

5. The Mired Restructuring of Russia's Banking System

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INTRODUCTION

Much has been written about Russia's banking crisis, and it has become clear that the August 1998 devaluation and the ensuing government default on its bonds triggered a crisis of the banking system. The underlying cause of the crisis, however, was the failure to restructure bank assets. Banks had long accumulated bad loans and failed to account for them in their portfolios. Therefore, a banking crisis had been overdue for some time. It can be said that the banking system was bound for serious trouble even if the August 1998 crisis had not occurred.

This contribution does not address the crisis itself, nor does it elaborate extensively on the role of the Agency for Restructuring of Credit Organisations (ARCO) or the government in restructuring (see: 'Bank Restructuring: Developments in 1999' by K. Eggenberger in this issue). Rather, this report concentrates on the restructuring that has taken place in the banking system, describes how restructuring was achieved, and identifies the winners and losers in this process.

MIREN RESTRUCTURING

Russian financial engineering: bridge banks, asset stripping and bargaining power

The 1998 crisis again brought to the surface a striking deficiency in Russian law, namely the exemption of banks from the bankruptcy code. The banking sector had insisted on this exemption and was thereafter successful in blocking all draft laws on bankruptcy of banks. Moreover, there was no system of deposit insurance, meaning that in practice creditor rights were non-existent. This intentional legal loophole gave less benevolent banks the opportunity to loot sinking ships by stripping valuable assets and transferring them to bridge banks. Bridge banks receive the assets, but not the liabilities, of the defaulting institutions. Note that Menatep St-Petersburg, Rosbank, and Impeksbank, the most notorious of the bridge banks, were all founded well before the August 1998 crisis. Apparently their parent banks had made contingency plans, just in case.

Bridge banks can serve two purposes. Obviously, they provide a convenient way to abscond with the money, leaving the liabilities to the receiver. The final solution for the troubled bank, in most cases, is a 'convenient bankruptcy'. The clearest cases of convenient bankruptcies are those of Menatep and Mosbusinessbank, whose valuable assets were transferred to Menatep St Petersburg and Bank of Moscow respectively before bankruptcy. Menatep St. Petersburg increased its number of branches from 1 in 1998 to more than 40 at the time of writing. Its branch network shows amazing similarities with the defunct Menatep.

Alternatively, bridge banks can be used to increase bargaining power in negotiations with creditors. This is precisely the strategy of such giants as Rossiisky Kredit and

The Mired Restructuring of Russia's Banking System

Uneximbank. Before the CBR revoked their licenses and bankruptcy could be filed, these banks had already transferred the lion's share of assets to their bridge banks, Impeksbank and Rosbank respectively. These bridge banks operate as a gun to the head of creditors, who understand from the example of Menatep just how easily they can be cheated. This implicit threat gives the busted banks a strong initial position in debt restructuring negotiations (we elaborate on this below).

A number of other banks, such as Alfabank, Avtobank or Mezhhombank have chosen to behave in a co-operative manner, starting negotiations with creditors early on rather than threatening them with use of a bridge bank. This was a matter of choice for these banks, since all of them have daughter banks or affiliated banks that could have served as a bridge bank if so desired. These banks had both the legal and the practical potential to swindle creditors, but they chose not to do so. This, however, is beside the point: the fact remains that creditor rights should be guaranteed by the law and by the Central Bank, not by the benevolence of the banks themselves. Indeed, a more active and timely de-licensing policy of the CBR could have prevented much of the harm done to creditors, both domestic and foreign.

De-licensing by the CBR: problematic

According to the law, bankruptcy proceedings against a bank may only be initiated if its license has been withdrawn by the CBR. It is important to stress here that the CBR has revoked more than 200 bank licenses since the crisis, and enforced the long overdue bank restructuring process for insolvent smaller banks. In fact, the CBR has been quite active so far as small and medium banks are concerned. The insolvent banks lose their licenses, bankruptcy proceedings are filed, the court declares the bankruptcy (or not), a receiver is appointed, a registry of creditors is compiled and in the end, if a creditor is lucky, he actually receives some money. The number of banks licensed to collect household deposits has decreased from 1589 in early 1989 to 1274 on December 1, 1999. Still, this is many more than was estimated initially. The CBR itself estimated after the crisis that only some 600–1000 banks would survive.

