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**Research  
Note**

## Russian banking sector risks -

### Sensitivity analysis

• In our recent review entitled “Sberbank: Betting on quality” published on August 13, we analysed the risks of the Russian banking sector, highlighting the major risks, such as macroeconomic instability, deficit of long-term resources within the country and dependence on global capital markets, contraction of liquidity, the risk of asset impairment due to the underestimation of credit risks during the recent economic boom, and a reduction in interest margins. We concluded that over the mid-term period, universal banks – with a high-quality brand name, diversified funding sources and credit portfolios and which are least dependent on global capital markets and capable of relying on a key shareholder (including the state) – will be best protected.

• The recent crisis in the global credit markets, which resulted in a liquidity crunch in Russia, revealed the vulnerability both of the banking sector as a whole and also individual banks. In this survey, we have conducted a sensitivity analysis of the biggest banks trading on Russian exchanges with respect to the following risks – credit risk, dependence on external financing, dependence on rising floating interest rates, the refinancing of external borrowings in the next few years, currency risks, liquidity risks, and the risks of a poorly diversified clientele.

• In terms of aggregate risks, the least vulnerable banks are Sberbank and Vozrozhdeniye. The risks facing the remaining banks, including VTB, may be classified as moderate. With respect to some criteria, Ursa-bank could be classified as highly exposed to risks (due to the small proportion of customer funds in its liabilities, low level of bad debt reserves, and significant proportion of liabilities financed on the international financial markets). However, the bank has reduced its exposure to currency risks via hedging and has also undertaken measures to reduce its credit risks. We consider the investment risk in any of the banks included in our report to be acceptable – with Sberbank and Vozrozhdeniye being the most suitable for strongly risk averse investors.

• We believe that despite the turmoil in the credit markets, the relative risks of the banks included in our study will remain close to our current assessment. That is why our analysis may be useful in assessing the risks involved in investing in these banks.

	Sberbank	VTB	Vozrozh- deniye	Bank of Moscow	Uralsib	Rosbank	Ursa- bank
Coverage from credit risk cover (reserves/NPL)	312%	119%	188%	214%	-	-	114%
Dependence on external markets (share of syndicated loans and Eurobonds in liabilities)	3.7%	27.2%	1.6%	19.4%	10.0%	10.6%	39.2%
Independence from key accounts, share of individuals in retail deposits	72%	37%	62%	33%	34%	31%	72%
Dependence on floating interest rate (changes in net interest margin as % of changes of the floating interest rate for 1 p.p.)	-0.35%	-3.27%	0.00%	-2.12%	-1.22%	-0.28%	-0.51%
Risk of refinancing external debt (share of external debts payable until end of 2010, as % of liabilities)	2%	20%	2%	11%	10%	9%	32%
Currency risk (net currency position/assets)	8.9%	8.1%	8.7%	7.8%	14.8%	10.0%	13.6%
Assessment of total risks	low	moderate	low	moderate	moderate	moderate	moderate

Source: Company data, Sovlink estimates

In our review “Sberbank: Betting on quality”, we analysed the exposure of the whole Russian banking system to several types of risks:

- macroeconomic instability,
- credit risks,
- deficit of long-term financial resources within the country and dependence on foreign capital markets,
- contraction of liquidity on the domestic market,
- reduction of interest margins.

We stated that the attention of investors will gradually shift towards risk analysis and that Sberbank – the largest bank in the country which receives unconditional support from its principal shareholder (the state), pursues a conservative credit policy and amongst Russian banks is the least dependent on global financial markets (90% of its liabilities are due to customer accounts and 64% to individual deposit accounts) – is best protected from both short- and mid-term risk.

We now analyse the risk exposure of other key Russian banks whose shares are listed on the stock market.

## 1. Credit risk

The principal credit risk parameters include the level of risk concentration (including industry, geographical, and credit portfolio diversification), the level and trend of overdue debts, the level of loan loss provisions, and the level of cover provided by bad debt reserves.

We assess credit risk primarily against the Reserves/NPL indicator. If the ratio is lower than 100%, we consider credit risk to be high, moderate if it ranges from 100% to 150%, and low if is higher than 150%. The limitations of such an approach are that banks usually reflect NPL in a quite peculiar way – for instance, Sberbank’s notes to its Q107 IFRS financial statements define overdue loans as “payments for loans which are overdue with respect to their contractual term and do not include total outstanding balance of loans overdue”. Obviously, such an approach leads to an underestimation of the actual amount of troubled loans.

