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DIRECT AND INDIRECT STATE OWNERSHIP ON BANKS IN RUSSIA [1]

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Abstract

This paper uses the banking industry case to show that the boundaries of public property in Russia are blurred. A messy state withdrawal in 1990s left publicly funded assets beyond direct reach of official state bodies. While we identify no less than 50 state-owned banks in a broad sense, the federal government and regional authorities directly control just 4 and 12 institutions, respectively. 31 banks are indirectly state-owned, and their combined share of state-owned banks' total assets grew from 11% to over a quarter between 2001 and 2010. The state continues to bear financial responsibility for indirectly owned banks, while it does not benefit properly from their activity through dividends nor capitalization nor policy lending. Such banks tend to act as quasi private institutions with weak corporate governance. Influential insiders (top-managers, current and former civil servants) and cronies extract their rent from control over financial flows and occasional appropriation of parts of bank equity.

Key words: Russian banks; state; government; public sector; state-owned banks; state-controlled banks

***JEL codes*:** G21, G28, P31, P43

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1. Introduction

This paper aims to contribute to the study of public sector in Russia using the banking industry as a case. While the pervasiveness of the public sector in Russia is broadly recognized, it is not a simple task to document it carefully. Clear-cut "black-and-white" distinction between forms of ownership (public *versus* private) does not exist, and we identify fairly many state-influenced banks where the government is not a shareholder of record.

Our motivation is to clarify the allocation of state-owned banks among controlling entities. That might add color and detail to the picture of state-banking in Russia and underpin policy recommendations. The data sample collected on the basis of our definition of public sector can be used for subsequent empirical research.

A few papers dedicated to state-banking in Russia and its effects have emerged since 2007. Babayev [2007], Glushkova and Vernikov [2009] and Vernikov [2009] discuss key definitions related to state banking, try to develop a comprehensive classification of public banks and to assess the size of public sector in terms of its market share of total bank assets.

Empirical research has already started covering selected aspects of state banking in Russia. Karas *et al.* [2008] find – surprisingly – that in Russia domestic public banks are no less efficient than private banks. Fungáčová and Poghosyan [2009] analyze interest margin determinants with a particular emphasis on the bank ownership structure and argue that state-controlled banks do not seem to take credit risk into account in their pricing strategy. Fungáčová *et al.* [2010] look into bank competition in Russia by measuring the market power and its determinants over the period 2001-2007 and find no greater market power for state-controlled banks. Glushkova [2010] makes a very preliminary empirical assessment of behavior patterns and relative performance of state-owned banks vis-à-vis other groups of market participants. She finds that banks directly owned by state authorities display lower profit efficiency than private institutions, whereas banks indirectly owned by the state behave more or less like their private peers.

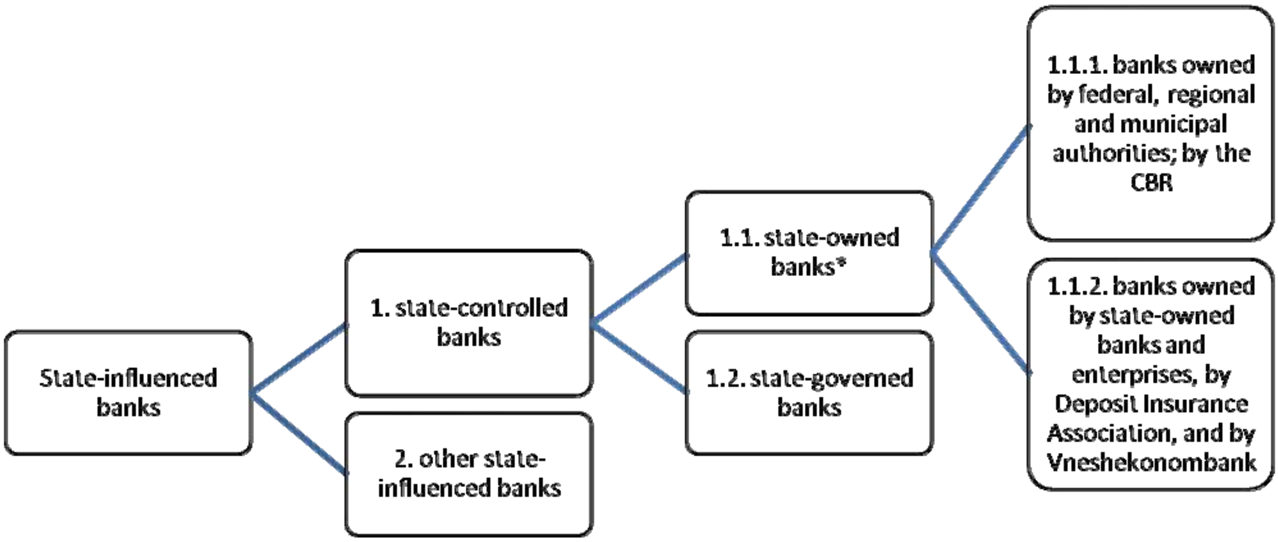
In this paper we collect bank-level statistics to reveal changes in the ownership structure of the banking industry and the techniques of ownership control. These issues are relevant for studies of comparative efficiency and performance of institutions with different ownership types.

The rest of this paper is organized as follows. *Section 2* briefly introduces key definitions and a classification of state-influenced banks. *Section 3* assesses the size of public sector and its main components. *Section 4* addresses the interplay between ownership and control in indirectly state-owned banks. *Section 5* suggests an outlook, and *Section 6* concludes.

2. Public sector in Russian banking: Scope, definitions and classification

The main criterion of classifying a bank is the degree of *control* over its decision-making and lending policy by state authorities and managers in charge of public capital. Control can be exercised via equity ownership, via governance, or otherwise. We depict diverse forms of interaction between banks and the authorities in a classification scheme (**Fig.1**).

