

**Russian Federation: Targeted Detailed Assessment of Observance of Basel Core Principles for Effective Banking Supervision**

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FINANCIAL SECTOR ASSESSMENT PROGRAM STABILITY MODULE

# RUSSIAN FEDERATION

BASEL CORE PRINCIPLES FOR EFFECTIVE BANKING SUPERVISION

# TARGETED DETAILED ASSESSMENT OF OBSERVANCE

JULY 2011

International Monetary Fund  
Monetary and Capital Markets Department

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**GLOSSARY**

AML/CFT	Anti-money Laundering/Combating Financing of Terrorism
BL	Federal Law on Banks and Banking Activities
BCBS	Basel Committee on Banking Supervision
BCP	Basel Core Principles
CBR	Central Bank of Russia
CP	Core Principle
CBR Law	Federal Law on the Central Bank
DAR	Detailed Assessment Report
DIL	Deposit Insurance Law
EC	Essential Criteria
FIU	Financial Intelligence Unit
FSAP	Financial Sector Assessment Program
ICAAP	Internal Capital Adequacy Assessment Program
KYC	Know Your Customer
NPLs	Nonperforming Loans
SIFI	Systemically Important Financial Institution

## I. SUMMARY, KEY FINDINGS AND RECOMMENDATIONS

### EXECUTIVE SUMMARY

1. **A targeted assessment of the Basel Core Principles for Effective Banking Supervision (BCP) was conducted which revealed some improvement since the 2007 assessment.** The principles reviewed covered the following risk areas: major acquisitions, capital adequacy, risk management process, credit risks and provisions, exposure to related parties, abuse of financial services, remedial actions and consolidated supervision. Although the CBR continues to improve its supervisory process and issue recommendations to banks on monitoring and managing risks, it lacks the supervisory framework to support enforcement of those recommendations and that inhibits improvement in BCP compliance. CP-9 on problem assets and provisioning was upgraded to largely compliant but CP-11 on exposure to related parties was downgraded to materially noncompliant.

#### A. Introduction

2. **This assessment of the BCP was conducted from March 30 through April 12, 2011 as part of an FSAP Stability Assessment.** As agreed with the authorities, the supervisory framework was assessed against the BCP methodology issued in October 2006 and the scope was targeted based on a risk-based review of the results from the most recent (2007) FSAP. The assessment was conducted by Mr. José Tuya, consultant.

#### B. Scope

3. **The selection of the principles to be reassessed was made by the mission team based on an analysis of the risks and vulnerabilities of the Russian Federation.** The risks and vulnerabilities were identified through the findings from previous assessments, as well as country work, bilateral, multilateral, and regional surveillance. The process followed for the identification of the principles that needed reassessment did not suggest the need to reassess other principles.

4. **The scope was set to include CPs 5, 6, 7, 8, 9, 11, 12, 18, 23, and 24.** Principles 5, 9, 12 and 24 were graded materially noncompliant at the previous assessment and the others, although graded largely compliant, were selected for review as they represent areas of important risks in Russia.

5. **Relevant information from the 2007 FSAP was incorporated into the current assessment,** and the principles that were not covered by this targeted assessment were carried over from the 2007 DAR to the annex of this DAR.

#### C. Information and Methodology Used for Assessment

6. **The assessment was performed in accordance with the guidelines set out in the 2006 BCP Methodology and is based on several sources:** (i) a preliminary self-assessment prepared by the CBR; (ii) meetings with the Heads and staff of the CBR supervisory departments; (iii) review of laws, regulations, and other documentation on the supervisory framework and on the structure and other developments in the Russian financial sector; (iv) supervisory directives

and guidelines, where available, on-site supervision reports and documents following-up on deficiencies noted on inspection reports. We are grateful for the generous assistance of all those without whose support our work would not have been possible.

