

A Sustainable Bank Versus Speculative Markets

Dr Vasily Vysokov,

President and Chairman of the Board of Directors, Center-invest Bank

The crisis triggered a search for alternatives to speculative banking, resulting in, for example, a revival of the system of state-owned banks and the increased popularity of Islamic banking¹. At the same time, we see continuing efforts to restore the reputation of speculative banking through tighter regulation. Amid the volatility of the speculative markets, the sustainable banking business model is ever more appealing.

The contemporary banking business combines two products: payment systems and investment banking. The greatly increased speed of payments and settlements does not leave universal banks scope to take investment risks with the funds in customers' current accounts and call deposits. The countries that are the first to separate out payment systems and investment risks will be the most attractive in the post-crisis economy. Unfortunately, even in a crisis, politicians want to demonstrate economic growth, to the detriment of the balanced modernization and structural economic reform of their countries. Consequently, they are reluctant to ringfence payments and investments. Instead, under the guise of government support, and at the expense of the taxpaying public, they are reproducing speculative banking and outdated banking technologies.

The English word "sustainability" is usually translated into Russian as "ustoichivost", but it can also be understood as "zastoi", meaning "stagnation". However, in international practice, sustainability is generally taken to mean social and environmental responsibility in the interests of current and future generations. Under the sustainable banking model, banks focus on ensuring long-term profitability, with due regard for current and future risks, rather than on maximizing instantaneous, speculative profit.

Sustainable banking is caught between two challenges: focusing on long-term results, and managing the speculative risks and opportunities of the market. This model requires banks to constantly innovate and apply international best practice, both in their own operations and in those of their customers.

Center-invest Bank has already been commended for its performance based on sustainable banking principles: in 2007, it became the first Russian bank to be a runner-up in the Sustainable Banking Awards, organized by the Financial Times and IFC, and it was named the best Russian bank of 2010 for sustainability by The New Economy magazine. The sustainable banking model has been resilient in the face of the crisis, proving its viability at a time of volatility on the speculative markets. While the ratings of many banks and even leading market economies were being downgraded, in August 2011, Moody's upgraded Center-invest's long-term international rating to Ba3 and its national scale rating to Aa3.ru.

SUSTAINABLE BANKING AS REFLECTED BY RATINGS

The ratings assigned by the influential agency RosBusinessConsulting for the first half of the year illustrate the characteristics and advantages of the sustainable banking model (ratings.rbc.ru). As at 01.07.2011, among more than 900 Russian banks, Center-invest ranked 87th for level of capital and 75th for net asset value. However, when judged by operational efficiency, we are one of the top 50 Russian banks. Unlike many larger banks, Center-invest Bank has not needed extra capital at the expense of its shareholders or government support. We are achieving organic growth, thanks to our own profits and sensible risk management. Ranked by profits, Center-invest is in 51st place. We do not take on



currency risks, nor do we pass these risks on to our customers. Meanwhile, we are pro-active in attracting both business and retail deposits (89th and 44th place among Russian banks, respectively). Our high-quality settlement processes are appreciated by many bank customers in southern Russia and our foreign partners (71st place for value of funds in settlement accounts). In 2011, we received a prestigious Citi Bank award for the quality of our international settlements and payments.

Center-invest's main income comes from ruble-denominated business loans (49th place) and consumer loans (43rd place). We ranked 6th for value of SME lending in the first half of 2011, and 11th for our SME loan portfolio. The bank's SME modernization programme, launched mid-2010, is generating an increase in new SME loans. Earlier this year, we began an additional loan programme for business start-ups, and we also provide free advice on setting up a business.

When it comes to modern banking products that improve standards of living, we are rising up the rankings of the top 50 Russian banks: for mortgages, we are in 18th place for the number of loans and 20th for their value, and for car loans we are in 28th place for the number of loans and 29th for their value (including 25th place for our portfolio of loans to purchase new vehicles).

¹ *Southern Russia Versus the Global Crisis*, Dr V. Vysokov, Rostov-on-Don, 2009, ISBN 978-5-7972-1398-7 http://www.centrinvest.ru/pdf/vysokov2009_allbook.pdf

² www.ratings.rbc.ru

Center-invest Bank provides quality banking services, and we are committed to introducing modern banking technologies and developing our operational environment. With our own processing centre, we rank 38th among Russian banks by number of ATMs and 32nd for the number of active bank cards, and we have a stable customer base (38th place for the number of newly issued cards, 21st for the number of re-issued cards).