However, the largest share of frozen deposits is in the defaulting banks, which were in the ex-top 20 Russian banks. Unfortunately, the CBR has been very reluctant to withdraw the license of any big bank, with the exception of Inkombank, which had its license revoked on December 29, 1998. Even Inkombank has managed to avoid a final ruling on its bankruptcy so far. It is clear that the CBR was under considerable political pressure not to revoke the licenses of major banks before the banks themselves agreed to this. Before Menatep's license was revoked on May 18, 1999, the majority of valuable assets had been transferred to Menatep St-Petersburg. Menatep was later declared bankrupt, a convenient solution for all parties, except for the creditors.

In June 1999 the CBR faced strong political pressure to revoke the licenses of some of the major banks, as the IMF pressed for a harder stance on bank restructuring as a precondition to release the next loan tranche. At the start of July, the CBR surprised the world by revoking the licenses of Uneximbank, Mezhhombank, Promstroibank and Mosbusinessbank. Mosbusinessbank received the treatment of 'convenient bankruptcy' in January 2000, much to the benefit of its majority shareholder Bank of Moscow. It is interesting to note that in December 1999 its license was reinstated for a very short period of time. Presumably there were some valuables left that could serve a better cause than bankruptcy. The prospects of Promstroibank are not bright either; most likely it will be bankrupted and liquidated. Uneximbank initially had a very strong bargaining position in its negotiations with creditors, because most valuable assets were shipped to its bridge bank (Rosbank). However the prospect of bankruptcy, which became more credible after its license was revoked, apparently whetted the bank's appetite for a negotiated solution, which was reached on November 25, 1999.

The Mired Restructuring of Russia's Banking System

The withdrawal of license of Mezcombank, which was actively and openly negotiating with creditors to restructure debts, was severely criticised by all creditors and the CBR finally had to return the license. The most notorious example of the CBR's failure to withdraw bank licences in a timely manner is the case of SBS-Agro (see below).

