

Cbonds Russia Risk Conference

Управление кредитным риском

Базовые принципы управления кредитными рисками и их применение в российской банковской системе

Fundamental principles of credit risk management and how they apply to the Russian banking system

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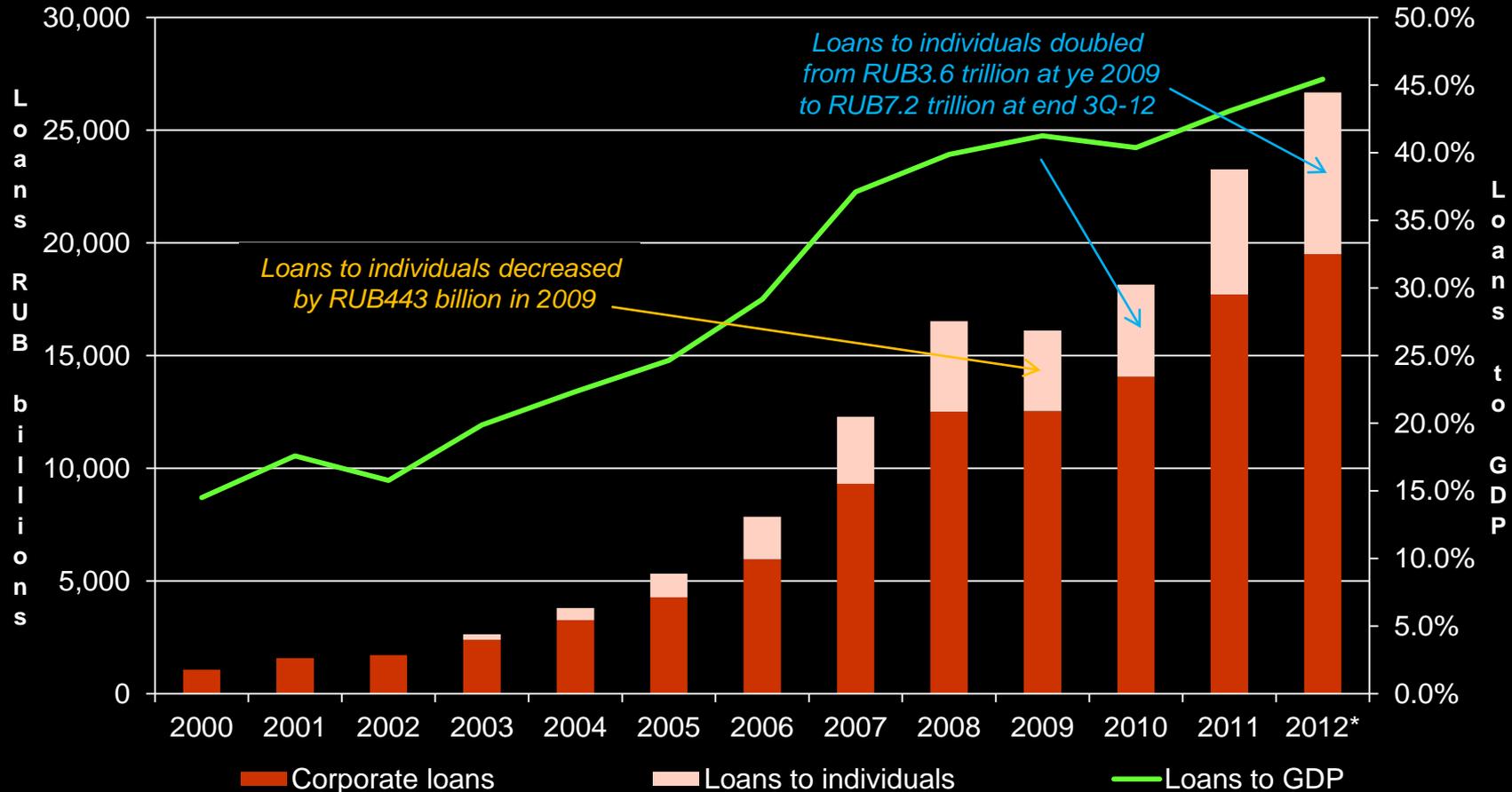
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Fundamental Principles of Credit Risk Management and How They Apply to the Russian Banking System

- I. The context in 2012: State Banks Lead Resumption of Credit Boom After Deep Recession of 2009
- II. Clear Policies, Diversification, Safeguards Against Unhealthy Internal Influences
- III. Obstacles to Effective Credit Risk Management in Russia
- IV. Concluding Observations

Long-term Russian Credit Boom Resumes

system-wide loan grew from 15% of GDP in 2000 to 45% of GDP at end of 3Q-12
loans grew over RUB 10 trillion 2010 - 3Q12

