

A Sustainable Bank for a Sustainable Region

The formula for successful post-crisis development is: know your own business, your markets, and your advantages in these markets; have a development strategy. Center-Invest Bank chose the “sustainable banking” business model to effectively manage risks in southern Russia and it has produced a development strategy for the region. By Dr. Vasily Vysokov, Chairman of the Board of Directors of Center-Invest Bank.

1. SUSTAINABLE BANKING

The crisis triggered a search for an alternative to speculative banking. We believe that the alternative should be sustainable banking, which requires business development to be in the interests of both current and future generations. The sustainable banking business model retains long-term profit as an incentive, with due regard for environmental and social risks.

Center-Invest Bank integrates sustainable banking principles into its operations. Our many years of cooperation with international financial organisations and foreign partners have allowed us not only to study international best practice, but also to see the limitations that are inevitably inherent in even the very best approaches and methods, and to develop mechanisms to adapt these practices to specific Russian conditions. Working together with IFC and the EBRD, Center-Invest Bank became the first regional bank to introduce a corporate governance system, internal control and risk management systems, strategic planning, and financial reporting under International Financial Reporting

Standards as well as Russian Accounting Standards.

When writing our business plan for the following year we also produce a business forecast for the three subsequent years as of (01.01.2012-2015). This practice, which is incorporated in our strategic and operational planning procedures, means that as well as macroeconomic trends we can also factor in developments in the regional economy, taking on board the views of Center-Invest managers and specialists working at the local level.

In risk management, Center-Invest Bank is guided by the requirements of the Russian Central Bank, the recommendations of the Basel Committee, and also its own assessments, which are based on a combination of formal and content analysis and expert opinion. The bank’s total risk exposure is calculated on the basis that losses will not exceed 10% of planned profits. As we work in the real sector of the economy, risks are distributed between loan and market portfolios, in the ratio 80:20.

In anticipation of the phased introduc-

Table 1. Key Performance Indicators for Center-Invest Bank, calculated according to IFRS (as at 1st January of each year)

RUB, billions

AS AT 1ST JANUARY	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
						(PLAN)	(FORECAST)			
CAPITAL	2.2	4.2	5.2	5.5	5.4	5.5	5.4	6.2	7.1	8.7
ASSETS	13.6	23.8	39.5	50.6	42.9	46.3	51.8	58.8	65.3	74.1
LOANS AND LEASING	8.2	15.8	28.7	30.7	26.3	29.2	35.7	42.4	49.2	57.5
DEPOSITS	7.7	12.4	19.2	21.3	27.8	31.6	35.4	39.3	43.3	47.1
NET PROFIT	0.3	0.5	0.7	0.3	0.1	0.2	0.4	0.6	1.0	1.6

tion of new Basel rules (Basel III), Center-Invest Bank conducted a preliminary assessment of its capital adequacy indicators. The results were as follows:

- Total equity - 20.77%, when the minimum, including buffer capital, will be 10.5%;
- Tier I capital – 12.37%, when the minimum, including buffer capital, will be 8.5%;
- *The evaluation was carried out using the bank's capital to risk weighted assets ratio as at 01.07.2010 (unaudited IFRS accounts), and applied the strictest of the new Basel-III rules, which is not expected to take effect until 1st January 2019.

Center-Invest Bank ensures that its loan portfolio is diversified, maintaining a sustainable balance between the different groups of borrowers. Almost half of our loan portfolio consists of SME loans, and retail lending accounts for approximately one third of all loans. Our loan portfolio is differentiated by economic sector, reflecting the diversified structure of the economy of southern Russia.

As well as ensuring that our own internal procedures are effective, we also promote the sustainable development of our customers' businesses. Together with international financial institutions, Center-Invest Bank develops standard products for SMEs, energy efficiency projects, and agribusiness. These products help both the bank and our customers to assess and manage business risks properly.

In October 2008, we presented our business customers with the programme, "Southern Russia Versus the Global Crisis" http://www.centriinvest.ru/pdf/vysokov2009_allbook.pdf, which helped them to identify measures that would compensate for the negative impact of the crisis and ensure that their businesses could compete in the post-crisis economy.

During the crisis, we did not pass currency risks on to our customers, nor did we raise interest rates for existing loans. As a result of all these measures, business owners in southern Russia who bank with Center-Invest were able not only to complete existing projects, at a time of uncertainty, but also to confidently develop their businesses in the »



DR. VASILY VYSOKOV

Chairman of the Board of Directors of Center-Invest Bank

new post-crisis economy.