7. **The assessment of compliance with each principle is made on a qualitative basis.** A four-part assessment system is used: compliant; largely compliant; materially noncompliant; and noncompliant. To achieve a "compliant" assessment with a principle, all essential criteria generally must be met without any significant deficiencies. A "largely compliant" assessment is given if only minor shortcomings are observed, and these are not seen as sufficient to raise serious doubts about the authority's ability to achieve the objective of that principle. A "materially noncompliant" assessment is given when the shortcomings are sufficient to raise doubts about the authority's ability to achieve compliance, but substantive progress has been made. A "noncompliant" assessment is given when no substantive progress toward compliance has been achieved. In addition, a Principle will be considered not applicable when the Principle does not apply given particular circumstances as described in the 2006 BCP Methodology.

#### **D. Institutional and Market Structure—Overview**

8. **The CBR Law and the Law on Banks and Banking Activities (BL) assign responsibility for the licensing and supervision of banks to the CBR.** The law empowers the CBR to grant banking licenses, approve permissible activities, issue regulations, supervise and enforce compliance with laws and regulations.

9. **As part of the Russian Federation's *Development Strategy for the Banking Sector through 2015*, the CBR is in the process of overhauling the supervisory, legal and operational landscape to enable the implementation of supervision by risk; including an enhancement in the scope of consolidated supervision.** A published strategic plan to strengthen capital requirements and strengthen banking supervision is comprehensive and candid in recognizing shortcomings in the banking supervision framework. The strategy proposes to strengthen the CBR's legal supervisory powers, and improve transparency, asset valuation, and corporate governance in banks. Adopting the proposed agenda and pending legislation will enhance the CBR's ability to conduct more intensive supervision, identify risks, and take timely corrective action.

10. **Current oversight of banking activities by the CBR relies on an integrated process combining offsite reviews with on-site inspections.** In the course of supervision exercised by the CBR's territorial offices, as well as by the CBR's central staff with respect to SIFIs, frequent contact is maintained with bank management. Since the last FSAP, the CBR has been working on legislative changes required to enable the CBR to appoint resident inspectors at SIFIs.

11. **Legislation, granting the CBR increased professional judgment to implement international best practices without always requiring a revision of existing legislation would enhance the safety and soundness of the banking system.** Currently, the CBR is unable to require banks to implement best practices in many areas of corporate governance, and risk

management or to perform consolidated supervision because of a lack of regulatory authority. Authority, within an approved legislative framework, to rely on professional judgment to implement best practices as prescribed by international standard setters, adjusted to the local market, is an essential element of supervision.

12. **The Russian banking sector is dominated by state-owned banks.** As of January 1, 2011 there were 1,012 banks operating in Russia, a decline of 46 from January 1, 2010. The number of banks is expected to decline further as a result of increased minimum capital requirements. As of January 2010, minimum capital was raised to Rub 90 million and will be raised to Rub 180 million on January 2012. The 50 largest banks control 80 percent of assets and the top five (all state-owned) control 48 percent.

13. **The level of nonperforming loans and overdue loans has declined.** As of January 1, 2011 banking system assets totaled Rub 33,805 billion and the capital adequacy level was 18.1 percent. Nonperforming loans (NPL), which are defined as loans classified in categories IV and V, amounted to 8.2 percent of total loans, a decline from 9.6 percent on January 1, 2010. Total loan provisions currently cover 102 percent of total NPLs but seem inadequate to cover possible losses in the remainder of the loan portfolio. Profitability has increased over the last year, with a return on equity moving from 5 percent in 2009 to 12.5 percent in 2010.

#### **E. Preconditions for Basel Core Principles Assessments**

14. **The Russian economy is emerging from a sharp recession with lower growth potential, at least in the near-term.** The economy contracted by almost 8 percent in 2009, reflecting plunging oil prices and a sharp reversal of capital inflows. A recovery started in mid-2009 led mostly by domestic consumption, which, in turn reflected a policy stimulus. The recovery remains modest, with growth projected at the 4–4 1/2 percent range in 2010–12. While risks appear manageable in the short-run, the combination of a more modest pace of economic growth and abiding regulatory and governance shortcomings cloud the outlook for Russian banks.

