

TROUBLE AND STRIFE: THE RUSSIAN BANKING SECTOR IN 2004 – WELL AFTER THE HONEYMOON



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provides his unique
account of the year
in banking

Dr. Samuel Johnson famously quipped that a second marriage is the triumph of hope over experience. To put things in context, the recent contretemps over issues both relevant (such as Yukos) and peripheral (such as the Ukrainian elections) between Russian and Western counterparts in the Russian FDI and portfolio markets can be compared to newlyweds – each with ‘a past’ – who find themselves taking a cold, hard look at the person to whom each has once again plighted his (or her) troth. Each half of this couple went through a torrid, head-spinning relationship that ended, in 1998, in the Mother of All Divorces. So while the respective partners to this second-time-around pairing dearly want to make this relationship work, more and more of their ‘discussions’ begin with ‘Why do you always . . . ?’. Although cooler heads might prefer not to get involved, let’s jump right into this increasingly tempestuous dynamic and try a little role-playing.

Bon. So the bloom is off the lily, and it’s time to do some careful reassessing of whether we can hold things together for the long haul. While the Other Half is pretending to enjoy the Winter Holidays, let’s make a list and check it twice:

1. Structural Reforms

Here’s our biggest complaint with The Spouse. ‘You have not done what you

promised,’ meaning implementing necessary structural reforms in areas such as banking law, bankruptcy, and other highly market-sensitive administrative-regulatory functions. ‘But Daphne, dear, I have a war on terrorism to fight. You remember Beslan . . .’.

What would the marriage counsellor say? Vladimir did make an effort. In fact, he implemented a significant change to the banking legislative regime by requiring compulsory deposit insurance with the Russian Central Bank by all domestic retail banking entities. Yes, he did promise Daphne a good deal more in 2004, and – truth be told – he has not delivered. But Vladimir appears to be making a good-faith effort to audit all domestic banking players – even snatching away licences here and there to show that he can indeed regulate.

After all, besides Daphne, Vladimir needs to mollify those ogres in Paris – the OECD’s Financial Action Task Force (FATF). They made it clear that Vladimir was being removed from the FATF’s Black List of Non-Cooperative Countries & Territories on the specific understanding that he get serious about regulating his banks – especially for effective Know-Your-Customer and anti-money laundering (AML) practices.

So what say, Daphne? Shall we give Vladimir one more try in 2005 to show his ardour on this score? We’ll need to

keep an eye out for those dodgy Siloviki chaps with whom he’s been spending more and more time. They don’t really seem to know what they’re doing. But his other mates – Gref, Kudrin, Vyugin, and others – have not left his side. Perhaps Vladimir will begin listening more carefully to their increasingly contrary assessments of how he’s doing.

2. The Summer Crisis

Vladimir did seem to go bonkers for a few weeks in May and June. That made us very nervous indeed, especially since the cause was apparently self-inflicted. After all, why withdraw Sodbizness-bank’s licence – that dreadful name notwithstanding! – straight out of the blue? Didn’t he realise that such a precipitous move would spook the markets and cause a liquidity crunch? Yes, many of the domestic banks have engaged in shady – and sometimes just shoddy – AML practices. And the point about FATF’s expectations is well taken. But that run on the banks by the babushki did seem a bit . . . well . . . scripted.

Prior to the May mini-meltdown, many Russian banks had been engaging in fairly rough-and-tumble press and PR campaigns against each other. The Russian business newspapers and journals – never known for their principled objectivity – had been printing more and more – what does he call that? oh yes

– kompromat (attack journalism). No one seemed to realise or care that by attacking each other's reputations and business dealings so aggressively, they were denigrating the entire Russian banking sector.

Marriage Counsellor: Daphne, it's not fair to blame Vladimir for the questionable business ethics of private domestic banks – especially after giving him such grief for building his Vertical of Power when you were just getting acquainted. Yes, perhaps his timing and style in confiscating Sodbiznessbank's licence was typically ham-handed. But you've always loved his certain Slavic, emerging-market je ne sais quoi. I mean, you could have done what your mother told you after 1998 and stayed out of Russia. There are, after all, plenty of nice English lads . . .