Center-Invest Bank has never engaged in express retail lending, which many banks carry out on a large scale without any serious analysis of credit risks. Notably, our application form for consumer loans, used to assess credit risks, always includes questions about the long-term plans of the customer and their family. Assessing the sustainability of borrowers' personal plans helps us to reduce risks and the cost of borrowing. To avert future crises, politicians are currently proposing tighter bank regulation in the form of stricter requirements for capital, liquidity and asset quality, caps on bonuses, and the introduction of special taxes. The "speculative banking: strict regulation" construct is becoming increasingly unsustainable, and, ultimately, it will collapse, much in the same way as did the targets system perfected by Gosplan, the Soviet State Planning Committee, during its seventy-year existence.

A new system of regulation will emerge from the ruins of this construct. In a recent book, http://www.centrinvest.ru/pdf/vysokov2009_allbook.pdf I proposed my own version of the post-crisis system of bank regulation, the main contours of which can be summarised as follows:

1. Banking will be split into a strictly regulated payments and settlements system and investment banking. The main regulator of the latter will be a requirement for all credit and loan agreements to carry a warning, similar to that on cigarette packets, "investment kills".
2. Ratings agencies will be re-registered as bookmakers.
3. Stock exchanges must include the word "casino" in their names.
4. The Basel Committee will become known as a construction company, "Tower of Babel 1, 2, 3 and so on".

The introduction of a regulatory system such as this might require a new generation of financiers and politicians. However, Center-Invest Bank already self-regulates: in addition to observing the Bank of Russia's requirements, we comply voluntarily with all international regulatory requirements and apply best international practice to effectively manage regional risks.

2. SOUTHERN RUSSIA: A REGION OF SUSTAINABLE DEVELOPMENT

Center-Invest Bank has 120 branches in the Rostov region, Krasnodar Krai, the Volgograd region and Stavropol Krai, areas which together account for more than 70% of the economy of southern Russia. In terms of its size, southern Russia is comparable to many European countries. In 2009, the Southern Federal District occupied an area of 591km² and had a population of approximately 23 million. At the end of 2009, the Southern Federal District was divided with the creation of the new North Caucasus Federal District, which includes the North Caucasus and Stavropol Krai national republics.

Many financial analysts are recommending that the current market situation be used for regional expansion. Situational analysis has shown that whatever the developments on global markets (economic recovery in developed countries, accelerated development in developing countries, various combinations of price trends for raw materials), southern Russia adapts to any changes easily. As for regional expansion within Russia, of all the federal districts, southern Russia has the best combination of risks and growth opportunities. Clear advantages

of southern Russia are its convenient geographical location (an intersection for rail, road and air routes between Ukraine and the Urals, and the Caucasus and central Russia) and its natural and climatic conditions (on average, 5° warmer than Moscow). It also has advantages associated with its diversi-

Table 2. The Southern Federal District as a % of the Russian Federation

	2009	+/- against 2005
Population	16.18	0.22
Gross regional product	8.00	0.54
Industry	6.33	0.13
Agriculture	21.56	-0.21
New housing	15.72	1.46
Trade	13.30	1.65
Personal income	11.92	1.26
Investment	11.90	3.16

Gross regional product – data from the previous year

With the crisis, the sustainability of southern Russia's business model became even more apparent: the downturn was less pronounced in southern Russia and the regional economy is recovering at a faster pace than the Russian economy as a whole.

Table 3. Economic indicators (in %) 2009–2010 (YoY)

	2009			3Q 2010		
	Russian Federation	Southern Federal District	Incl. North Caucasus Federal District	Russian Federation	Southern Federal District	Incl. North Caucasus Federal District
Industry	-10.8	-9.8	2.9	8.9	9.4	7.0
Agriculture	1.2	-5.2	-1.5	2.9*	6.0*	4.5*
New housing	-6.7	-5.5	6.5	-5.5	-0.1	9.6
Trade	-5.5	-2.4	5.4	4.4	9.3	9.3
Personal income	11.7	12.1	14.2	11.3	25.0	19.2
Investment	-14.8	-0.8	1.4	-5.7*	28.7*	-8.3*

*2Q2010

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Due to their low incomes (25% lower than the Russian average), the people of southern Russia could not afford to speculate on the stock market or the property market, and, as a result, they avoided financial losses during the crisis. The crisis caused a sharp fall in the speculative component of personal

incomes. As this component was lower in southern Russia, personal incomes in the south are now increasing faster than elsewhere in the Russian Federation.