15. **Russian standards and the application of international accounting and auditing standards are improving but further measures are still required.** Approval of new draft laws on consolidation, accounting and audit would benefit the effectiveness of supervision and regulation. In the meantime, progress has been made to converge Russian and international accounting standards, but important differences remain, for instance on revenue recognition, consolidation, employee benefit and pension accounting, impairment testing, the application of fair value accounting, and related party transaction disclosure requirements. Proposed laws on consolidation and accounting envisage the mandatory use of IFRS in the consolidated financial statements of banks, listed companies, insurers, pension funds and other public companies. All in all, a roadmap exists to enhance the quality of financial reporting in Russia. The CBR requires all banks to prepare supplementary IFRS financial statements, although there is no requirement to publish. Improving transparency and reliability of financial information is an important element of the strategy of the government to develop the financial system reporting and bring supervisory

standards to meet international best practices. An extensive legislative agenda is being developed to achieve those goals.

16. **The CBR's response to the financial sector turmoil confirmed its ability to respond to the liquidity stresses in the system.** The CBR has powers to require early remedial action, mandate change of management and intervene in a failed bank. A system for early intervention would enhance the CBR's powers, as well as powers to take action against individual managers and directors. Since 2005, Russia has a Deposit Insurance Agency, which has improved the level of confidence of depositors in the system.

#### F. Main Findings

17. **Overall, there has been some improvement in compliance with the BCPs. However, the CBR remains limited to issuing "recommendations" that lack enforcement powers in critical areas such as corporate governance and related party supervision and identification.** The CBR Law and the BL do not give the CBR sufficient authority to implement many of the BCP requirements. Proposed amendments to the CBR Law and the BL are pending at the Duma that when approved will address deficiencies noted at the previous and current BCP assessment concerning consolidated supervision and related party supervision.

18. **Legislative amendments are pending before the Duma that would enhance the CBR's ability to conduct consolidated supervision** by amending the CBR Law to expand the CBR's supervisory authority to regulate bank holding companies and to take supervisory actions to mitigate risks to the bank from affiliate operations, including the ability to limit or not allow them. Additionally, the amendments will expand the definition of control to capture not only direct ownership but also economic dependency.

19. **Without appropriate regulatory support to conduct consolidated supervision, the CBR is not able to efficiently monitor and limit risks created by related party abuse.** The narrow definitions of related parties makes it difficult, if not impossible, to: (i) identify all the lending relationships of each related party with the bank; (ii) identify all of the bank's affiliates to monitor transactions and measure risk to the bank's financial condition from affiliates, and (iii) be able to capture all related risks under the lending limits as a percent of capital to limit concentrations.

20. **The CBR lacks authority to set key requirements to prevent abuses arising from exposures to related parties and to address conflict of interest.** The CBR also lacks the authority to sanction individual Board members. The CBR lacks the power to: (i) establish a comprehensive definition of related parties, (ii) require that exposures to related parties be granted on the same terms as those offered to non-related parties, and (iii) require that directors recuse themselves from voting on issues affecting them.

21. **In an effort to continue strengthening the supervisory framework while the legislative process grinds on, the CBR has been issuing letters of recommendations to banks for**

**implementing international best practices on risk management and corporate governance.**

However, without the regulatory support, the CBR lacks enforcement authority over the recommendations made in the letters. Currently, the CBR lacks regulatory power to require banks to implement the internal capital adequacy assessment process (ICAAP) under Pillar 2 of the Basel II framework so the CBR is planning to issue a recommendation letter to banks in 2011 on implementing the Pillar 2 requirements. Other areas where the CBR lacks enforcement authority and has issued recommendation letters include: “Up-to-date Approaches to the Organization of Corporate Governance in Lending Institutions,” “On Carrying out Transactions with Parties Related to a Bank and the Assessment of Risks Arising in carrying them out,” and “On International Approaches (Standards) to Organizing the Management and Supervision of Country Risks.” The CBR reports that through moral suasion, and the fact that the banks are aware that regulations are in process, it has been able to make progress in having banks implement some of the recommendations.