Figure 1. Classification of state-influenced banks



* At least 50% of equity originates from public funds

Group 1.1 - *state-owned banks* (hereinafter SOBs), or *government-owned banks*, or *public banks,* represents the center-piece of the suggested classification of state-influenced banks. SOB is a bank with state ownership exceeding 50%. In the literature one comes across more liberal criteria: La Porta, López-de-Silanes and Shleifer would recognize a bank as "government-owned" if government holds at least 20% of equity but acts as the single largest shareholder [La Porta *et al.*, 2002]. We define the category of *state-controlled banks* (group 1) more broadly than just SOBs to include as well banks that are governed by the state or its bodies in the absence of majority equity participation (*state-governed banks* – subgroup 1.2).

Banks in subgroup 1.1.1 are *directly* state-owned in the sense that that their major or sole shareholder is an executive body at the federal, regional or municipal level, or a CBR. Strictly speaking, however, Russian law provides three forms of ownership (public, municipal, and private ownership), so municipal property is not the same as state property. Banks in subgroup 1.1.2 are *indirectly state-owned*, because they are mostly capitalized by funds of public origin and do not belong directly to state authorities. We refer here to banks over 50% of whose equity belongs to companies and banks that are fully public property or have mixed public/private capital with prevalence of public funds.

The legal status of bank equity belonging to SOEs and SOBs remains blurred. There is no universally recognized methodology for classifying bank shares and participations as public or private, especially with regard to downstream holdings. Absence of the state (understood as federal-level authorities) among bank shareholders of record provides a formal basis for treating such a bank as private property. Commonsense would suggest that predominantly public origin of funds at the top-level company must reproduce the same form of ownership downstream. Therefore a bank even at the bottom of the corporate control pyramid should also be regarded as public property. Not so in Russia. According to Law on Privatization and other pieces of legislation, public property invested in a subsidiary company or bank stops being public. A subsidiary bank of SOE is nominally private even if in essence it is not. From this viewpoint, for example, VTB24, the retail banking subsidiary of VTB bank, does not belong to state property and is a joint-stock company whose shares belong to another joint-stock company.

State control over a bank's activity can as well exist in the absence of majority equity participation. Absolute majority of "state-governed banks" (subgroup 1.2 "state-governed banks" in the classification depicted in **Fig.1**) are the failed financial institutions now run by the Deposit Insurance Agency (*ASV*).

Regardless of legal formalities, broad public often refers to indirectly SOBs as "quasi-state banks", i.e. para-statals. We do not think it is correct. A quasi-state bank is actually one that is broadly perceived as a SOB while not being one, so this term would for example fit VTB24 that technically does not belong to the state. Conversely, banks that are nominally private JSCs but are funded with public resources we prefer to call "quasi-private".

In order to develop a sample of SOBs, we screened individual banks for presence of public sector institutions among listed shareholders. No official publication contains data broken down by form of property in a way acceptable to us from a substantive viewpoint. Information sources included statutory disclosure by banks and their parent companies, annual and quarterly reports, CBR publications and website. Statistical data were borrowed from *Interfax* quarterly database of Russian banks, *RBK* rankings, and bank web-sites. By January 2010 our sample of state-owned banks consisted of 50 institutions (**Table 1**). Out of this number, 16 banks are state-owned in the legally strict sense: 4 of them are fully or majority owned by federal level authorities (federal government and the Central Bank of Russia) and 12 by regional authorities[3]. Three banks belong to municipal authorities[4].

Table 1. Breakdown of state-owned banks

	Number of banks	
	01.01.2001	*01.01.2010*
Federal executive authorities and the CBR	6	4
Regional authorities and federal city governments	10	12
Municipal authorities	1	3
State-owned companies, state-owned banks and "state corporations"	19	31
Total	**36**	**50**

Source: Author's estimate based on bank data

The remaining 31 banks in the sample we regard as *indirectly state-owned* because they are controlled by public sector entities and not the federal government itself. Funds of public origin have been invested in subsidiary bank equity by state-owned enterprises (hereinafter SOEs) such as *Gazprom*, *Rosneft*, Russian Railways, and *Alrosa*, by a SOB (*VTB*) and by 2 of the "state corporations"[5] (*ASV*, the Deposit Insurance Agency, and *Vneshekonombank*, the Bank for Development and Foreign Economic Affairs). Some of indirectly SOBs (*Gazprombank*, *TransKreditBank*, *VBRR*, *Bank Moskvy* etc.) in their turn own stakes in other commercial banks. Full sample of SOBs is specified in [Vernikov, 2009b]. Constructing a data sample of state-owned banks is a continuous process. Since the release of our previous studies in November-December 2009 [Vernikov, 2009a; 2009b] some banks have changed hands, fell under state control or were divested from by state-owned companies.

[3] Governments of relatively affluent regions like Khanty-Mansiysk, Tatarstan, Sverdlovsk, Krasnodar, Orenburg and the city of Moscow are majority owners of commercial banks. Some other regions and municipalities launched their banks too but could not sustain them.