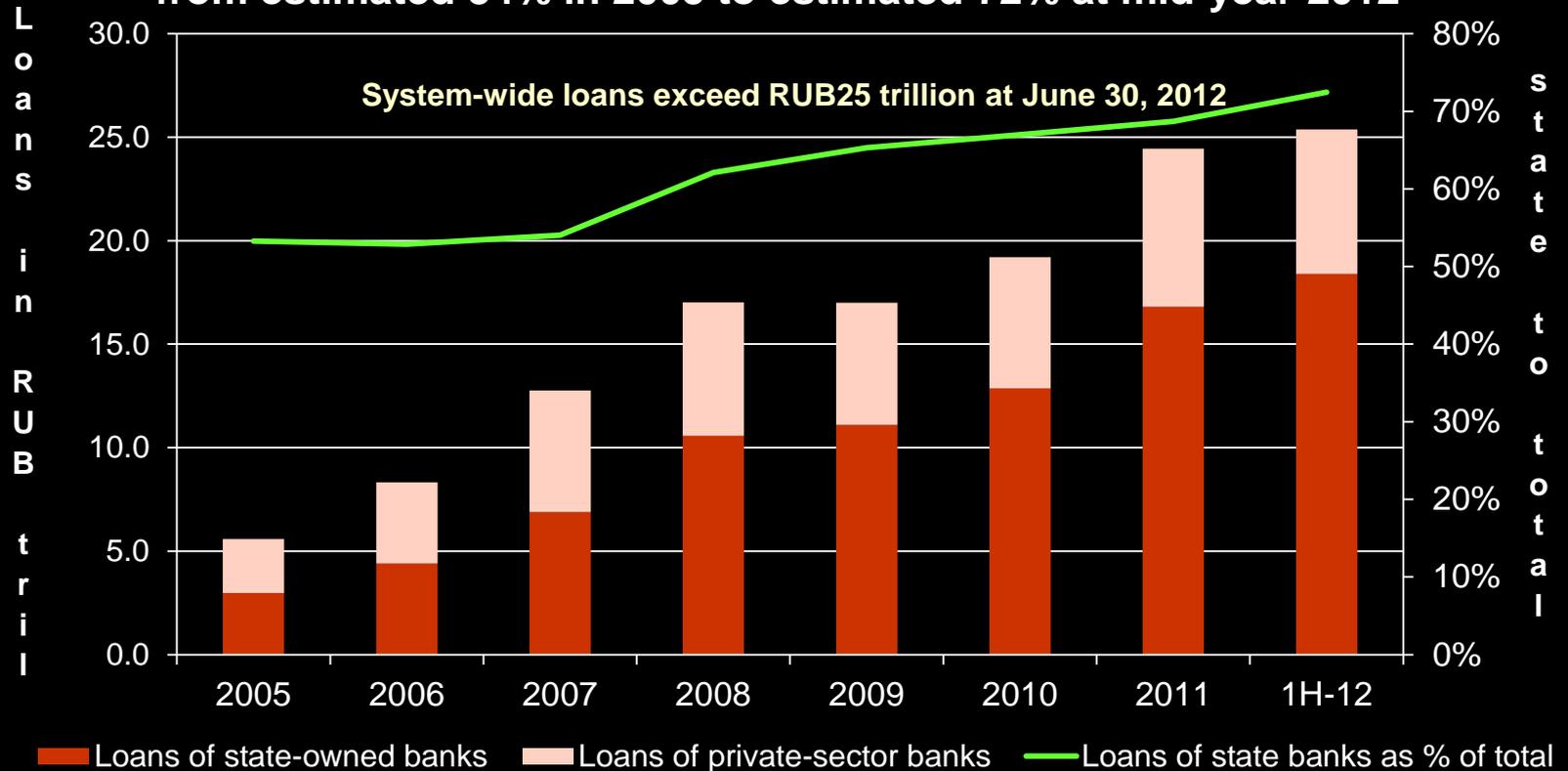


* Loans at October 1, 2012

Source of data: CBR Review of the Banking Sector

State Banks Increase Dominance in Lending After 2008 Crisis

Russian state-owned banks' share of system-wide loans increased from estimated 54% in 2005 to estimated 72% at mid-year 2012



State banks: Sberbank, VTB, VEB, Russian Agricultural Bank, GPB, Bank of Moscow, TKB