Daphne: You're our marriage counsellor, not my mother! Besides, there are real issues, here. Who went after Alfa Bank once GutaBank began to sink? And how is it that GutaBank was snapped up by Vneshtorgbank for a song – for the price of a brand-new Volga with all the Novorussky extras? How can these things go on if he wants to be taken seriously by me or anyone else? In retrospect, these certainly seem harbingers of the Baikal Finance Group and . . .

Marriage Counsellor: Daphne, let's stick to one issue at a time, and not get sidetracked. Vladimir, you've been rather quiet. Any thoughts?

Vladimir: Happy New Year! Happy Christmas! I loff you!

Marriage Counsellor: Yes, well he's certainly enjoying the spirits of the Season. Shall we press on?

3. Mergers & Acquisitions

Notwithstanding the absence of sweeping structural reforms in 2004, the Russian banking sector experienced a rash of mergers & acquisitions. Clearly both international and domestic financial institutions determined that there are undervalued banking assets that merited snapping up. Among the major multinational acquisitions:

- GE Customer Finance purchased DeltaBank
- BNP Paribas acquired 50% of Russky Standart
- Deutsche Bank AG was rumoured to be negotiating the acquisition of a

partial ownership interest in Vneshtorgbank

However, foreign players in the Russian banking sector are understandably charier of such significant acquisitions – and the concomitant exposure – than their domestic counterparts. M&A activity among Russian banks in 2004 included:

- Vneshtorgbank's (slightly dodgy) acquisition of GutaBank and its more orthodox purchase of an additional 25% of Promstroybank
- The merger of Uralsib and Nikoil banks (Nikoil itself had already acquired Avtobank and several smaller regional banks)
- LUKOil's decision to sell its controlling interest in Petrokommertsbank to the IFD Capital Group
- In July 2004, Rosbank announced its acquisition of OVK Group, which thereafter commenced with re-branding under the Rosbank name
- Other M&A rumours abound in the Russian media; but the current legal-regulatory regime in Russia tends to hinder rather than facilitate these tendencies.

In addition, market analysts anticipate that core assets of Paveletsky Bank and

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Dialog-Optim, two banks currently in bankruptcy proceedings, will likely be purchased by domestic rivals. But these developments have not occurred without controversy. BNP Paribas' acquisition of a 50% stake in Russky Standart triggered an investigation by the Russian Federal Anti-Monopoly Service. And BNP Paribas recently initiated legal action in England's High Court over the same as yet uncompleted transaction. BNP Paribas alleges that Russky Standart has not followed through on its commitments to

complete certain prerequisite administrative procedures with the Russian Central Bank.

Finally, market analysts are closely following rumoured cross-border M&A discussions between (primarily) Russian and Kazakh and Russian and Ukrainian banks. Kazakhstan's domestic banking sector, although smaller than Russia's, is in significantly better structural shape thanks to the concerted efforts of that country's former Central Bank Chairman Grigory Marchenko. And December's Ukrainian election results have raised hopes that that country will soon be prepared to address longstanding structural deficiencies in its banking sector and financial markets. President-Elect Viktor Yushchenko has extensive experience in the Ukrainian banking sector including serving as the head of the Ukrainian National Bank, where he managed the introduction of the new Ukrainian currency, the hryvna. These factors, albeit unrelated to Russian regulatory or administrative policies, have encouraged cross-border M&A initiatives among these CIS states.

Looking Forward

In an earlier era of television broadcasting, daytime soap operas would regularly end with syrupy organ music, while a throaty baritone voice-over would intone provocative questions such as 'What will become of our star-struck lovebirds?' Will Vladimir make good on his previous promises to Daphne and follow through on as yet unimplemented structural reforms? Will Daphne decide that her commitment to Vladimir is indeed for the indefinite future, and that her love for him can endure the ups and downs of their occasionally turbulent relationship? For those already caught up in the dynamic of this soap opera plot, there can be little choice but to tune in next week. But for those who haven't yet acquired a taste for this excessively dramatic genre, it may be more difficult than in previous years to attract and hold their interest. And to her pleasant surprise, Daphne continues to receive sometimes subtle and occasionally overt expressions of interest from a Chinese gentleman, from a handsome Brazilian widower, and from a quite substantial Indian computer-programming magnate . . . so stay tuned! 