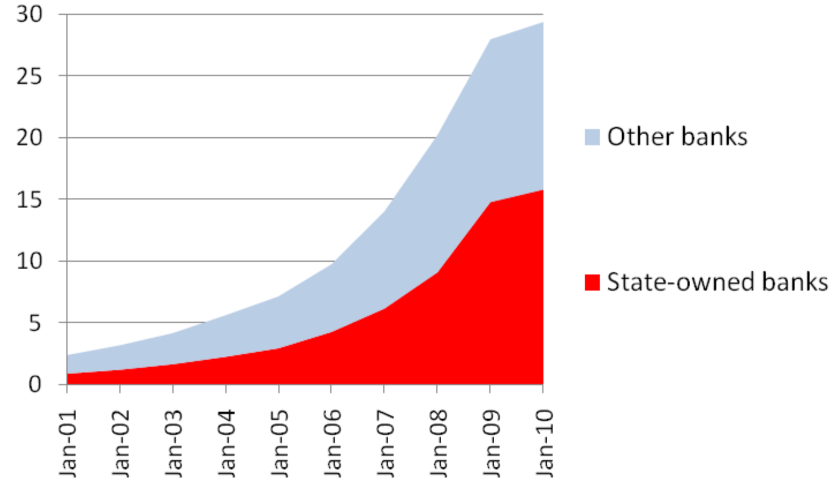
[4] The number of banks controlled by municipal authorities is certainly greater, but so far we have not been able to document. These banks are usually small in size, so their omission does not affect the accuracy of our estimates.

[5] *ASV* and *VEB* have legal status of "State Corporation" that is neither a joint-stock company nor executive agency nor part of the Russian federal government. Each of them is governed by an individual federal law. We put the legal status in quotation marks because "state corporations" are not really corporations in the conventional sense but not-for-profit entities.

3. The growing share of indirectly state-owned banks

During the decade of 2000s, state-owned banks have increased their combined assets to RUB 15.8 trillion (**Fig.2**). Public sector grew organically due to the greater dynamism of state-owned banks, as well as via takeovers of failed private banks. First takeovers were unrelated to the 2008 financial crisis. *Vneshtorgbank* (now VTB) used public funds to take over the failed *Guta-Bank* in 2004 and the viable *Promstroybank* in 2005. *Guta-Bank* was transformed into VTB fully-owned subsidiary under the brand of VTB24. The 2008 crisis greatly accelerated transfer of formerly private banks under state control.

Figure 2. Growth of Russian bank assets, RUB trillions



Source: Author's calculations based on data from CBR, *RBK* and *Interfax*

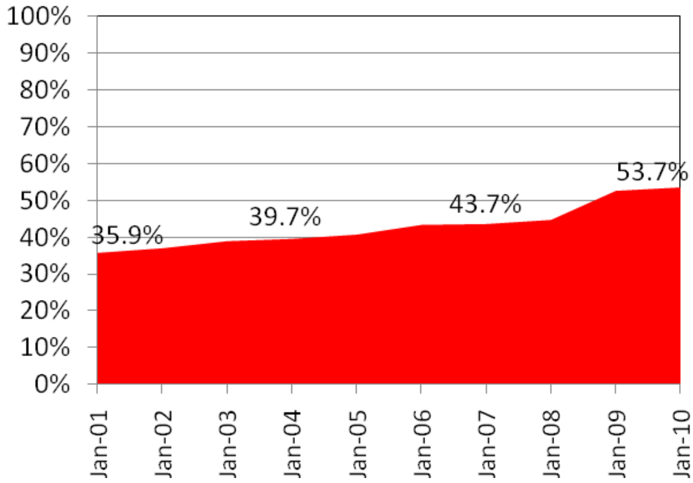
The combined market share of state-owned banks[6] reached its bottom of 30% or so in 1998 and then started to grow again. The recent financial crisis of 2008-9 catalyzed the process but certainly did not originate it. Over 2001-10 there was not even a single year-on-year decrease of state-owned banks' market share (**Fig. 3**), and by January 2010 it reached 53.7%. There are alternative estimates of the same indicator (**Table 2**). Central Bank of Russia experts put the share of total assets held by state-controlled banks[7] at 40.6%, which is fairly close to our estimate under a narrow definition of state property (federal and regional authorities only). The gap of 12 percentage points between the CBR figure and our broad estimate is attributed to

[6] We define market share as the percentage of total banking assets held by state-owned banks. When state participation exceeds 50%, the bank's assets are counted fully at 100%. Banks with minority state participation were not included. For further detail see [Vernikov, 2009b].

[7] CBR experts use the term "state-controlled banks" in their analytical reports without specifying which exactly banks are meant [CBR, 2009, pp.18, 20, 24]. As far as we can judge by the statistical indicators provided, CBR experts stick to a rather narrow definition of "state" that comprises banks belonging to federal and regional executive authorities.

difference in coverage, namely (non-) inclusion of indirectly-owned banks such as the offspring of SOEs, SOBs and "state corporations".

Figure 3. Market share of state-owned banks (% of total assets)



Sources: Author's calculations based on data from CBR, *RBK* and *Interfax*

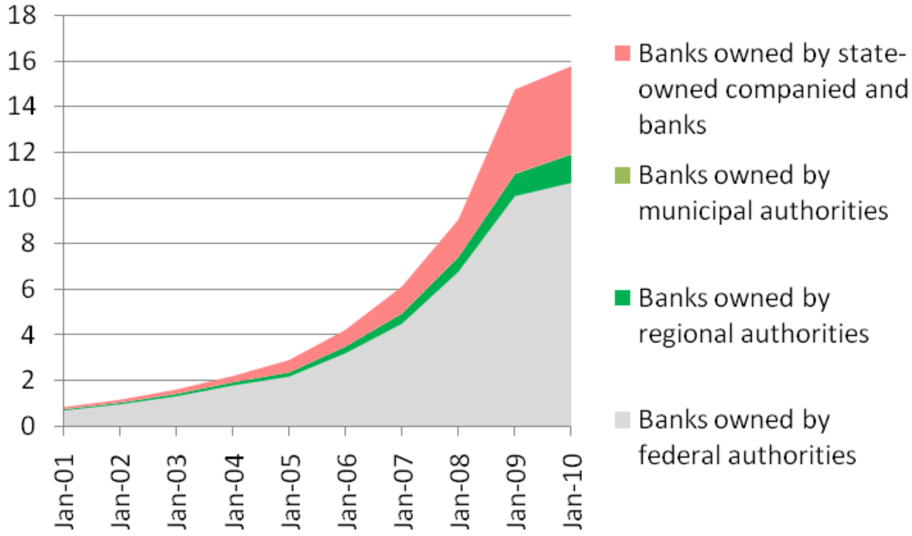
Table 2. Market share of public banks in Russia, January 1, 2009