Even in the crisis conditions, the population of southern Russia continued to purchase essential goods. Consequently, retail sales declined less in the south than in Russia as a whole. The construction industry also suffered less, with prices for new housing containing a significantly lower speculative mark-up. Industry in southern Russia, with its more diversified structure, experienced a smaller decline in output, and production is returning to its pre-crisis level at a faster rate. It is important to note that during the crisis the engineering, chemical, food, and construction materials industries in southern Russia proved more competitive in terms of the price to quality ratio.

After a bumper harvest in 2008, agricultural output in southern Russia fell in 2009. However, the region enjoyed a good harvest in the first half of 2010, and this did much to compensate for the losses resulting not only from the crisis, but also from the fires in central Russia. The increased investment in southern Russia even in crisis conditions reflects the commitment of the authorities and construction companies to complete the infrastructure for the 2014 Winter Olympics in good time, to carry out the planned reconstruction work in the North Caucasus, and also to begin developing ski resorts and recreational facilities in the North Caucasus.

3. THE POST-CRISIS DEVELOPMENT AND MODERNISATION OF SOUTHERN RUSSIA

For speculative bankers, post-crisis development means searching for new bubbles and constructing new financial pyramids. Southern Russia is continuing to develop in a sustainable manner: by using the more modern equipment and technologies of developed countries, companies in southern Russia will be able to increase efficiency in all sectors of the region's economy and produce competitive goods to meet local demand and supply developing markets.

Center-Invest Bank and its customers have considerable experience of financing projects to introduce new equipment and technologies in southern Russia.

- For a distance of more than 300 kilometres from the regional centre, one can see well-tended fields where producers are using the very latest agricultural equipment from leading international manufacturers. In the same area, there is a farm producing high-grade marbled beef, almost all of which is sold for export.
- In hangars in the outskirts of Rostov, bricks are produced using energy-efficient technologies, and production continued during the crisis. Nearby, there is a factory producing energy-efficient boilers. German advisors are helping this company to reduce its costs and optimise its manufacturing processes. The company's high-quality products are being bought up by a French firm.
- In an orchard abandoned several years ago, the trees are now heavily laden with apples. The fruit are grown using Italian methods, and the producers have seen yields triple.
- Just outside a farm, in former repair workshops, a company is using Korean equipment to manufacture quality toilet paper from paper waste supplied by the nearest town. Their products are snatched up by retail chains in big towns.
- In a small settlement in the foothills of the Caucasus, a company is using Swiss production lines to manufacture plastic packaging for dairy products. The company is one of the leaders in the Russian market.
- An important extra touch to add to each of these pictures: today, the children of the founders of these small businesses are working alongside their parents. Having studied abroad, this younger generation are fluent in English.

Labour productivity in southern Russia is only 20-25% that of European countries. When it comes to foreign trade, southern Russia lags 30-100 times behind. To a large extent, this situation is a result of the Soviet-era centralisation of foreign trade. (This centralisation persists, in that trade flows to the regions via Moscow.) Therefore, entering global

markets is one of southern Russia's main post-crisis development tasks.

Southern Russia is in a good position to succeed in this. Firstly, although its transport infrastructure is 5-6 times less developed than in Europe, road and rail density in southern Russia is 3-5 times higher than the Russian average. Secondly, in terms of yield and productivity, agriculture in southern Russia is gradually approaching European levels. Thirdly, despite relatively low levels of investment in research and development (half of the Russian national average), the people of southern Russia are proving particularly capable of introducing technological innovations. This is all the more important given that the introduction of new technologies can be seen as the Achilles heel of Russia's modernisation.

Indeed, with their notably proactive mentality, the population of southern Russia are already engaged in the post-crisis development and modernisation in their region: even during the crisis, southern Russia accounted for more than 20% of total investment in SMEs in the Russian Federation. Although recent years have seen a considerable increase in the share of employment in SMEs, it is still only a third of the European average. To eliminate this disparity, SMEs alone will require about five billion dollars in investment.

Economic recovery in southern Russia will be faster than in the country as a whole, and the region has a good chance of being able to overcome the disparity between personal income levels in southern Russia and the rest of the country. The post-crisis modernisation of southern Russia, using the latest internationally proven technologies, will enable the region to increase the efficiency of its production, and this increased productivity will, in turn, pay for the investment in modernisation. **ff**