Thanks to all these qualities (a sustainable capital base, sustainable organic growth, sensible risk management, support for the modernization of the real economy, lending for the sustainable development of businesses and the population of southern Russia as a whole, and our own modernization), Center-invest now ranks 16th among the best retail banks in Russia.

THE SUSTAINABLE BANKING BUSINESS MODEL

Sustainable banking requires: a sustainable shareholder structure and corporate governance system; sustainable procedures for developing strategies and plans and managing assets, liabilities and risks; reporting under international standards; sustainable internal audit and operations management systems; the selection of sustainable products and services; and a sustainable customer and investor relationship management system.

1. Center-invest's **sustainable shareholder structure** (EBRD – 27.45%, DEG – 22.45%, the Vysokov family – 17.85%, Erste Bank – 9.80%, Raiffeisenlandesbank – 3.6%, and the funds Renaissance Capital – 8.15%, and Firebird – 9.9%) has enabled us to establish a **sustainable corporate governance system** and a new ethos in the relationships among shareholders, senior management, employees and customers. For example, all bank employees have the right to raise questions with senior management and to receive proper answers. As all of the Board of Directors' decisions require unanimity, due care must be taken when preparing issues for discussion. In 2009, all the members of the Board of Directors and the Executive Board voluntarily agreed to a 30% cut in bonuses. This initiative set a good example for all staff, allowing us to successfully cut costs and optimize operational processes throughout the bank.

2. Thanks to its **sustainable strategic planning system**, as early as October 2008, Center-invest Bank was able to introduce an anti-crisis programme for its customers ("Southern Russia Versus the Global Crisis") and, following its successful implementation, to then approve the new strategy for 2011-2015. The post-crisis development strategy takes into account: risks resulting from global market developments, risks involved in Russian reforms, southern Russia's potential, and the assumed trajectory of the sustainable, balanced expansion of the bank's network, products, and operations.

5. **Our sustainable risk management (RM)** is based on clear procedures and accountability for risk assessment and monitoring and ensuring that risks are properly covered by provisions and capital. Center-invest Bank carries out regular stress tests to check its compliance with Basel 2 and Basel 3 requirements. Such tests are not mandatory for Russian banks. As at 1.10.2011, the capital available to the bank to cover its risks was 1.6 times more than the minimum required by Basel 2.

Center-invest Bank's 2011-2015 Strategy (RUR bn.)

	1 Jan 2011	3Q2011	2012	2013	2014	2015
	Fact			Plan		
Capital	5.8	6.5	6.2	7.1	8.2	9.6
Assets	48.3	52.7	49.0	55.3	62.1	70.2
Net loans and leasing	30.6	38.9	35.7	41.8	48.2	55.9
Deposits	33.8	37.0	35.4	39.0	42.7	46.4
Profit	0.2	0.8	0.7	0.9	1.2	1.6

3. **Sustainable assets and liabilities management (ALM)** means that assets and liabilities are balanced in terms of time periods, currencies and structure. Customer funds (retail and business) make up about 70% of the bank's liabilities, and retail and business lending accounts for roughly the same proportion of its assets. About 10% of the bank's assets and liabilities are held in a balanced mix of foreign currencies.

4. **Sustainable and transparent reporting system.** Center-invest Bank has reported under IFRS since 1997, with its accounts audited by PricewaterhouseCoopers. We are also obliged to report under Russian standards (RAS), and the international financial institutions and ratings agencies with which we work require yet further forms of reporting. Our ability to respond to the constant changes to IFRS and RAS demonstrates that the work of a sustainable bank is invariant to different reporting systems.

The bank's compliance with Basel 3 requirements is shown below:

	Basel 3 requirements ("strictest" version, factoring in buffer capital, applicable from 01.01.2019)	Center-invest Bank (as at 01.10.11)
Total capital	10.5%	18.94%
Tier 1 capital	8.5%	12.02%
Common equity	7.0%	11.75%

6. At **Center-invest Bank, internal audit and compliance (IA&C)** is the responsibility of every business unit, not just the internal control service. Every employee has the right to ask management to explain transactions carried out by the bank. While IA&C has traditionally been concerned with losses, sustainable IA&C also requires checking of compliance with international best practice, the introduction of which will make existing operations and procedures more efficient.

7. *Sustainable operations management*

is based on modern information technologies and systems. These technologies should be used to automate not only routine business processes, geared towards the speculative markets, but also sustainable business processes that factor in the interlinkages between bank products, the work of the sales divisions, the sustainable development needs of customers, and risks. In 2007, Center-invest Bank began introducing a new information system based on SAP for Banking. This was an ambitious attempt to marry a fairly rigid German software product with the very rapidly changing Russian regulatory environment. However, the advantages of SAP products (commercial productivity and scalability, separation of business processes and accounting, built-in mechanism to manage business processes, and editable code) have enabled us not only to carry out a new process of localisation, but also to introduce a platform to manage HR and reporting processes, set up a centralised customer database, and support new customer service technologies.