Author / source	*Indicator*	*Market share, % of total assets*
EBRD, 2009	"state-owned banks"	37.5
CBR, 2009	"state-controlled banks"	40.6
Raiffeisenbank, 2009	"state-owned banks"	45.7
author's calculation	"state-owned banks", narrow definition	39.5
author's calculation	"state-owned banks", broad definition	52.8
*author's calculation**	"state-owned banks", narrow definition	40.5*
*author's calculation**	"state-owned banks", broad definition	53.7*

* January 1, 2010

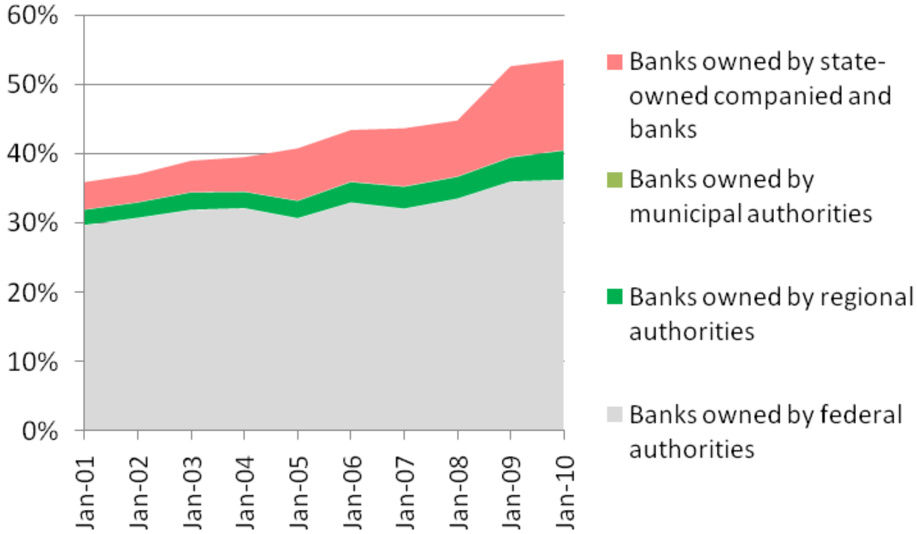
We deem it essential to distinguish two main components within public sector, namely directly-SOBs and indirectly-SOBs. **Figures 4** and **5** and **Annex Table 4** display the main trends in assets growth and market share dynamics of individual categories of banks.

Figure 4. Growth of state-owned banks' assets (RUB trillions)



Source: Author's calculations based on data from CBR, *RBK* and *Interfax*

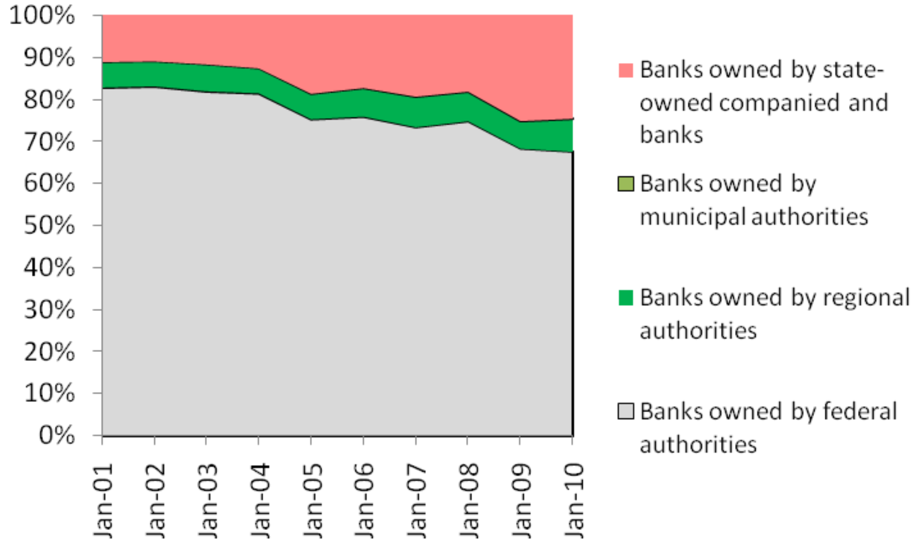
Figure 5. Market share of different types of state-owned banks (% of total bank assets in Russia)



Source: Author's calculations based on data from CBR, *RBK* and *Interfax*

Among the 4 banks directly controlled by federal-level authorities, three are very large (*Sberbank*, *VTB* and *Rosselkhozbank*). It is the assets of these "national champions" that drove upwards the share of directly-owned banks in Russia's total from 29.7% to 36.3%. The shares of banks controlled by regional and municipal authorities did not change much. The fastest-growing category was, however, the banks owned by public sector companies and banks. Their number grew from 19 to 31, and their share of total bank assets jumped from 4.0% to 13.1%. This led to a visible restructuring *within* the public sector, and contribution of indirectly state-owned banks has exceeded 25% (**Fig.6**).

Fig. 6. The growing share of indirectly state-owned banks (% of total assets of public banks)



Source: Author's calculations based on data from CBR, *RBK* and *Interfax*.