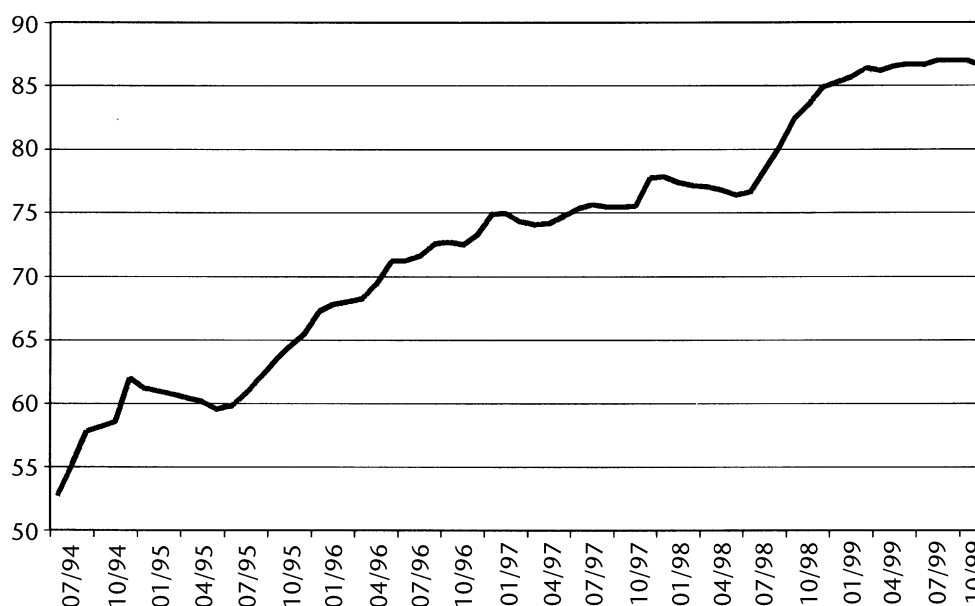
THE WINNERS

State banks

Sberbank and Vneshtorgbank, both CBR satellites, have benefited greatly from the crisis. Sberbank now completely dominates the household deposit market. The transfer of household deposits from some large illiquid commercial banks to Sberbank, organised by the Central Bank on somewhat unfavourable terms, explains only some of this shift. The share of Sberbank in household deposits sadly demonstrates the failure of commercial banks to conquer the deposit market in the 1990s. In the Soviet era, the share held by Sberbank was around 90%. It then fell to a low of under 45% in 1994. After the financial scandals in the second half of 1994 and the exchange rate crisis in October 1994, its share of the household deposit market started to rise steadily, reaching a level well above 80% by end-1999. Every financial crisis was marked by a jump in Sberbank's share of the deposit market. The August 1998 crisis brought another boost of 10%. Households trust Sberbank mainly because of its government guarantee, and they are right to do so. The government bailed out Sberbank at the occasion of the crisis of August 1998, when the bank lost half of its net assets in the government default on GKO's.

That story is well known. More worrying is the fact that more and more corporate customers are turning to Sberbank or Vneshtorgbank for deposit and payment services. At the moment these banks hold about one-third of company clearing and current accounts. If one takes into account that much of the remaining two-thirds of corporate accounts are held by so-called pocket banks or other government banks, one sees that the position of independent commercial banks has become very weak. As a consequence, most accounts of firms without pocket banks are now with Sberbank or Vneshtorgbank

Figure 14: Share of Sberbank in household deposits



Source: CBR, Sberbank

Box 1. SBS-Agro's magic: Good money, bad money, no money

One of the most astonishing episodes in post-crisis bank restructuring in Russia is the case of SBS-Agro. Before the crisis, this bank was the biggest private retail deposit bank, second only to Sberbank. SBS-Agro had, by far, the largest retail network of all private banks (more than 1,500 branches and more than 250,000 individual depositors), played an important role in the domestic payment system, and handled the lion's share of subsidised credits to the farm sector. One should recall that the bank was already in a dire state before the crisis of August 1998. About a week before the crisis, SBS-Agro failed to redeem a credit on the interbank market, revealing its illiquidity. The crisis was even a godsend for SBS-Agro because it substantially increased the readiness of the authorities to supply the bank with fresh and free liquidity. From the very beginning, SBS-Agro was perceived by the authorities as a bank of systemic importance that should be saved at all costs. In the first year after the crisis, the CBR disbursed more than R20 bn to bail out big banks. The Soyuz group, successor of the SBS-Agro empire, received more than R10 bn of these so-called stabilisation credits. This is about half of all stabilisation credits granted in this period and roughly equal to the R10 bn 1999 budget of ARCO, the state agency for bank restructuring. The authorities defended this huge flow of money by claiming the systemic importance of the bank. However, in 1998 the bank had more nostro accounts in foreign countries (more than 40 in a wide range of countries) than it had domestic correspondent banks (less than 30). Therefore the claim that the stabilisation credits to SBS-Agro helped to mend the domestic payment system is, at best, only partially true. Also, the credits were not of real benefit to the bank's depositors. Some of the depositors chose to have their deposits transferred to Sberbank, on unfavourable terms. The vast majority of remaining depositors, however, chose to stay and are still waiting for their money. One of the more valid reasons to support the bank was its strategically important role as the main bank of the agricultural sector. Until the 1999 harvest was completed, the bank had strong arguments to require additional liquidity. It is possible that some of the liquidity injections disappeared to bank accounts abroad. The famous report of the bank review unit of May 1999 on 18 Russian banks estimated the negative capital of SBS-Agro at R19 bn in May 1999. In April 1999 the bank received a stabilisation credit of R5 bn. Still, when the CBR finally installed a temporary administration in August 1999, the capital had shrunk further to minus R25.4 bn. Even after the installation of a temporary administration by the CBR, asset stripping continued. According to a report, prepared by the CBR temporary manager, the negative capital of the bank reached a record low of R33 bn in November 1999. Some of this additional loss was due to the further devaluation of the rouble, but it is also likely that some money disappeared. Also, most valuable assets, including real estate, bank equipment, and so on, do not belong to the bank but to connected firms. On November 16, SBS-Agro, by then an empty shell, finally came under ARCO's management. Initially ARCO announced its intention to liquidate the bank. However on January 25, 2000, ARCO decided to found a new agricultural bank, Selkhozbank, that will mainly distribute subsidised credits to the agro-industrial complex, just as its predecessors SBS-Agro and Agroprombank did. Despite the fact that the law on bankruptcy of banks prohibits managers of bankrupt banks from holding a management function in another bank, Juri Trushin, the former director general of Agroprombank and SBS-Agro, will head the new institution. The bank presumably will not assume its predecessor's debts to depositors and foreign creditors, unless the government picks up the bill. Enough said.

