bank of Russia division	Total number of jobs as of January 1, 2007	Total number of employees as of January 1, 2007 (excluding part-timers)	of whom: age			education		length of work in banking system		women
			under 30 (born in 1977 and later)	50 years and over (born in 1956 and earlier)	of whom women aged 55 years and over and men aged 60 years and over	higher	secondary vocational	under 3 years	15 years and over	
Head office										
Banking Regulation and Supervision Department	182	165	22	60	20	162	2	17	49	117
Credit Institution Licensing and Financial Rehabilitation Department	145	134	25	29	14	128	5	13	32	105
Financial Monitoring and Foreign Exchange Control Department	110	102	21	23	10	98	1	14	11	61
Main Inspectorate for Credit Institutions	156	151	30	35	13	150	1	38	14	82
Head office total	**593**	**552**	**98**	**147**	**57**	**538**	**9**	**82**	**106**	**365**
Regional branches										
Credit Institutions Supervision Division (Section)	1,264	1,225	154	257	102	1,183	40	55	502	1,039
Credit Institutions Inspection Division (Section)	999	981	139	195	54	962	18	60	236	547
Financial Monitoring and Foreign Exchange Control Division (Section)	642	633	112	93	26	613	17	40	169	439
Credit Institution Licensing Division (Section)	309	307	41	59	17	298	7	16	100	267
Moscow branch divisions	675	662	209	113	39	594	58	75	91	475
Main Divisions/National Banks total	**3,889**	**3,808**	**655**	**717**	**238**	**3,650**	**140**	**246**	**1,098**	**2,767**
Bank of Russia total	**4,482**	**4,360**	**753**	**864**	**295**	**4,188**	**149**	**328**	**1,204**	**3,132**

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