8. *Sustainable customer and investor relationship management* (CRM & IRM).

At a time of increased market volatility and uncertainty about economic policies, the bank's customers and partners need up-to-date, reliable information about the current situation. To this end, we have held meetings with customers, investors and ratings agencies, and we have conducted seminars and participated in regional and international conferences. By providing objective, timely and user-friendly information, we have managed, despite the crisis, to help our customers and investors further develop their businesses in cooperation with Center-invest Bank.

9. *Sustainable banking products and services for retail and business customers in southern Russia*

- *SME Development in Southern Russia* Center-invest Bank launched its first SME sustainable development programme back in 1997. Today, more than 50,000 SMEs and sole traders bank with us. To support their sustainable business development, we advise them on business planning, bookkeeping and international best practice. Center-invest Bank did not

increase its loan interest rates during the crisis. This meant that SMEs were able to complete investment projects, modernize their operations, and, ultimately, become market leaders in the post-crisis economy.

- *Energy efficiency lending* in Russia has to contend with factors that constrain the introduction of energy efficiency technologies: relatively low energy prices, a tariff system that does not encourage reduced consumption, and social groups with vested interests in energy sales. Together with our partners IFC, the EBRD and KfW, we have developed special energy efficiency lending methodologies that combine technical, financial and social engineering. Using this integrated approach, Center-invest Bank has lent in excess of USD100m to finance more than 500 energy efficiency projects in various sectors of southern Russia's economy. Over 100 loans were for individuals to make energy efficiency improvements to their homes.
- *Agribusiness lending* is classed as high risk by ratings agencies because they take into account weather volatility, but not climate predictability. Accounting for 23-25% of total Russian agricultural output, southern Russia has sustainable advantages in terms of its natural environment and climatic conditions. Center-invest's loan portfolio in this sector exceeds USD250m. The loans are being used for the long-term modernization of agriculture in southern Russia, enabling producers to increase yields and productivity by more than one third.
- *Sustainable retail lending*. In contrast to speculative banks, which practise high-interest express lending, Center-invest Bank always asks how a loan will affect a customer's overall financial position and that of his family. This approach predisposes the customer to take a more responsible approach to borrowing, and encourages a long-term relationship with the bank.

10. *The next generation*

Center-invest Bank is actively involved in shaping the next generation, running educational programmes for schoolchildren, students and business people.

- *Schoolchildren*. We sponsored free training in basic Internet skills for more than 3,000 schoolchildren. Thanks to Center-invest Bank, since

2004 more than 55,000 schoolchildren have visited the exhibition "Treasures of the Don Steppes" at the Rostov Region Local Studies Museum for free, where they have learnt about the region's history. For the second year in a row, we are running the "Enterprise for All" project for schoolchildren (www.centrinvest.ru/business_study), providing an understanding of the principles of enterprise. Teachers in the region's schools are using a textbook written by specialists from the bank. For several years now, we have awarded prizes to the winners of the "Don Region Teacher" competition. We have also set up a kind of school for our customers' children and grandchildren called "The Secrets of the Art of Banking", at which experts talk in an accessible way about banking operations, new products and technologies.

- *Students*. More than 35,000 students use a Center-invest plastic card to obtain their grants. The bank set up the first endowment fund in southern Russia, the Endowment Fund for Education and Science in the Southern Federal District, which has capital of RUR35m. Since 2007, southern Russia's 250 top students have received scholarships from the Fund (totalling RUR5m annually). More than 3,000 students have used Center-invest loans to help finance their studies. Together with SAP CIS, we set up training centres in the Southern Federal University and the Southern State Technical University under the SAP University Alliance Program.
- *Business people*. Center-invest Bank holds weekly seminars for its customers on current economic issues. Together with IFC we set up an Energy Efficiency Centre, which trains IFC partner organisations from Belarus, Ukraine and other countries. Under the Partnership for Modernization programme, we work with partner banks to organise networking meetings for business people from Austria, Italy, France, Germany, India and China. Earlier this year, we organised a series of lectures as part of our current SME modernization programme, and in the summer we arranged free training for business start-ups.

Today, sustainable banking is seen as something of a "white cow" by participants in speculative markets, but in the not too distant future, it will be the "black swan" of the global post-crisis economy.