The Mired Restructuring of Russia's Banking System

The most worrying development is the increasing share of CBR-owned Sberbank and Vneshtorgbank in total credits to the economy. This share has risen from 12% at end-1997, to over 15% by end-1998, and to more than 26% currently, as shown in Table 6. Through its satellites, the CBR is allocating more than a quarter of all credits to the economy. This is reminiscent of the CBR policy of directed credits in 1992–1994. It remains uncertain what criteria are employed in the granting of credits this time around. There is certainly a risk that Sberbank, which has very limited lending experience, will have a preference for large loans to big enterprises in 'priority' sectors, such as heavy industry or the military-industrial complex, and neglect other profitable sectors of the economy. The question arises to what extent these credits are an expression of directed industrial policy of the old Soviet kind. More importantly, no-one seems to actually control the lending behaviour of CBR-owned banks. The thorny issues of connected lending and possible corruption inside these banks will have to be addressed. In any case, the direct influence of the CBR on the economy seems to be increasing. This tendency seems to be supported by Vladimir Putin, who reportedly encouraged the CBR to 'improve people's purchasing power'.

Table 6: The increasing share of CBR banks in domestic credit markets

	Bank credit to the economy (R mn)			Share of CBR banks
	Sberbank	Vneshtorgbank	Total banking sector	
1 Jan 98	27,238.0	5,463.7	269,982.2	12%
1 Jan 99	40,151.6	16,577.2	379,603.1	15%
1 Nov 99	108,237.2	17,700.9	492,331.0	26%

Source: Own calculations based on CBR data and Mobile data

The state continues to found new state banks. In early 1999 the Russian Development Bank was founded, but its function remains unclear. There is a chance that the bank will, to a large extent, be used to distribute soft credits to industry. As already mentioned before, ARCO decided to found Selkhozbank in early 2000. The new state-owned bank will distribute subsidised credits to the farm sector. There have been rumours that the Ministry of Agriculture had a strong hand in the foundation of the new bank.

Government ownership of regional banks is also on the rise. In Moscow the best example is the Bank of Moscow (BoM), which is majority-owned by the city government. The bank serves about 70% of Moscow City budget funds. In this respect, Moscow has set an example for other municipal or regional authorities. Many federal, regional, city and municipal governments hold stakes in commercial banks and they found new banks regularly. This means that the grip of government and state bodies on the banking sector is growing, and now seems to be tighter than at any time since the beginning of transition.