All previous tables and figures use data referring to aggregate categories of banks depending on type of ownership. But composition of data sample has not been stable because banks have migrated from one category to another[8]. The burgeoning of the group of banks owned by SOEs, SOBs and "state corporations" took place since the 2H2008 only. Hence for empirical purposes a new stable data sample needs to be constructed. We left only banks that throughout the entire period of observations (1Q2001 through 4Q2009) remained in the same category of public ownership. Description of the new sample is in **Table 3**. A stable data set loses numerically as compared to the original sample (coverage of 54%) but retains satisfactory representativeness in terms of combined market share of banks in the sample (87.2% of the full original sample).

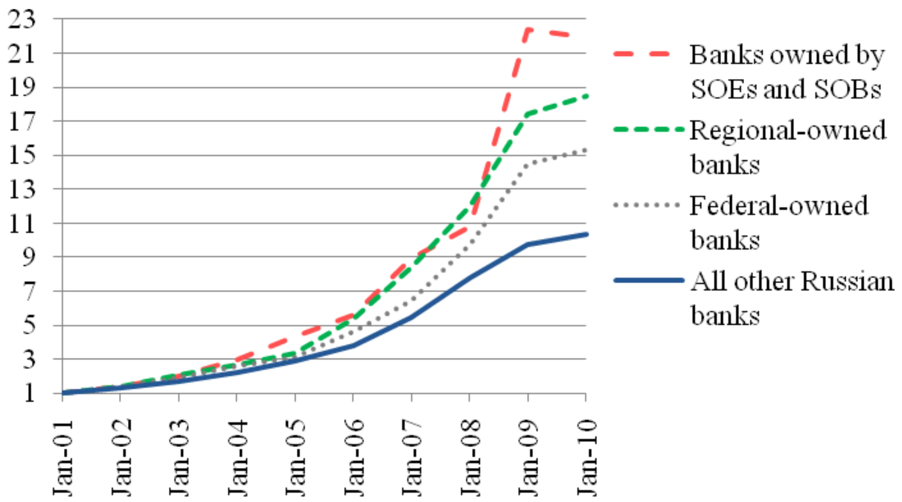
[8] For instance, in 2007 the government transferred two of its banks (*Rossiyskiy bank razvitiya*, reg.#3340 and *Roseximbank*, reg.#3340) from federal ownership into the property of *VEB*, a "state corporation". In the second half of 2009 the Republic of Tatarstan injected funds into equity of *Ak Bars Bank* to become its core shareholder, so we reclassified *Ak Bars Bank* from subgroup 1.2 (state-governed) to subgroup 1.1.1 (bank owned or controlled by regional authorities).

Table 3. Description of stable data sample of public banks for empirical research

New sample: indicator	*As % of the full sample, January 1, 2010*	
	Number of banks	*Market share*
Federal-owned banks (3)	75%	100%
Regional-owned banks (9)	75%	77.6%
Municipal-owned banks (0)	0%	0%
Banks owned by SOEs and SOBs (15)	48.4%	55.2%
Total (27)	**54.0%**	**87.2%**

Analysis of the stable sample reveals that SOBs have grown faster than the remaining Russian market players, and among SOBs the indirectly-owned banks have grown faster than others categories – federal-owned and regional-owned banks (**Fig.7**). Whether SOBs have outperformed other Russian banks in terms of efficiency remains a question on our research agenda. Glushkova [2010] makes a very preliminary empirical assessment of behavior patterns and relative performance of SOBs *vis-à-vis* other groups of market participants. She finds that banks directly owned by state authorities do display lower profit efficiency than private institutions, whereas banks indirectly owned by the state behave more or less like their private peers.

Figure 7. Indirectly state-owned banks grow fastest (bank assets on January 1, 2001 = 100)



Source: Author's calculations based on data from CBR, *RBK* and *Interfax*

4. Interplay between ownership and control

We argued in the previous section that the importance of indirectly SOBs has consistently grown over the decade of 2000s. Indirect public ownership represents a fairly flexible arrangement beneficial for all parties involved. For government authorities themselves, indirect ownership might be convenient from political and propagandistic points of view as it conceals the true magnitude of public sector and allows promoting Russia's image of a "normal market economy".

Banks directly owned by the state are bound by government rules and regulations. Authorities appoint delegates to the board of directors, and those delegates have to vote according to government orders and guidelines. Indirect form of ownership helps to overcome bureaucratic hurdles related to management of public assets and disposition of them and implies lesser accountability. By migrating from direct to indirect public ownership bank insiders unwilling to perform one of the specific roles expected from a SOB[9] may distance from the state authorities.

This might be one possible explanation to the trend of banks migrating from direct to indirect public ownership. Moscow city government used to control *Bank Moskvy*, Russia's 5th largest financial institution, from the bank's inception in 1995, but at a certain point direct control slipped away from the government through a chain of apparently legitimate corporate actions. Now the Moscow city government owns directly just 48.11% percent of equity; another 15.28% belongs to *Stolichnaya strakhovaya gruppa*. The latter is an insurance company affiliated with the Moscow city government and co-owned by the government and *Bank Moskvy*. As for control, *Bank Moskvy* might be under decisive influence of its CEO and a few persons close to the Moscow city government.

