Russian Basel II adoption unlikely before 2010

Implementation of the new capital standard slowed by language difficulties and inertia. Bankers' association takes leading role

Moscow bankers now believe that the new Basel capital standard, aimed at underpinning the solvency of banks around the world, is unlikely to be adopted in Russia before 2010, according to Vladimir Gamza, who is leading the local banking community's strategy for implementing the new standard. This date is some two or three years later than the Central Bank of Russia (CBR) had initially hoped, he says, answering questions submitted by ***Global Risk Regulator***.

It is the Association of Russian Banks (ARB), representing over 700 banks and other institutions, with 90% of banking system assets, that is now attempting to drive the implementation process

The CBR, which is said to be firmly committed to adopting the new risk-based Basel standard (Basel II), first aimed to implement it in Russian in 2007, then 2008, says Gamza. However, these dates seem to have been informal objectives. In practice, the central bank has not given a high priority to preparing Russia's 1,100 banks for Basel II. A draft translation of the Basel II framework was put on the CBR website only this January.

It is the Association of Russian Banks (ARB), representing over 700 banks and other institutions, with 90% of banking system assets, that is now attempting to drive the implementation process. The ARB's new Committee on Risk Management and Basel Accord Implementation held its first working session in late November, approving Vladimir Gamza as chairman. He is also chairman of Agrokhimbank, a Moscow-based joint-stock company.

In a press release, ARB said its new committee will arrange Russian translation of key Basel Accord documents; organize training and certification sessions to educate the required specialists; arrange appropriate scientific materials and methodology, to ensure a comprehensive use of international experience; and establish a web-based system of efficient cooperation among the committee members.

2007 work schedule

Chairman Gamza and other senior committee officers will also develop a work schedule for 2007 and set up working groups to deal with major issues of the Basel implementation process in Russia "in a relatively short time." Educational events were planned for January 2007, the first being *Basel II: Organizing Operational Risk Management* training session. In March or April the committee will also hold a nationwide conference on organising Basel Accord implementation in Russia.

Vladimir Gamza has little doubt that in the longer term Russian banks, which currently apply the existing Basel I capital rules, will implement a Basel II regime. But the short-term situation is unclear. Banks are looking to the CBR to give a lead. And, as the implementation date has slipped, it has becoming increasingly clear just how much preparatory work is involved, he says. He also suggests that the implementation deadline may not be the same for all banks. It may be "less uniform" than previously announced, he says.

Vladimir Gamza
Slow adoption of Basel II in Russia is partly caused by "insufficient pressure from the regulator"

Under Basel II, banks can choose between three different approaches to measuring their credit and operational risks, and calculating their minimum capital requirement. The biggest banks in Russia, particularly those with substantial foreign capital ownership, may adopt the most advanced measurement approaches using internal risk models. Most banks will opt for the simpler approaches.

The impact of Basel II on Russian banks will vary greatly, Gamza says, depending on their size and whether they are "capital city banks" or based in the more, or less, attractive investment regions. Smaller banks based in less attractive *to page 8*

Russian Basel II adoption unlikely before 2010

From page 7

investment regions, for example, will be forced into an aggressive search for new investment opportunities and market niches, probably in preparation for being sold to larger competitors.

Among the reasons why the whole Basel II implementation has proved so slow in Russia, Gamza cites "insufficient pressure from the regulator," along with linguistic and comprehension difficulties of translating the official texts into Russian. Above all, however, the "driving force for this process is missing," he says. It is this gap that he hopes his new committee will fill. "We hope that the process speeds up and becomes more goal-oriented as of now, and we would be happy to cooperate with our colleagues worldwide," says chairman Gamza. He still sees many obstacles – inertia, lack of knowledge and specialists, and the banks' limited resources.

Banks still play a more limited role in the Russian economy than they do in many other countries. Banking assets represented just 42.5% of the country's gross domestic product (GDP) in 2004 and banking loans financed just 7% of investment, according to a report last year from credit rating agency Moody's. In developed economies, banking assets are closer to 100% of GDP. However, increased intermediation over coming years should have a favourable impact on the size of banks and their profits, Moody's added.

At the same time transparency and information disclosure among Russian banks is only improving very slowly. In a recent survey of Russia's 30 largest banks, conducted by credit rating agency Standard and Poor's, the average score was a very poor 39% in 2006, compared with 36% in a similar 2005 survey.

The woes of the banking system probably also explain the failure of the CBR to drive the Basel II process. It has other, more pressing, concerns

While 14 banks improved their scores in 2006, another 12 saw their scores fall. By comparison, the average score for a group of top US and European banks was 79% (scores are based on a checklist of over 100 items, such as ownership and corporate structure, discloser of financial and operational information, and board and management structure and process).

Little wonder that many Russians still have little confidence in the banks, particularly the private sector banks. The woes of the banking system probably also explain the failure of the CBR to drive the Basel II process. It has other, more pressing, concerns.

Concepts of risk management have been embraced by the country's biggest banks, which do have fairly comprehensive credit risk management systems in place. But, for the majority of banks, such systems are still at a very early stage of development, says Gamza. Only a tiny handful of banks have begun to implement aspects of Basel II as "best practice," he says. And, operational risk management systems are still "in a kind of embryonic state" at most banks. But interest in such ideas is growing.

Why Basel II is compelling

There are compelling reasons why Russia must implement Basel II, Gamza says. For a start, Russian wants to joint the World Trade Organisation, which will no doubt require that it open up its market to more competition in financial services, as was required of China when it joined the organisation. "Russia simply has no choice," but to adopt Basel II. Otherwise, the best Russian and foreign customers will be going to the Russian banks' competitors.

Despite the CBR's dilatory approach to implementing Basel II, the central bank claims to be committed to doing so. Gamza says this commitment reflects a recognition that Russian banks must adopt internationally accepted ideas of proper banking practices, both to enhance their competitiveness against international rivals, and increase their contribution to providing financial stability and investment potential in Russia. GRR