Regional banks

The demise of some of the larger Moscow-based national banks has offered an opportunity for regional banks that were less exposed to the crisis. These banks were less exposed to currency risk and government default risk and had a smaller retail deposit base, so they were much less affected by the summer 1998 crisis. The demise of their nation-wide competitors has allowed them to attract new business quite easily, including for example corporate accounts of enterprises whose banks are in trouble, or the regional currency exchange business of these big banks. Regional banks also have a windfall opportunity to expand their branch network at a considerably lower cost than before the crisis.

Table 7: Are regional banks expanding their retail network?

	Number of staff		Number of branches	
	1998	1999	1998	1999
AK Bars	1045	1370	10	17
Baltiisky Bank	n.a.	1067	n.a.	9
Baltuneximbank	262	336	2	2
Bashkreditbank	1019	1019	4	4
Zapsibkombank	2003	1484	34	33
Nizhegorodpromstroibank	1043	1072	25	25
Petrovskii	2765	2247	25	18
Surgutneftegazbank	350	350	3	3
Khanti-Mansiiskii bank	67	402	6	6
Chelindbank	1579	1535	29	28

Source: Own calculations based on data from Intelbridge

The lower cost of investment and higher return due to diminished competition mean good prospects for expansion. The network expansion argument, however, is only partially confirmed by the data. Table 7 shows data on 10 of the biggest regional banks at end-1999. The evidence is mixed at best. Most regional banks have managed to keep their pre-crisis position. Some have expanded substantially (e.g. AK Bars), while others have shrunk considerably. Zapsibkombank and Petrovskii, both successors of the former specialised state banks, are most heavily affected by the crisis, as is the case for their national counterparts Mosbusinessbank and Promstroibank.

The cautious and co-operative among the top 20 banks

Some of the top 20 banks have been able to honour all their obligations and reach debt restructuring agreements, before default. Examples of such banks are Bank of Moscow, Gutabank, Alfabank, Avtobank, and Promstroibank St. Petersburg (PSB). These banks were illiquid directly after the crisis, but were able to restore liquidity and expand quickly thereafter. Since they did not default on their deposits, popular trust in these banks was restored quickly and they managed to significantly increase their share in a number of key banking markets. Bank of Moscow received part of the late Mosbusinessbank. Alfabank increased its regional network from 3 to 14 branches, and its personnel from 1569 to more than 2000, thanks to a credit from ARCO. Gutabank increased its number of branches from 2 to 30 and its staff from 590 to 1458, mainly thanks to its decision to buy part of Inkombank's branch network. BoM has seized the branch network of the former Mosbusinessbank, acquired a number of other small and medium banks, and is now serving customers in more than 30 regions. PSB thrived and expanded because large regional competitors, such as Inkombank or SBS-Agro, suffered heavily from the crisis. In Table 8, we show some key financial indicators for these banks. It is clear that they have improved significantly.

The chosen ones

Large financial-industrial groups restructured their banking empires in the aftermath of the crisis. The groups made the strategic decision of whether or not to maintain a banking network, and depending on that choice, determined which banks would be recapitalised and which would be jettisoned. The restructuring of pocket banks, financial satellites of non-financial enterprises, has therefore depended largely on the willingness of the parent company to maintain a banking network. Let us take the example of Gazprom. Gazprombank (100% Gazprom) and National Reserve Bank (25% Gazprom) are two examples of top 20 banks that were chosen by their mighty parent company to be recapitalised. Gazprom chose to concentrate its banking empire mainly around Gazprombank and to a lesser extent National Reserve Bank. Banks like

The Mired Restructuring of Russia's Banking System

Table 8: Some relative success stories of big banks (%)

	Data on 1/11/99 divided by data on 1/07/98				
	Bank of Moscow	Guta-bank	Alfa-bank	Avtobank	PSB
Net assets	371	240	658	145	305
Household deposits					
Short term	360	532	419	40	139
Long term (>30 days)	1075	864	358	122	285
Deposits of legal persons					
Short term	4436	161	158	202	2698
Long term (>30 days)	1111		14	446	18
Liquid assets	702	505	407	275	221
Credits to the economy	229	394	314	282	260
Credits to other banks	4241	1463	195	250	994

Source: Own calculations based on Mobile data

Promstroibank (25% Gazprom), Inkombank (13.2% Gazprom) or Imperial (13.6% Gazprom) were less fortunate.