**Table 2a – Credit risks, 2006**

	<b>Sberbank</b>	<b>VTB</b>	<b>Vozrozhdeniye</b>	<b>Bank of Moscow</b>	<b>Ursa-bank</b>
NPL/loans	1.1%	1.8%	1.7%	0.6%	5.7%
Reserves/loans	3.8%	3.2%	3.6%	1.3%	4.2%
Reserves/NPL	346%	182%	210%	214%	74%*
Concentration of credit risks (proportion of 10 largest borrowers)	15.4%	18.0%	17.9%	18.2%	-
Retail loans as % of total loans	26.2%	8.4%	16.5%	44.5%	46.7%
Risk	low	low	low	low	high

Source: Company data, Sovlink estimates

\* Calculated based on the bank’s (IFRS) statements. The actual amount of coverage for bad debts might be greater, as the bank buys out a portion of its credits from third parties, who provide collateral for consumer and auto loans. At the same time, most of the overdue loans were issued by the bank itself.

**Table 2b – Credit risks**

	Sberbank 1Q07	VTB 1Q07	Vozrozhdeniye 2Q07	Ursa-bank 2Q07E
NPL/loans	1.2%	2.7%	1.7%	3.60%
Reserves/loans	3.6%	3.2%	3.3%	4.10%
Reserves/NPL	312%	119%	188%	114%
Share of retail loans, %	26%	9%	17%	-
Risk	low	moderate	low	moderate

Source – Company reports, Sovlink estimates

In 1Q07 for most of the banks under consideration, the level of troubled loans either increased or remained at the same level whilst reserves were reduced, which resulted in a lower Reserves/NPL cover ratio. Nevertheless, the aggregate credit risk level of banks such as Sberbank and Vozrozhdeniye remains quite low, whilst VTB's risk level increased from low to moderate. Regarding Ursa-bank, based on management's forecast 2Q07 IFRS statements, the general trend is expected to reverse – its level of overdue debts should decline, and its bad debt reserves should increase. Consequently, the bank's high credit risk level may drop to a moderate risk level.

## 2. Dependence on external financing

Table 3 provides information on the proportion of customer funding, as well as the share of Eurobonds and syndicated loans within the banks' liabilities. We consider a bank's dependence on external financing to be "low" if the proportion of foreign borrowings (Eurobonds and syndicated loans) within its liabilities is less than 20%, "moderate" for borrowings ranging from 20 to 25% and "high" if they exceed 25%. We stress that a high proportion of foreign borrowings within liabilities does not necessarily imply high risks, since a bank may reduce its exposure by using risk management techniques (for instance, by hedging open currency exposure).

**Table 3a – Dependence on foreign financing, 2006**

	Sberbank	VTB (Group)	Vozrozhdeniye	Bank of Moscow	Uralsib	Rosbank	Ursa-bank
Assets, \$ mn	131,662	52,403	2,789	14,518	11,606	11,160	4,239
Liabilities, \$ mn	119,945	45,411	2,579	13,304	9,865	10,090	3,668
Customer funds/Liabilities	89.6%	44.0%	89.3%	74.1%	70.4%	77.0%	37.8%
Other long-term borrowings/Liabilities	8.2%	37.9%	9.7%	14.5%	6.2%	13.9%	43.2%
Syndicated loans at then end of the year, \$ mn	2,500	2,864	0	1,175	522	166	202
Syndicated loans/Liabilities	2.1%	6.3%	0.0%	8.8%	5.3%	1.6%	5.5%
Eurobonds at year end (2006), \$ mn	2,250	7,554	0	1,540	0	696	997
Eurobonds/Liabilities	1.9%	16.6%	0.0%	11.6%	0.0%	6.9%	27.2%
Total Syndicated loans + Eurobonds/Liabilities	4.0%	22.9%	0.0%	20.4%	5.3%	8.5%	32.7%
Risk of dependence on external financing sources	low	moderate	low	moderate	low	low	high