22. **Progress is noticeable in the risk supervision practices applied by the CBR.** Pursuant to Directive No. 2005-U, the assessments of banks’ financial condition is based on the analysis of quantitative indicators for the adequacy/quality of capital, assets, profitability and liquidity, and qualitative indicators characterizing the status of risk management systems, internal supervision systems, strategic risk management systems, and transparency of ownership structure. With a view to identifying problems in the operations of banks at an early stage, projected values for capital and profitability are reviewed using forecast values projected 12 months out, based on data for the two previous years and on trend models. Based on the results, banks are assigned to one of five risk categories.

23. **The enforcement actions/tools provided by the CBR Law do not allow sufficient options or flexibility to address imprudent practices at an early stage.** The CBR is provided with a number of supervisory tools to encourage banks to address violations or unsafe banking practices. However, the corrective actions set by Art. 74 of the CBR Law and Art. 20 of the BL have limitations. The CBR lacks enforcement authority to: (i) penalize or otherwise sanction individual bank directors at open banks; (ii) suspend<sup>1</sup> some or all of the shareholders from participation in the management of the credit organization, including their right to vote or accept dividends; (iii) establish limits on salaries and bonuses paid out to directors and key bank personnel; (iv) require additional capital levels to be maintained against the risks specific to the bank, except to impose higher CAR as sanction for violations of federal law and limited to a six-month period, and (v) require prior consent of the supervisory authority to incur a major expenditure or take on a new liability.

24. **The following summarizes** the main findings of the detailed assessment of compliance with the BCP.

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<sup>1</sup> When not under temporary administration, as laid out in Article 74 of the Law on the Central Bank.

## **Objectives, independence, powers, transparency and cooperation**

### *Licensing and structure (CP 5)*

25. **The CBR Law does not establish requirements for banks to seek prior CBR approval when making domestic investments in nonbank financial institutions.** Foreign investments by Russian banks require prior approval by the CBR, when they lead to the establishment of a subsidiary abroad, or acquisition of the status of parent company of a non-resident entity. A domestic acquisition of shares in a bank above a 20 percent ownership requires prior CBR approval. Acquisitions of over one-percent share require ex- post notification to the CBR. There is also an aggregate 25 percent limit on investments in banks and other entities. However, bank investments in nonbank financial firms do not require prior CBR approval. The CBR relies on the 25 percent aggregate limit to control that risk. Licensing regulations should provide for an approval/notification process for bank investments in non-banking institutions. Without such requirement the CBR is not able to measure the possible impact of acquisitions on a bank's condition or to determine whether the acquisition will affect the transparency of the bank's organizational structure and affect the ability of the CBR to supervise it.

### *Prudential Regulations and Requirements (CPs 6, 7, 8, 9, 11, 12 and 18)*

26. **Capital adequacy rules generally meet Basel II, Pillar 1 guidelines but the CBR lacks a legal authority to implement the Pillar 2 component.** The standardized, simplified approach is being implemented but the CBR lacks the regulatory authority to implement the supervisory review process prescribed by Pillar 2. Under Pillar 2 the CBR plans to issue recommendations in the second quarter of 2011 on minimum standards for organizing internal procedures for assessing the adequacy of internal capital to cover potential and assumed risks and to provide for future capital needs based on stress testing, strategic plans and risk evaluation. Without legislation specifically stating the authority of the CBR to stipulate standards for risks and capital management, the CBR may not oblige credit institutions to implement said recommendations, to develop internal capital adequacy assessment procedures and to implement them.

27. **The existing risk management regulatory framework is complex and multi-faceted.** However, it does not provide the foundation necessary for full implementation of supervision by risk. The CBR has issued numerous regulations, instructions and recommendations which directly or indirectly support banks' strengthening their internal risk management processes. The nature of existing regulations enable a compliance approach to supervision but limit the ability of the CBR to exercise professional judgment to rate the adequacy of risk management systems or Board of Director policies and governance. Addressing these deficiencies is an area where the CBR is focused but needs amendments to existing legislation.

28. **The concept of related parties has been identified in the regulations and the CBR collects reports on related parties.** However, the definition of related parties is narrow and based on legal relationships. Legislation is being reviewed by the Duma that would expand the definition of related parties and allow the CBR to make judgments based on economic relationships or

evidence of ability to influence decisions. The regulatory framework for related party transactions is also deficient in that it does not require that lending to related parties be on same terms and conditions as those generally offered to the public. The CBR has issued recommendations to banks on related party lending, however, they lack enforcement capacity.