Dilution of corporate control is more common yet in indirectly SOBs. *Gazprombank*, Russia's 3rd largest bank initially was under control of *Gazprom*, but by now *Gazprom*'s stake has fallen below the level of direct control (41.73% of shares). Instead the bank's majority shareholder of record with 50% plus one share is now *Gazfond*, the *Gazprom*'s pension fund; another 6.98% of shares belong to "*OOO Novfintekh*", *Gazprombank*'s own subsidiary company. Who actually

[9] Core SOBs have preferential access to public funds and enjoy a variety of other privileges, but have to perform special functions in addition to those routinely performed by all commercial banks, i.a.: (a) to allocate liquidity obtained from Finance Ministry and CBR among banks in the lower tier; (b) to acquire and hold non-core industrial assets deemed as strategic by state authorities; (c) to make long-term investment available to "systemically-important" enterprises and "strategic projects", including those with a social or political dimension like sport or congress facilities; (d) to provide first-aid funds to companies and regions hit by natural or technological disasters.

controls indirectly state-owned banks? In the case of *Gazprombank*, it is no longer its parent company (*OAO Gazprom*) or the government. The bank might be influenced by St.-Petersburg-based shareholders of *Bank Rossiya* who act through *Lider* management company that manages the assets of *Gazfond*, the bank's core shareholder of record.

We note two particular features inherent to indirectly SOBs: (a) public sector entities recur to circular ownership and control structures (*Bank Moskvy* and *Stolichnaya strakhovaya gruppa* own each other's shares, and so do *Gazprombank* and *Novfintekh*); and (b) Moscow city government can exercise full control over Bank Moskvy, but legally it is a minority shareholder. Mutual ownership of shares was, and still is, broadly used in the private sector as a defense instrument against corporate raiders. Its usage in a public bank may mean that its affiliated persons do not fully trust existing mechanisms of ownership protection and, just in case, prefer to put in place additional defense against a possible suitor, including the state itself.

Indirect ownership is often organized through several levels, or tiers, of corporate control between a bank and its ultimate beneficiary owner. Indeed, we find growing evidence of multi-level holding structures with a large SOE or SOB at the top of the pyramid. In the corporate pyramid we see up to five intermediate ownership levels between a government entity and the equity stake in a downstream commercial bank. Each superior entity holds a controlling stake in the lower-level entity. We refer to two pieces of evidence, one related to holding structure within *Gazprom* group (Annex **Fig.8)** and the other to Russian Railways, the state-owned transportation monopoly (Annex **Fig.9**). Russian Railways JSC owns *TransKreditBank* that in turn owns five subsidiary banks. In a more complicated fashion, the Russian state controls *Gazprom,* one of whose divisions (*Mezhregiongaz*) owns *Gazenergoprombank,* that took over *Sobinbank*, that had been in control of *Russky ipotechny bank* (until April 2009).

Corporate pyramids enable separation between ownership and control. Under normal circumstances ownership title should give control rights. But state bodies do not hold ownership title for a stake in indirectly owned banks. The state only has authority over corporate decisions of the company one level down but not of the downstream companies. Nominally the SOE/SOE on top of the pyramid can act through management bodies (board of directors, CEO and/or executive board) of the subsidiary bank that can theoretically project the influence and will of the top institution further down the chain. But with each additional tier of the corporate pyramid public control and scrutiny over the use of public funds gets weaker. There is however no reason to argue that downstream banks have escaped from the control of the SOE on top of the corporate pyramid, rather that control mechanism has become less formal and transparent. When necessary, this control chain works well. When insiders find it less beneficial for them, the machine comes to a halt, and simplest corporate actions can be take a long time.

The use of multi-level holding structures often signals *entrenchment* of the blockholder against outside shareholders[10]. The blockholder might be the government or the top management of SOEs or SOBs. Entrenchment is a way to leave without leaving, i.e. to maintain leverage over the company after the state formally divests from it partly or fully.

Indirect state ownership creates fertile ground for all kinds of *opportunistic behavior* by bank insiders including top-managers, current and former civil servants, and cronies. For all practical purposes, influential insiders (bank top managers, board members and the public officials who represent the authorities) run indirectly state-owned banks as if it were their own private property. Dilution of property by insiders and tacit appropriation of parts of bank equity are not uncommon. Some of the large banks that are universally perceived as state-controlled banks technically are not.

Delegation of owner rights by executive authorities to related companies was already widespread by the start of this decade, but the 2008 financial crisis gave it a powerful boost. When banks started collapsing in autumn 2008 and for a combination of reasons their nationalization became imminent, none of them was taken over in a straightforward way by federal executive authorities. In each case an individual scenario was selected, involving one or another entity to act on behalf of the state. The most common case was delegation of rescuer functions to the deposit insurance agency (ASV) that prior to the crisis did not have such authority. ASV presided over rehabilitation of 19 banks and received back-up funding of RUB 200 billion from the budget. In a similar fashion VEB – Development Bank, another "state corporation", received public funding for a bail out of *Svyaz-Bank* and *Globex Bank*. A USD 2.5 billion deposit from CBR allowed VEB to extend RUB 90 billion for recapitalization of *Svyaz-Bank.* There were also cases when rescue and rehabilitation of failed banks was entrusted to public sector companies. Russian Railways and *Alrosa* (diamond-mining company) received a mandate for bail-out of *KIT-Finans* investment bank (*Alrosa* later quit the project). *Gazenergoprombank* (an offspring of *Gazprom*) was brought into the rescue of *Sobinbank* and *Bank Soyuz*. *Khanty-Mansiysky Bank* took over *Novosibirsky municipalny bank*.

[10] A blockholder would entrench against outside shareholders [Morck, Steier, 2005].

There is no proof that asset quality in SOBs is radically higher than in other Russian banks. Nevertheless SOBs were not allowed to fail during the crisis of 2008. The state remains liable for those banks, even if unknowingly and unwillingly.

5. What next?

The *outlook* embraces two trends with regard to governance structure in the public sector.

On the one hand, we expect indirect public ownership to expand organically (through faster growth of more flexible quasi-private banks) and through takeovers of failed private banks by SOEs and SOBs.