Source – Company reports, Cbonds, Sovlink estimates

**Table 3b – Dependence on foreign financing**

	Sberbank 1Q07 IFRS	VTB (Group)** 1Q07 IFRS	Vozrozhdeniye 2Q07 IFRS	Bank of Moscow 2Q07 RAS	Rosbank 2007Q2 RAS	Ursa- bank 2007Q2 RAS
Assets, \$ mn	151,359	56,153	3,594	16,702	9,140	5,565
Liabilities, \$ mn	129,616	49,010	3,181	15,185	8,166	4,792
Customer funds/Liabilities	90.9%	47.7%	84.5%	80.6%	76.1%	33.1%
Other long-term borrowings/Liabilities	7.9%	37.5%	12.3%	-	-	-
Current syndicated loans, \$ mn	2,500	2,505	50	1,000	165.95	348
Syndicated loans/Liabilities	1.9%	5.1%	1.6%	6.6%	2.0%	7.3%
Eurobonds at the current date, \$ mn	2,250	10,806	0	1,940	701	1,532
Eurobonds/Liabilities	1.7%	22.0%	0.0%	12.8%	8.6%	32.0%
Total Syndicated loans + Eurobonds/Liabilities	3.7%	27.2%	1.6%	19.4%	10.6%	39.2%
Risk of dependence on external financing sources	low	high	low	moderate	low	high

Source – company reports, Cbonds, Sovlink estimates

\*\* Calculated based on the volume of issues in circulation, including VTB, VTB24, VTB North-West and foreign subsidiaries (VTB Bank Europe (MNB) and VTB Bank France (BCEN-Eurobank)). According to VTB, the volume of syndicated loans and Eurobonds is slightly lower – about \$11 bn, or 22-23% of its liabilities.

90% of Sberbank's liabilities are made up of customer accounts, and about 8% consist of other long-term borrowings (issued debt instruments, syndicated loans and a subordinated loan). Foreign borrowings (syndicated loans and Eurobonds) account for less than 4% of its liabilities. Vozrozhdeniye bank has a similar funding pattern – customer accounts make up 85% of its liabilities, the bank has no outstanding Eurobonds (and is not planning an issue), and has raised only one syndicated loan (\$50 mn) on foreign markets. Thus, amongst Russian banks, Sberbank and Vozrozhdeniye are the least dependent on foreign financing and global financial markets.

VTB and Ursa-bank are at the other extreme. Due to the low proportion (less than 50%) of customer funds in their liabilities, foreign borrowings have become an important financing source for them. Accordingly, these banks have greater exposure to foreign market risks in terms of servicing and refinancing their debt. Besides, banks highly dependent on foreign debt financing may find it difficult to continue increasing their loan portfolios at the high growth rates forecast by them – particularly, if the crisis in global credit markets persists and they cannot find an alternative cheap long-term credit source domestically. However, in such an eventuality, the \$8 bn equity capital raised via VTB's IPO will act as a useful buffer. As far as Ursa-bank is concerned, despite problems with its Eurobond issue, so far it has been able to continue raising syndicated loans – even during the peak of the crisis in August, Ursa-bank raised two syndicated loans for a total value of \$ 225 mn at acceptable rates: a one year loan at LIBOR + 85 basis points, and a loan maturing in two years 2 years at LIBOR + 125 basis points.

### 3. Dependence on rising interest rates

In this section we examine the interest margin sensitivity of banks against the growing costs of servicing foreign floating interest rate borrowings, since their interest rate directly depends on changing market conditions (the risk of higher LIBOR rates). Clearly, if the current negative situation in global financial markets leads to a long-term tightening of credit terms and the end of the availability of cheap money, higher borrowing costs will affect not only the servicing of current floating rate loans, but also the terms for raising new loans. However, here we confine ourselves to analysing the short-term consequences of a one percentage point increase in floating rate loans on net interest margin.