29. **The CBR is considering amending Regulation 254-P to address country and transfer risk.** The current system does not impose country risk limits or provisions, except for operations with residents of offshore centers. The CBR has issued recommendations to credit organizations on the management of risk country based on the approaches specified in the BCBS document “Management of Banks’ International Lending (Country Risk Analysis and Country Exposure Measurement and Control)” and also includes BCP requirements.

30. **The supervisors do not have the authority to directly share client information with other agencies and regulators, at home or abroad, which constitutes a serious deficiency.** However, it can share such information with the FIU. Also, the CBR is aggressive and very successful in closing banks that are involved in money laundering.

#### *Corrective and Remedial Powers of Supervisors (CP 23)*

31. **The legal regime for corrective and remedial actions is clearly addressed in the regulations.** Enforcement powers are broad and clearly spelled out. The remedial powers of the CBR are deficient in some key areas, such as the inability to sanction Board members and to prevent transactions between the bank and its affiliates.

#### *Consolidated supervision (CP 24)*

32. **An inability to limit transactions between affiliates, and request information from holding companies limits the ability to conduct consolidated supervision.** Legislation is pending with the Duma to amend the CBR Law and the BL that will extend the supervisory authority of the CBR to cover bank holding companies. The amendments will also expand enforcement authority over banking groups and bank holding companies by granting the CBR authority to limit transactions between affiliates. The CBR will be able to dictate the types of consolidated information that bank holding companies will need to provide. The CBR actively collaborates with foreign supervisors and the amendments will enable the CBR to exchange customer-specific information. Finally, the definition of direct and indirect influence is expanded. Absent such powers, the ability of the CBR to monitor transactions between affiliates is severely hampered, increasing risks that losses are hidden through affiliate operations or off-balance sheet transfers. In defining bank holding company the EU standard (to be a bank holding company, over 40 percent of the company’s activities must be in banking) will be applied. However, in Russia that definition may not be adequate as a large banking group would not be included. The definition should be reviewed and adjusted to the Russian market and ensure that all SIFIs are covered.

**Table 1. Summary of Compliance—Detailed Assessment**

*Only principles 5, 6, 7, 8, 9, 11, 12, 18, 23 and 24 have been reassessed.*

Reference Principle	Rating	Comments
CP 5	MNC	There is no requirement that banks seek prior CBR approval to make nonbank domestic investments. The lack of an ex-ante determination of an acquisition's possible impact on a bank prevents the CBR from being able to limit the exposure to the bank of undue risks. While ex-post the CBR may address risks, it does not meet a critical object of this CP; preventing adverse impacts by an ex-ante review.
CP 6	LC	Russia meets the CP-6 essential criteria and has partially implemented the Basel II standardized simplified approach. Legislation is being drafted to permit Pillar 2 implementation.
CP 7	LC	The CBR is endeavoring to improve the banks' risk management regulatory regime, strengthen the requirements on the board of directors and define the concept "independent directors." In addition, assess through regulation corporate governance, risk management and audit in banks
CP 8	LC	The CBR has sufficient legislative and regulatory authority to enable the regular monitoring of banks' credit risk exposures through a robust reporting and inspection regime. EC3 is not complied with as CBR lacks the regulatory framework to be able to require lending to related parties be done at market terms and sanction banks that do not comply.
CP9	LC	The CBR continues to strengthen implementation of its provisioning regime.
CP 11	MNC	A narrow definition of related parties and connected relationships prevents the CBR from linking all the exposures and applying limits or imposing supervisory restrictions. In addition, the CBR lacks to authority to sanction directors individually.
CP 12	MNC	The CBR has not issued guidelines for banks on provisioning for country and transfer risk.
CP 18	LC	The CBR is prevented by privacy laws from sharing account information with other banking supervisors.
CP 23	LC	Whilst the CBR has the right to impose fines on the credit institution, it cannot sanction individual bank directors and officers (at non-intervened banks). Appropriate powers should be provided the CBR to administratively sanction (and/or remove if necessary) persons affiliated with banks: this is more efficient and expedient and would have a strong signaling effect to deter others. CBR has announced plans to seek this authority.
CP 24	MNC	In performing consolidated supervision the CBR is unable to capture all related parties and affiliates due to the narrow definition in Russian legislation. The amendments will extend CBR supervisory authority to bank holding companies.