On the other hand, the state may divest from some of the banks it had to bail out and take over during the financial crisis of 2008-9. We anticipate state withdrawal initiatives to develop under the aegis of "privatization" and "replenishing budgetary funds". In the process of state withdrawal insiders will benefit. We already witness signals that the state would like to merge or sell some of the banks in order to eliminate duplication and to overcome managerial capability constraint in the public sector. VEB – Development Bank is looking for a strategic investment partner to launch Post Bank on the platform of *Svyaz-Bank* that it currently controls. It might also consider selling *Globex-Bank* into which RUB 80 billion of public funds have already been sunk. After being rescued at public expense, *Bank Soyuz* will sell at significantly lower price one-half of its equity to *Ingosstrakh* insurance company belonging to the same beneficiary owner as before.

For a better understanding of "privatization" prospects, a brief reference to the history of bank "privatization" in Russia is relevant. State withdrawal from the commercial banking sector in the 1990s was quite messy. Schoors [2000] cites a CBR source suggesting that at the beginning of 1994, 609 banks, or 29.8% of the 2,041 registered banks were actually successors of the former Soviet system of State Bank and its affiliated "specialized banks", or *spetsbanki* (*Promstroybank*, *Zhilsotsbank*, *Agroprombank* and *Vneshekonombank*). Of these 609 banks, 42.7% were off-shoots from *Agroprombank*, 28.2% from *Promstroybank* and 20.2% from *Zhilsotsbank*. These banks are the successors of a branch, a local department, a regional department or a sectoral department of one of the specialized state banks. Schoors refers to all these banks as "former state banks" and describes their inception in 1990-92 as "decentralized spontaneous privatization". Spontaneous indeed it was. Bank top managers and other insiders tacitly appropriated of substantial banking assets and the physical infrastructure held by hundreds of *spetsbanki* branches; they would steal whatever they could touch upon. The state got practically no compensation from the "spontaneous privatization". *Sberbank* (the savings bank) network was the least affected by the tide of property grabbing. Ironically, a large proportion of the "former state banks" did not survive the series of bank crises of 1995, 1998-99, 2004 and 2008-09, due to mismanagement, incompetence, fraud, asset stripping etc.

We see no reason why a new wave of "privatization" should be cardinally different in essence, or yield significantly better results for the country. We are already starting to see signs of the next wave of crony privatization when insiders try to appropriate parts of equity at indirectly SOBs. In 2009 the supervisory board of *VTB* bank authorized a management buy-out of a blocking stake at its Cyprus subsidiary, Russian Commercial Bank, as presumably unprofitable non-core asset. The price paid to *VTB* for the stock turned out to be lower than the intermediate dividend for 2H 2009 that new stockholders received shortly after the transaction. Following huge injections of public funds over 2008-2009 (*Sberbank* alone received a subordinated loan of RUB 500 billion) the management of both largest banks, *Sberbank* and *VTB*, proposed to the government privatizing the banks and launching option schemes to provide additional incentive for the management.

6. Conclusions and policy implications

State-owned banks exist in many countries of the world, and financial crisis led to bank nationalizations in quite a few countries including United Kingdom. What singles out Russia, however, is the sheer scale of state ownership of banks and the governance structure. It is unusual to move strategic assets from direct control of government agencies into the hands of public sector managers at SOEs. Corporate pyramids conceived by taxpayers' money are a bizarre feature even by emerging market standards.

We detected two new trends: (a) delegation of bank owner's rights from government authorities to SOEs, SOBs and 'state corporations'; (b) multi-level structures of corporate ownership over banks, as part of the 'entrenchment' of the state and/or other insiders against external shareholders. Our hypothesis is that indirect control is an essential component of the new paradigm of state participation in the financial system.

Our study suggests that along with 16 commercial banks fully or majority-owned by federal and regional authorities there are at least 31 banks that we qualify as indirectly state-owned. Nominally private joint-stock companies, those banks have equity that can be traced back to originally public funds invested by the state into a SOE. Indirectly-state-owned banks now command slightly over one-quarter of all public sector bank assets and 13 percent of

Russia's total bank assets. Direct public ownership of banks is gradually giving way to indirect ownership and control. This phenomenon cannot be deemed coincidental and deserves close attention.

Ownership is not fully equivalent to control, and state authorities usually cannot project substantial influence on corporate decisions of indirectly-owned banks. The banks are held by insiders including top-managers, current and former civil servants and their cronies. Insiders extract their rent from control over financial flows and occasional appropriation of parts of bank equity.

Indirect public ownership gives flexibility and broadens the discretion of bank insiders, but for the state as a whole it is a suboptimal arrangement. Here ownership does not necessarily entitle control. For the state owning banks via SOEs and SOBs, and not directly, makes little financial sense. Indirect public ownership is neither efficient nor transparent. The state benefits little from those banks in terms of dividend flow, capitalization or policy lending. It continues to bear ultimate financial responsibility for survival and viability of indirectly owned banks and carries associated risks, while benefits are usurped by individual insiders.

The *policy implication* from our study is as follows. If the state cannot effectively control those banks and cannot make good use of them, it should impede public funds being invested in them. We would envisage a program aimed at removing bank equity stakes from SOEs and SOBs and transferring these stakes to the federal (which is preferable) and regional level of government, similarly to what happened to the equity stakes previously held by *GUP*s (state unitary enterprises) after such holdings were banned by law. It must be ruled out for SOEs and SOBs to establish their own "subsidiary" banks directly or via intermediate corporate vehicles, and existing corporate pyramids in the public sector must be dismantled. Instead a state bank holding could be set up to own and dispose of bank equity participations. This would render transparency and efficiency to the management of public funds and in future facilitate genuine privatizations, as different from fake privatizations and mere appropriation by insiders that constitute baseline scenario.