**Table 4a – Dependence of interest margins on a 1 p.p. increase in the cost of borrowings, 2006**

	Sberbank	VTB	Vozrozhdeniye	Bank of Moscow	Uralsib	Rosbank	Ursa-bank
Liabilities, \$ mn	119,945	45,411	2,579	13,304	9,865	10,090	3,668
Syndicated loans with floating interest rates, \$ mn	2,500	1,414	0	1,100	522	166	202
As a share of Liabilities, %	2.1%	6.3%	0.0%	8.3%	5.3%	1.6%	5.5%
Eurobonds with floating interest rates, \$ mn	0	4291	0	0	0	0	0
As a share of Liabilities, %	0	9.4%	0	0	0	0	0
Total syndicated loans + Eurobonds with floating interest rates/Liabilities, %	2.1%	14.6%	0.0%	8.3%	0.0%	1.6%	5.5%
Interest expenses, \$ mn	-4,490	-1,892	-103	-498	-379	-475	-131
Interest expenses on foreign liabilities with a floating interest rate, % mn	-141	-338	0	-66	-31	-10	-6
As a % of interest expenses	3.1%	17.9%	0.0%	13.2%	8.1%	2.1%	4.8%
Net interest margin, %	7.5%	4.5%	7.1%	5.2%	5.1%	7.6%	6.9%
Changes in the net interest margin due to a 1 p.p. increase in the servicing costs of liabilities with floating interest rates (in p.p.)	-0.03%	-0.15%	0.00%	-0.11%	-0.06%	-0.02%	-0.04%
Changes in the net interest margin due to a 1 p.p. increase in the servicing costs of liabilities with floating interest rates. (in %)	-0.35%	-3.27%	0.00%	-2.12%	-1.22%	-0.28%	-0.51%

**Table 4b – Dependence of interest margins on a 1 p.p. increase in the cost of borrowings, 2006**

	Sberbank 1Q07 IFRS	VTB 1Q07 IFRS	Vozrozhdeniye 2Q07 IFRS	Bank of Moscow 2Q07 RAS	Rosbank 2Q07 RAS	Ursa- bank 2Q07 RAS
Liabilities, \$ mn	129,616	49,010	3,181	15,185	8,166	4,792
Syndicated loans with floating interest rates, \$ mn	2,500	2,505	50	1,000	166	348
As a share of Liabilities, %	1.9%	5.1%	1.6%	6.6%	2.0%	7.3%
Eurobonds with floating interest rates, \$ mn	0	5,945	0	0	0	0
As a share of Liabilities, %	0.0%	12.1%	0.0%	0.0%	0.0%	0.0%
Total syndicated loans + Eurobonds with floating interest rates/Liabilities, %	1.9%	17.2%	1.6%	6.6%	2.0%	7.3%
Interest expenses, \$ mn	-1,452	-580	-73	-323	-261	-128
Interest expenses on foreign liabilities with a floating interest rate, \$ mn	-36	-106	-1	-27	-5	-7
As a % of interest expenses	2.5%	18.2%	1.2%	8.3%	2.1%	5.1%
Net interest margin, %	6.6%	4.1%	6.8%	3.5%	4.3%	-
Changes in the net interest margin due to a 1 p.p. increase in the servicing costs of liabilities with floating interest rates (in p.p.)	-0.02%	-0.15%	-0.01%	-0.06%	-0.02%	-
Changes in the net interest margin due to a 1 p.p. increase in the Servicing costs of liabilities with floating interest rates (in %)	-0.3%	-3.5%	-3.5%	-1.8%	-0.4%	-

Source – Company data, Cbonds, Sovlink estimates

On the whole, the proportion of banks' floating rate foreign loans is quite low (with the exception of VTB, where foreign loans account for 15-17% of its liabilities). The servicing costs of such loans as a proportion of total interest expenses are significant only in the case of VTB and the Bank of Moscow. Accordingly, given a one pp. increase in the LIBOR rate, the interest margin of the majority of banks included in our analysis does not change, and it decreases by about 0.1 p.p. only for VTB and the Bank of Moscow. The sensitivity of VTB to declining interest margins is enhanced by its initially low interest margin level of less than 5%, which is the minimum level for banks under IFRS accounting.

According to the VTB's representatives, the total amount of the group's liabilities with respect to bonds and syndicated loans amounts to \$11 bn, out of which \$ 6 bn was raised at fixed rates and \$5 bn at floating rates. So, VTB is exposed to the higher floating interest rates. However, the situation could be partly compensated for VTB if the bank is able to transfer the higher loan servicing costs to higher floating rate loans to customers.



#### 4. Risks related to refinancing foreign borrowings

This can be considered as a significant mid-term risk. Although the amount of foreign borrowings does not allow us to draw unambiguous conclusions on the banks' exposure to refinancing risks, the repayment schedule clearly points to a dire need to refinance the loans raised in the next few years. Worsening credit conditions could at the very least influence the growth rates of the banks' credit portfolios.

In the repayment schedule we have included payments for Eurobonds denominated in roubles –although they do not create currency risks for the borrower, nonetheless, they can be refinanced in foreign markets. In any case, even though the justification of including rouble payments as part of foreign debt payments is debatable, their value as a proportion of the total amount of foreign debt is insignificant.