## II. RECOMMENDED ACTION PLAN AND AUTHORITIES' RESPONSE

### A. Recommended Action Plan

**Table 2. Recommended Action Plan to Improve Compliance of the Basel Core Principles**

*Only principles 5, 6, 7, 8, 9, 11, 12, 18, 23 and 24 have been reassessed. In order to provide a complete view, grading for the other principles has been carried over from the assessment conducted in 2008.*

Reference Principle	Recommended Action
1.1. Responsibilities and Objectives	Implement action plans included in the Strategy for the Development of the Banking Sector through 2015.
1.2. Independence, accountability and transparency	Balanced by appropriate accountability structures, consider a higher level of representation of the CBR in the National Banking Council, request stronger political support for the CBR's work in the banking sector, and provide an explicit legal basis for the CBR's role in financial stability.
1.3. Legal Framework	Commence a project to streamline banking regulations, to make them more accessible to banks and supervisors.
1.4. Legal Powers	Continue work to introduce a stronger legal basis for the CBR's use of professional judgment in its work, accompanied by appropriate accountability.
1.5. Legal Protection of Supervisors	Prepare a written CBR guideline to confirm that the CBR will finance the legal defense of individual officials, from the beginning of the procedure, in advance, not just reimbursement after the fact.
1.6, 24 and 25. Cross border cooperation	Remove unwarranted legal barriers against exchange of individual client information.
3. Licensing criteria	Strengthen vetting of senior managers, shareholders, and Board members, allowing for the use of professional judgment by the supervisor, i.e., lowering the vetting threshold to 10 percent of shares, versus the current 20 percent.
4. Transfer of Significant Ownership	Lower threshold for the vetting of shareholders to 10 percent from 20 percent.
5. Major acquisitions	Require ex-ante CBR approval of acquisitions of domestic nonbank financial institutions.
7. Risk management	Continue to work on introduction of regulations on banks' risk management, e.g., by strengthening requirements of the BL with regard to the functions and composition of the banks' Boards of Directors, and amending the Central Bank Law to allow the CBR to issue regulations on bank governance.
9. Problem assets, provisions and reserves	Continue implementation and enhancement of provisioning standards to ensure an adequate level of loan loss reserves for the banking system.
11. Exposure to related parties	Reinforce ability of CBR to obtain information on nonbank group entities, including bank holding companies and "sister" companies. Amend Article 4 of Banking Law to broaden definition of related parties, Introduce 25 percent limit on exposure to "groups of connected debtors."

Reference Principle	Recommended Action
12. Country and transfer risks	Introduce regulations on provisioning of country and transfer risk.
14. Liquidity risk	Continue work to introduce a new approach to liquidity supervision, and issue new recommendations or regulations to banks, including that the Board of a bank approve the liquidity strategy.
15. Operational risk	Continue work to prepare methodological recommendations on IT and technology risks.
20. Supervisory techniques	Amend the Banking Law to permit follow-up inspections of a bank on the same topic, with appropriate safeguards to prevent the supervisory burden.
22. Accounting and auditing	Implement the new accounting rules, which are more closely IFRS based. Amend the Law on Auditing Activity and issue CBR recommendations on audits of banks and consolidated groups.
23. Corrective and remedial powers	Introduce sanctions against individual directors and officers of a bank.
24. Consolidated supervision	Introduce broader powers with regard to bank holding company supervision. Continue to improve the database on consolidated groups. Continue to work with the Ministry of Finance to update the main provisions of the rules on supervision on a consolidated basis.

### **B. Authorities' Response**

The authorities were in general agreement with the conclusions and observations in this assessment. Written comments provided have been incorporated in the report.