Foreign banks

The market position of foreign banks has clearly improved (see Table 9). Foreign banks were severely hit by the 1998 crisis, but they did not default on their obligations because they were able to draw from the deep pockets of their parent banks. In the aftermath of the crisis, the position of foreign banks in Russia has been considerably strengthened in several key banking markets. We selected the 50 biggest banks in Russia before the crisis (July 1, 1998) and according to our most recent data (November 1, 1999). The number of truly foreign banks in the top 50 has grown from 8 before the crisis to 12 recently.

The share of foreign banks in both household deposits and corporate deposits has increased greatly. Their share in liquidity has almost tripled, and credits to the economy and to other banks have grown by 40% or more. This flood of foreign banks is not likely to lose pace, since in December 1999 a number of important foreign banks (eg ABN-AMRO, Bank Austria, Raffeisenbank Austria and Citibank) made their entry on

Table 9: Market position of foreign banks (thousands of roubles)

The growing importance of foreign banks in Russia	Before crisis (01/07/98)			Last date (01/11/99)		
	50 big banks	Foreign	% foreign	50 big banks	Foreign	% foreign
<i>Household Deposits</i>						
Short term	26425948	6524	0%	20949220	426263	2%
Long term (>30 days)	4373936	249150	6%	12653248	1377597	11%
<i>Deposits of legal persons</i>						
Short term	32758180	1271474	4%	80014041	6914305	9%
Long term (>30 days)	13519602	3415564	25%	33240790	11309541	34%
Liquid assets	15733921	613573	4%	65648106	7158259	11%
Credits to the economy	146519139	13861955	9%	290329683	36584739	13%
Credits to other banks	24229059	2451389	10%	112731057	16326862	14%
Government bonds	50984522	9326903	18%	46858907	6738224	14%
Accumulated profit	987120	9606	1%	-12473207	1678149	
Non-balance obligations	746466395	43619384	6%	246755655	65023027	26%

Note: Numbers are reported with the exclusion of Sberbank, since we want to analyse competition between foreign and domestic private banks.

Source: Own calculations based on Mobile data

the retail deposit market, not without success. The share of foreign banks in household deposits is therefore likely to grow further.

Debtors of bankrupt banks

It is typical even in developed market economies that debtors are reluctant to pay back their debts if they sense the imminent bankruptcy of their creditor. Even if they eventually have to pay the receiver, they will at least have bought a considerable amount of time. There are indications that one reason for Inkombank's prolonged insolvency is that, after losing its license and entering bankruptcy proceedings, Inkombank had a lot of trouble making its debtors pay – even if the money was there. In this way, many companies have been given some financial breathing space because they could avoid repaying their loans to insolvent banks. Given the widespread Russian practices of pocket banks and connected lending, this phenomenon may be rather significant. It seems unlikely that an insolvent pocket bank would try to enforce loan payments from its parent enterprise, unless the latter believes it profitable to keep the bank afloat. Indeed, if credits to the parent were funded to a certain extent by outsider deposits and credits, a bankruptcy may be more convenient. In the worst case, the parent still buys some time to pay back the receiver. In the best case, the receiver will never follow up on the loan, for a variety of reasons. After all, a pocket bank serves in the first place as a provider of cheap credits to the parent enterprise.

A concrete yet slightly different version of this scenario might be the loans SBS-Agro has made to the agricultural sector. The agricultural sector was heavily indebted to SBS-Agro. SBS-Agro is now under ARCO's control, but it is not very likely that ARCO will see much of this money back. One possibility is that these credits will be transferred to the newly founded Selkhozbank and will only be paid back through fresh credits from this new institution (without provisions for SBS-Agro's domestic and foreign creditors).

WHO PAYS THE BILL?