As for *directions for future research*, we would mention:

- testing empirically whether indirectly SOBs perform better than directly SOBs and than domestic private banks;
- describing patterns of opportunistic behavior of public bank insiders; and
- developing methodology to assess the effect from state ownership on banks on a macro level.

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Annex.

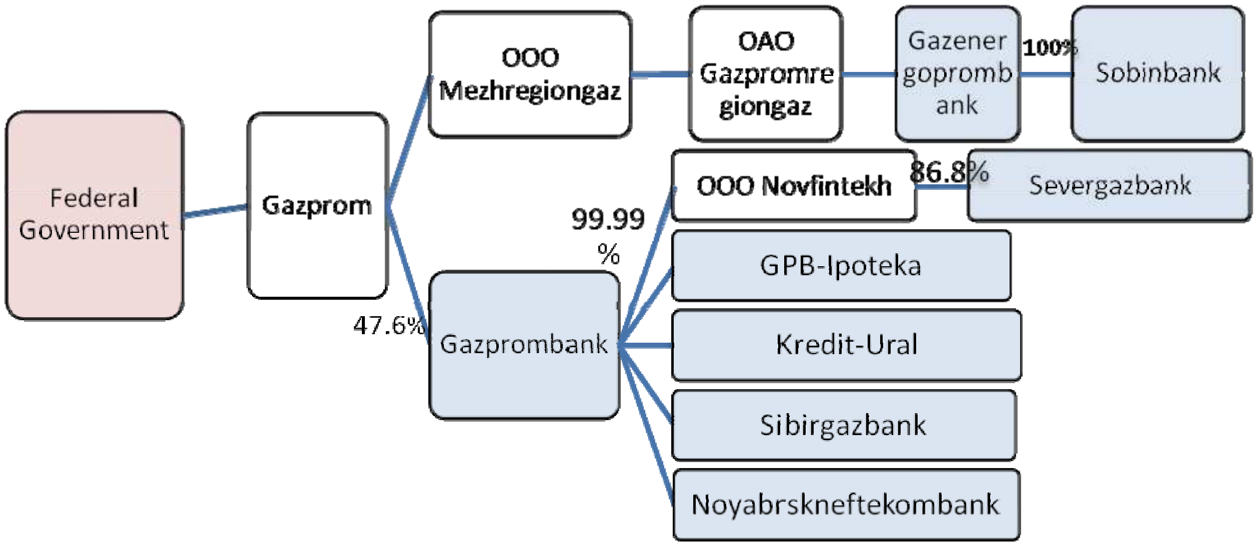
Table 4. Market share of state-owned banks* by subgroups, % of Russia's total banking assets at start of period

Banks controlled by	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**
Federal executive authorities and the CBR	29.7	30.8	31.9	32.2	30.7	33.0	32.1	33.6	36.0	36.3
Regional authorities**	2.2	2.2	2.5	2.4	2.5	3.0	3.2	3.1	3.5	4.2
***Sub-total**: State-owned banks according to narrow definition*	***31.9***	***33.0***	***34.4***	***34.5***	***33.2***	***35.9***	***35.3***	***36.7***	***39.5***	***40.5***
Municipal authorities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
State-owned companies, state-owned banks and "state corporations"	4.0	4.1	4.6	5.0	7.6	7.5	8.4	8.1	13.2	13.1
***Total:** State-owned banks according to broad definition*	***35.9***	***37.1***	***39.1***	***39.7***	***40.8***	***43.5***	***43.7***	***44.9***	***52.8***	***53.7***

* A list of state-owned banks can be found in [Vernikov, 2009b]; ** Including government of federal cities

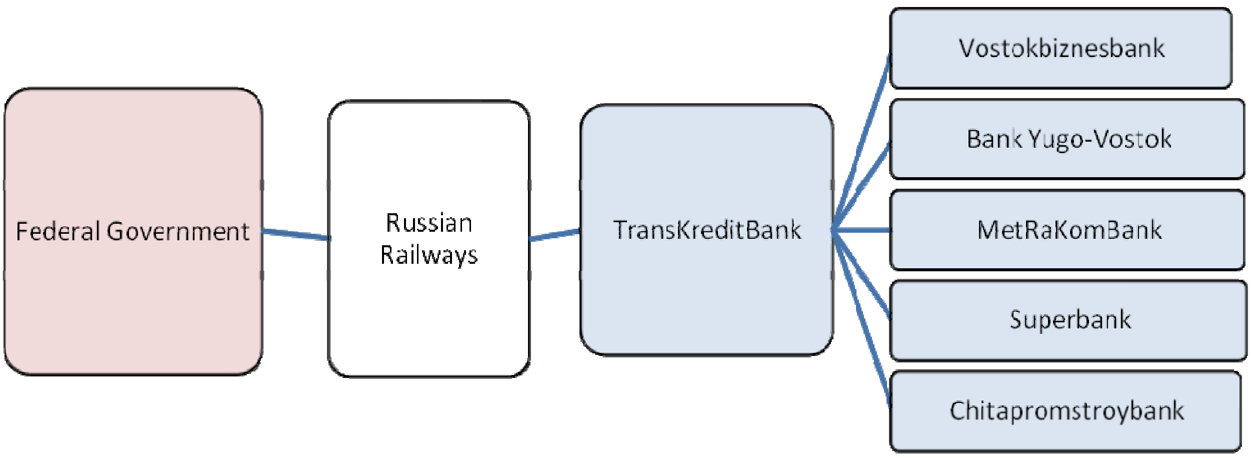
Source: Author's calculations based on data from [CBR, 2009], [Interfax, 2010], [RBC, 2009], and bank data.

Figure 8. Control structure in Gazprom group



Source: Bank data; corporate disclosure.

Figure 9. Control structure in Russian Railways group



Source: Bank data; corporate disclosure