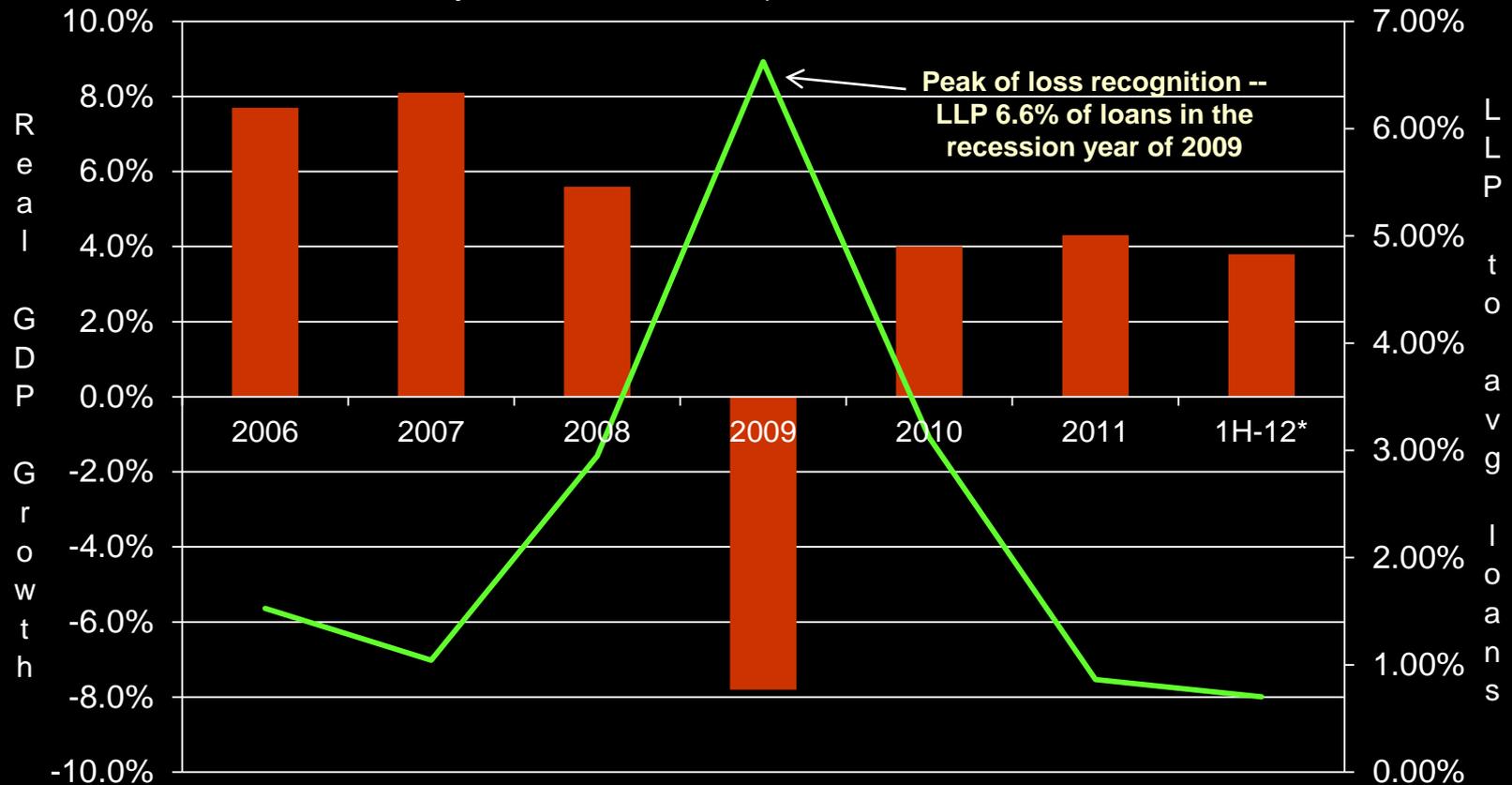
Source of data: CBR and company reports under IFRS

State Banks Lead Resumption of Credit Boom After Deep Recession of 2009

- All borrowers look better in a boom – lenders must counter the enthusiasm/optimism
- State bank dominance and aggressive expansion puts competitive pressure on private sector banks to keep pace
- Rate of credit losses (loan loss provisions) low in 2012, but was almost 10 times greater at bottom of cycle in 2009

Credit Loss Provisions of Russian Banks Are a Mirror Image of Economic Growth

Largest 16 Russian Banking Groups (which represent estimated 80% of system-wide loans); IFRS accounts



*loan loss provisions to average loans annualized; first half 2012 data for 12 reporting banks

Source of data: CBR and company reports

Fundamentals of Credit Risk Management

1. Clearly defined policies and criteria for credit underwriting, credit monitoring and for bank's overall credit risk profile
2. Separation of credit underwriting and review from commercial relationship
3. Diversification by geography, economic sector, and borrower
4. Restriction of loans to related parties (including companies controlled by a bank's owners)
5. Borrower's capacity to repay takes precedence over value of collateral
6. Periodic stress testing – in particular to understand and manage correlation risks and 'tail' risks

Avoid the pitfall of modeling with data that do not apply.

Obstacles to Effective Bank Credit Risk Management in Russia

- a. Incomplete data -- makes all 6 fundamentals difficult to implement
- b. Incomplete information on companies' owners – obstacle to fundamentals 3 and 4
- c. Concentrated economy with borrower credit quality linked to oil price movements – obstacle to fundamental 3
- d. Economy dominated by large corporations/state enterprises (including ones that own banks) -- obstacle to fundamental 3 and 4

Obstacles to Effective Bank Credit Risk Management in Russia (cont'd)

- d. State control of majority of banking sector – creates potential conflict for fundamentals 2 and 6
- e. Widespread use of foreign currency in Russia – this adds risk to capacity to repay (fundamental 5)
- f. Russian banks carry equity risk – but fundamental may not cover equity stakes

The use of real estate as collateral is undeveloped in Russia. The commercial real estate sector is unpredictable due to its weak legal infrastructure, and residential real estate sector is stunted.

Concluding Observations

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