Depositors

The biggest losers in the bank restructuring are depositors. Part of the problem was solved by transferring accounts from big and illiquid deposit banks to Sberbank, albeit on less than favourable conditions. Still, many depositors chose to have their deposits transferred to Sberbank because they understood they could not expect much more. In the second half of 1999 many big banks made proposals to restructure household deposits in order to avoid bankruptcy proceedings. These proposals are indicative of the high cost inflicted on depositors. Box 2 shows two examples.

However, a large number of depositors in smaller bankrupt banks did not have the opportunity to transfer their deposits to Sberbank, nor has any restructuring plan been proposed to them in most cases. Still, anecdotal evidence seems to suggest that bankruptcy proceedings work in the case of small and medium banks.¹ This is good news. Small insolvent banks without political clout are declared bankrupt by the court and liquidated. Depositors receive part of their deposit. Before the law on bankruptcy of banks of 1999, small depositors would have received nothing.

1 In one case, a small depositor in a bankrupt bank registered in the receiver's registry of creditors. Subsequently he received an advance of 15% of his deposit at an exchange rate of 23.12 (the rate on the date the CBR withdrew the license) as opposed to a current exchange rate of about 28.5. In current ruble terms, he received 12.4% of the current value of his original dollar deposit. If the further liquidation of the bank will deliver anything more, the proceeds will be divided among the creditors.

Box 2. Restructuring remaining debts to depositors

Inkombank

By December 1999, Inkombank had paid back 53% of its household deposits. Household deposits amounting to R10,000 are paid back in full. For deposits exceeding this amount, Inkombank proposed to reschedule the debt over a period of 3 years at 3% annual in foreign currency with repayments of 30% of the principal per year, beginning from the year 2000.

Rossiisky Kredit

Since June 1999 all household deposits up to \$1000 can be freely withdrawn. On November 25, the bank suggested an agreement for its remaining depositors. According to the agreement, household depositors would receive 10% in cash and 90% in rouble-denominated veksels with maturity of 1.5 years and zero interest rates.

Foreign creditors

Foreign creditors have lost a lot of money in Russia. First, there is still a large number of unsettled forward contracts. Second, banks had sizeable foreign debts in the form of bank loans and eurobonds. In most cases there are restructuring plans established or under consideration. The restructuring conditions vary wildly, depending on the goodwill and the bargaining power of the banks concerned. Once banks have their licenses withdrawn, they need debt restructuring agreements to avoid bankruptcy. On the other hand, as we have already mentioned, the practice of using bridge banks has affected the bargaining power of the foreign creditors, since bankruptcy might actually become convenient for banks and inconvenient for creditors. Box 3 gives some examples of debt restructuring agreements with foreign creditors. It is evident that the banks with increased bargaining power through their bridge bank were able to reach fairly favourable restructuring agreements.

The co-operative attitude of banks like Alfa-Bank or Mezhkombank is fundamentally different from the behaviour of Uneximbank or Rossiisky Kredit. The latter two successfully used the credible threat of the bridge bank as a way to strike a better deal. The bankruptcies of Bank Menatep and Mosbusinessbank have shown that asset-stripping by bridge banks makes bankruptcy a rather inconvenient solution for foreign creditors, since it leaves nothing much of value in the bank.

The budget

The government has not lent hefty resources to bank restructuring. ARCO received R10 bn in 1999 and is scheduled to receive only R1 bn of cash budget money in 2000. A considerable part of the banking sector owes the government money, mainly funds deposited in frozen bank accounts of the government, tax arrears of enterprises frozen in banks and tax arrears of illiquid banks. As the government has been passive in enforcing its creditor rights, this amounts to a considerable state subsidy to illiquid banks. To understand the magnitude of the problem, we note that the amount of government money frozen in banks under ARCO's supervision (these banks have 8% of 1998 bank assets) is estimated in the government budget at R5 bn. This equals the cost of the Chechen war in 1999.