**Table 5a – Foreign borrowings' repayment schedule**

	Sberbank 1Q07 IFRS	VTB 1Q07 IFRS	Vozrozhdeniye 2Q07 IFRS	Bank of Moscow 2Q07 RAS	Uralsib 2Q07 RAS	Rosbank 2Q07 RAS	Ursa- bank 2Q07 RAS
Liabilities, \$ mn	129,616	49,010	3,181	15,185		8,166	4,792
Syndicated loans and Eurobonds, \$ mn (including RUR Eurobonds)	4,750	13,380	50	2,950	1,004	876	2,081
As a share of Liabilities, %	3.7%	27.3%	1.6%	19.4%	10.2%	10.7%	43.4%
2007E (for the remainder of the year only)	0	1,200	0	0	0	0	0
2008E	1,000	3,792	50	500	590	100	228
Year of maturity, \$ mn	2009E	1,500	4,030	0	850	404	580
	2010E	0	600	0	300	0	65.9
	2011-15E	2,250	2,000	0	900	10	130
	Post 2015E	0	1,758	0	400	0	0

Source – Company data, Cbonds, Sovlink estimates

By the end of 2007, we expect VTB to repay borrowings of \$1.2 bn (out of which \$1 bn consists of VTB Eurobonds due in September, and \$200 mn consists of VTB Bank Europe (MNB) Eurobonds).

**Table 5b – Foreign borrowing repayment schedule**

Foreign borrowing repayment schedule, % of total debts	Sberbank	VTB	Vozrozhdeniye	Bank of Moscow	Uralsib	Rosbank	Ursa - bank
2007E (for the remainder of the year only)	0%	9%	0%	0%	0%	0%	0%
2008E	21%	28%	100%	17%	59%	11%	11%
2009E	32%	30%	0%	29%	40%	66%	26%
2010E	0%	4%	0%	10%	0%	8%	37%
2011-15E	47%	15%	0%	31%	1%	15%	27%
Post 2015E	0%	13%	0%	14%	0%	0%	0%

Source – Company data, Cbonds, Sovlink estimates

Please note that from 53% (Sberbank) to 100% of these banks' foreign borrowings will be repaid by 2010.

**Table 5c – Foreign borrowing repayment schedule**

		Sberbank	VTB	Vozrozhdeniye	Bank of Moscow	Uralsib	Rosbank	Ursa-bank
Foreign borrowings subject to refinancing as a % of liabilities	2007E (for the remainder of the year only)	0%	2%	0%	0%	0%	0%	0%
	2008E	1%	8%	2%	3%	6%	1%	5%
	2009E	1%	8%	0%	6%	4%	7%	11%
	2010E	0%	1%	0%	2%	0%	1%	16%
	2011-15E	2%	4%	0%	6%	0%	2%	12%
	Post 2015E	0%	4%	0%	3%	0%	0%	0%
Total foreign borrowings subject to refinancing before 2010, as a % of liabilities		2%	20%	2%	11%	10%	9%	32%
Refinancing risk		low	moderate	low	low	low	low	high

Source – Company data, Cbonds, Sovlink estimates

However, the main focus of the repayment schedule is not on the absolute values of the debt repayments, but rather on their correlation with the bank's business operations. Thus, Sberbank and Vozrozhdeniye are to repay foreign debt amounting to 2% of their liabilities prior to 2010, which allows us to assess their refinancing risks as low. Whilst VTB's debt repayments for this period amount to about 20% of its liabilities, which implies moderate risks. Ursa-bank is facing the toughest situation – as it has to repay debt amounting to 30% of its liabilities over the next 3-3.5 years.

A peculiarity of Russian banks concerns the financing of long-term assets via short-term liabilities, which means that Russian banks have to refinance their liabilities within the period of their assets' useful lives.