Box 3. Foreign debt restructuring agreements of some major banks

Alfa-Bank

In December 1998, Alfa-Bank reached a deal with foreign creditors to restructure \$70 mn in US commercial paper debt without foreign forgiveness. All due interest and part of the loan are paid up front. The rest is restructured over 3.5 years. Alfa-Bank has not yet restructured its \$175 mn eurobond debt (interest 10.375%, due in 2000), nor has it defaulted on it. In July 1999 Alfa-Bank paid the interest on its eurobond debt on time.

Mezhkombank (MKB)

In September 1998 MKB proposed a restructuring program to its creditors. The proposed restructuring program involves a partial debt-equity swap and issuance of short and medium term obligations. In this proposal the majority of shareholders agree to convert their deposits into capital. In June 1999 MKB paid back all debts to household depositors and the budget, and struck a deal with foreign creditors that was submitted to the CBR for approval. On July 1 the CBR withdrew MKB's license. Foreign creditors decided to actively define MKB, unlike Moscowbusinessbank, Promstroibank or Uneximbank, because MKB's restructuring was 'the only transparent and legitimate restructuring process in the whole of Russia' (D. Creeps, authorised agent of MKB international creditor's club). On July 29, MKB signed an agreement with its foreign creditors to reschedule its \$90 mn foreign debt.

Uneximbank

On November 25, Uneximbank reached debt restructuring agreement with its foreign creditors:

Pay 8% in cash.

Issue \$130 mn of Rosbank bonds with 12-year maturity (this represents about 10% of the debt).

Pay \$1.15 bn (83% of the debt) from the revenue of the management of a special trust company that will manage the remaining assets of Uneximbank.

A vast majority of the creditors approved the proposed rescheduling plan. The CBR cancelled its order to withdraw Uneximbank's banking license. The Moscow Arbitration Court postponed the case of the bankruptcy of Uneximbank till February 2000. Uneximbank proposed to merge with its bridge bank, conditional on approval of the rescheduling plan and cancellation of bankruptcy proceedings.

Rossiisky Kredit

On November 25, Rossiisky Kredit proposed the following agreement with foreign creditors:

- Pay 5% in cash.
- 15% of foreign debts is exchanged for 5-year zero coupon foreign currency veksel.
- 80% of the debt is replaced with 10-year zero coupon rouble veksel.

The creditors accepted the proposal on January 20, 2000.

Inkombank

In January 2000, Inkombank proposed a deal to its foreign creditors:

- Pay 5% in cash.
 - Pay 15% in shares of the Babaevskoe Confectionery.
 - Pay 80% in 10-year zero coupon rouble veksel, or new shares of the bank itself.
- The deal strongly resembles the Rossiiski Kredit deal proposed in November 1999.

CONCLUDING REMARKS

Even though restructuring has been poorly managed and supervised, some restructuring has taken place. The final outcome is in many cases still uncertain, but what is sure is that there will be winners and losers. The largest losers are likely to be the creditors, whose rights were strongly neglected in the course of restructuring by both the law and the CBR. The banking sector as a whole was affected by the crisis, but some players were able to strengthen their relative positions. In this respect, the largest winners are the state banks, the foreign banks and some of the former top 20 banks. Next to clear winners and losers, most banks seem to be muddling through. The consolidated number of bank branches and bank staff, however, has shrunk considerably.

In order to achieve a stable and healthy banking system in the future, there are at least three preconditions. First, Russia needs good bank regulation. Bank regulation has improved considerably lately, but there is still much to do. The provision that the CBR must withdraw licenses before bankruptcy can be filed is not very helpful, for example. Second, the development of a sound banking sector requires strict and independent prudential regulation and control by the CBR. Further reluctance of the CBR to withdraw licenses when necessary would be harmful. Last but not least, improvements in the real sector are a precondition for the development of a sound financial sector. As long as the real economy is not recovering in a sustainable manner, any rehabilitation of the banking sector will be on shaky ground.