**Table 6 – Russian banks' long-term assets and liabilities, 2006**

	Sberbank	VTB*	Vozrozhdeniye	Bank of Moscow	Uralsib	Rosbank	Ursa-bank
Long-term assets, RUR mn	572,511	15,964	8,581	90,153	10,435	67,725	5,706
Long-term liabilities, RUR mn	210,814	14,944	9,924	78,867	3,274	51,509	1,335
Gap (deficit of long-term liabilities for financing long-term assets), RUR mn	361,697	1,020	-1,343	11,286	7,161	16,216	4,371
% gap of long-term assets	63.2%	6.4%		12.5%	68.6%	23.9%	76.6%
Long-term criteria	Over 3 years	Over 1 year	Over 1 year	Over 1 year	Over 5 years	Over 1 year	Over 5 years

\* USD mn

Source – Company data, Cbonds, Sovlink estimates

Regrettably, many banks submit information about their liquidity risks for assets and liabilities maturing within one year, which does not allow us to adequately realise the extent of the mismatch in the term structure of their long-term assets and liabilities. Analysis of those banks that submit a more detailed repayment schedule regarding the repayment of assets and liabilities shows that beyond a 3-5 year horizon, over 60% of assets do not have adequate financing (term-wise). Thus, given the extension of asset lives (the terms of mortgage loans were extended to 20-30 years) the banks still have quite short-term liabilities, subject to refinancing over the next few years. Thus, they are exposed to the risk

of tightening refinancing conditions (interest rates, currency rates, etc) in case of a deterioration in Russian or global financial markets.

## 5. Currency risks

In case of significant open currency exposure, Russian banks are open to the risk of adverse currency rate fluctuations. When raising borrowings in foreign currencies, banks usually deposit them in Russia as rouble loans, which leads to the emergence of currency risks. However, even in case of a large net balance position, banks can hold hedging derivatives off-balance sheet. Ursa-bank and Rosbank managed to considerably reduce their net currency exposure by using derivatives to hedge their currency exposure.

**Table 7 – Currency risks, 2006**

	Assets, RUR mn	Liabilities, RUR mn	Net balance sheet exposure, RUR mn	% of assets	Off-balance currency exposure (spot transactions and derivatives), RUR mn	Total net balance sheet exposure, RUR mn	% of assets
Sberbank	2,851,255	2,541,353	309,902	8.9%	0	309,902	8.9%
VTB*	23,540	18,618	4,922	9.4%	-681	4,241	8.1%
Vozrozhdeniye	63,392	56,987	6,405	8.7%	0	6,405	8.7%
Bank of Moscow	271,654	241,902	29,753	7.8%	0	29,753	7.8%
Uralsib	220,806	181,992	38,815	12.7%	6 301	45,116	14.8%
Rosbank	183,446	139,152	44,294	15.1%	-14 938	29,356	10.0%
Ursa-bank	87,544	46,039	41,504	37.2%	-26 328	15,176	13.6%

Source – Company data, Sovlink estimates

\* - USD mn

## 6. Liquidity risks

Liquidity risks are caused by a mismatch of the term structure of their assets and liabilities. According to the requirements of the Central Bank, all customer on-demand deposits refer to short-term liabilities (on-demand and maturing within 30 days). Meanwhile, from the point of view of banks actively involved in retail deposits and loans (ie Sberbank, Vozrozhdeniye), these funds form long-term and stable financing sources. It's difficult to imagine that all (or the bulk) of on-demand deposits will be called within one month under normal conditions. However, technically, the banks with the largest proportion of customer funds as a % of liabilities also have the largest liquidity gap in their shortest term (one month) period.

**Table 8 – Liquidity risks, 2006**

	Sberbank	VTB*	Vozrozhdeniye	Bank of Moscow	Uralsib	Rosbank	Ursa-bank
On-demand assets maturing within 1 month, RUR mn	944,862	16,759	21,616	131,193	126,287	120,155	23,488
On-demand liabilities maturing within 1 month, RUR mn	1,063,503	15,602	31,333	122,728	123,076	108,467	21,086
Net liquidity gap, RUR mn (-)	-118,641	1,157	-9,717	8,465	3,211	11,688	2,402
Deficit of liquidity cover (net liquidity gap/total amount of short-term liabilities) (-)	-11.2%		-31.0%				

Source – Company data, Sovlink estimates

\* - USD mn



Furthermore, in accordance with the Civil Code, a depositor has the right to withdraw any term deposit before maturity (on condition of forfeiting the accrued interest). That is why in case of a massive panic amongst depositors a significant portion of not only on-demand but also retail term deposits might be withdrawn. Nevertheless, such a situation is highly unlikely in the foreseeable future. Even in case of a run on banks, state-owned banks are expected to be better protected for they enjoy higher confidence amongst the population. (For instance, there were hardly any withdrawals from Sberbank during the 2004 mini-crisis).

## 7. Risks of a poorly diversified client base

On the whole, banks with a significant proportion of customer funds as a % of their liabilities are best covered against adverse changes in financial markets. However, there is a danger of several key accounts making up a significant proportion of total customer funds, which indicates poor client diversification. The most vivid example – of the banks included in our study – is provided by the Bank of Moscow. Its 10 largest accounts generate 42% of its customer funds, and the federal and regional budget accounts form one third of its liabilities to customers. Such captive banks may appear to be more resistant to a liquidity crisis – as a rule, key accounts are affiliated with bank owners, who are well aware of bank's standing and are unlikely to rush and withdraw their funds in case of a panic in the banking sector, and may even support the bank during hard times. However, in the long-term, banks which rely on a wider and more diversified client base appear to be more sustainable.

**Table 9 – Dependence on key accounts, 2006**

	Sberbank	VTB	Vozrozhdeniye	Bank of Moscow	Uralsib	Rosbank	Ursa-bank
Share of the 10 largest accounts as a % of customer funds	-	-	8%	42%	15%	-	-
Funds of federal and regional budgets as a % of customer funds	-	-	-	31%	-	-	-
Retail deposits as a % of customer funds	72%	37%	62%	33%	34%	31%	72%
Dependence on key accounts	low	moderate	low	high	moderate		low

Source – Company data, Sovlink estimates

## Conclusion

We have studied the sensitivity of the largest Russian banks traded on the stock market to the following risks:

- credit risk
- dependence on foreign financing
- dependence on rising interest rates
- foreign borrowings' refinancing risks in the near future
- currency risks
- liquidity risks
- risks of a poorly diversified client base.

**Table 10 - Total risk assessment**

	Sberbank	VTB	Vozrozhdeniye	Bank of Moscow	Uralsib	Rosbank	Ursa-bank
Credit risk cover (reserves/NPL)	312%	119%	188%	214%	-	-	114%
Dependence on foreign markets (Syndicated loans and Eurobonds as a % of liabilities)	3.7%	27.2%	1.6%	19.4%	10.0%	10.6%	39.2%
Independence from key accounts (Individual accounts as a % of total deposits)	72%	37%	62%	33%	34%	31%	72%
Dependence on floating interest rates (Changes in net interest margin as a % of a 1p.p. change in the floating interest rate)	-0.35%	-3.27%	0%	-2.12%	-1.22%	-0.28%	-0.51%
Risk of refinancing foreign debt (Foreign debts payable until the end of 2010, as a % of liabilities)	2%	20%	2%	11%	10%	9%	32%
Currency risk (net currency position/assets)	8.9%	8.1%	8.7%	7.8%	14.8%	10.0%	13.6%
Assessment of total risks	low	moderate	low	moderate	moderate	moderate	moderate

Source – Company data, Sovlink estimates

This analysis confirms the conclusions of our previous survey, namely that universal banks – with a high-quality brand, diversified financing sources and credit portfolio, least dependent on global capital markets and capable of relying on a key shareholder, including the state – are best protected against risks. In terms of total aggregate risk, Sberbank and Vozrozhdeniye are least vulnerable. The other banks, including VTB, are exposed to a moderate level of risk. Against some criteria, Ursa-bank – in terms of a low proportion of customer funds as a % of liabilities, low level of reserves to cover against bad debts, and the significant proportion of its liabilities financed on international financial markets – could be considered as the most exposed of the banks included in our analysis. However, via hedging, the bank has reduced its exposure to currency risks and has also undertaken measures to reduce its credit risks. Thus, we consider the risk of investing in any of the banks included in this study as acceptable – with Sberbank and Vozrozhdeniye particularly suitable for risk averse investors.

We believe that despite the significant deterioration of the conditions in international credit markets, the risk level of the banks under consideration will remain close to our current assessment. That is why, in our opinion, our analysis may be helpful in assisting investors in making investment decisions related to the banking sector.

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## **STOCK RATING POLICY**

<b>STRONG BUY:</b>	Upside over 25%; confidence level – high / upside over 100%; confidence level - low
<b>BUY:</b>	Upside between 15 and 25%; confidence level – high / upside between 25% and 100%; confidence level – low
<b>HOLD:</b>	Upside of less than 15%; confidence level – high / upside of less than 25%; confidence level – low
<b>SELL:</b>	Fair value at or below current price levels

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