### III. THE DETAILED ASSESSMENT REPORT (DAR)

**Table 3. Detailed Assessment of Compliance of the Basel Core Principles**

*Only principles 5, 6, 7, 8, 9, 11, 12, 18, 23, and 24 have been reassessed. In order to provide a complete view, the description, comments, and grades for the other principles have been carried over from the 2007 assessment to the annex of this DAR. The selection of the principles that have been reassessed was done by the mission team based on an analysis of the risks and vulnerabilities of the Russian Federation, informed by the findings from previous assessments, as well as country work, bilateral, multilateral, and regional surveillance. The process followed for the identification of the principles that needed reassessment did not suggest the need to reassess other principles.*

	<p><b>Principle 5. Major acquisitions.</b> The supervisor has the power to review major acquisitions or investments by a bank, against prescribed criteria, including the establishment of cross-border operations, and confirming that corporate affiliations or structures do not expose the bank to undue risks or hinder effective supervision.</p>
Description	<p><b>Criterion 1: Laws or regulations clearly define what types and amounts (absolute and/or in relation to a bank's capital) of acquisitions and investments need prior supervisory approval:</b> Article 61 of the CBR Law and article 11 of the Bank Law contains a general stipulation that acquisition of more than 20 percent of a banks' shares requires prior CBR approval and acquisition of over one percent requires a post-notification. In accordance with Instruction No. 110-I, the risks emerging from the acquisition of equity in another domestic bank or nonbank are also controlled through application of the mandatory ratio between investment in other entities' stock, and the amount of a bank's capital (25 percent) (N12). But there is no requirement that banks seek approval for significant acquisitions of nonbank financial institutions and the CBR is therefore, unable to analyze impact of nonbank investments on the bank's financial position.</p> <p><b>Criterion 2. With regard to setting up or acquisition of an establishment abroad, laws or regulations provide criteria by which to judge individual proposals:</b> Article 35 of the BL establishes requirements on credit institutions that may have subsidiaries abroad. This article also gives the CBR the right to establish additional requirements for creating a subsidiary abroad.</p> <p><b>Criterion 3. Consistent with the licensing requirements, among the objective criteria that the supervisor uses is that any new acquisitions and investments abroad do not expose the bank to undue risks or hinder effective supervision.</b> The supervisor can prohibit banks from making major acquisitions/investments (including the establishment of foreign branches or subsidiaries) in countries with secrecy laws or other regulations prohibiting information flows deemed necessary for adequate consolidated supervision.</p> <p><b>Criterion 4. The supervisor determines that the bank has, from the outset, adequate financial and organizational resources to handle the acquisition/investment.</b> For domestic nonbank investments there is no pre-acquisition review performed since approval or notifications to the CBR are not required. Once acquired, the operation's impact on the bank is assessed through the supervisory process.</p> <p><b>Criterion 5. Laws or regulations clearly define for which cases notification after acquisition or investment is sufficient.</b> Such cases should primarily refer to activities closely related to banking and the investment being small relative to the bank's capital. In accordance with Directive 2332-U banks are required to submit to the Bank of Russia</p>

reports “Information on the banks investments and his clients—residents” (Form 0409404), “Information about banks` subsidiaries—non-residents” (Form 0409170). In accordance with Statute No. 290-P a bank is required to report to the CBR on acquisition of shares in a foreign subsidiary within a month. The bank is also required to notify the CBR regional office within five business days of any subsequent changes in the amount of its participation. If through disposal of shares or in another way a bank loses the status of parent company, the bank must notify the CBR regional office within five business days. Statute No. 290-P requires that the economic justification for the establishment of a subsidiary abroad must contain information on the system of risk management on a consolidated basis, with consideration for the activity of the foreign subsidiary organization. If the information about the risk management system does not meet the requirements of Statute No.290-P the Bank of Russia has the right to deem the project of establishing the subsidiary economically unfeasible and refuse to grant approval. In addition, to acquire a permit to create a cross-border subsidiary a bank must provide its written consent to an examination of the subsidiary by the CBR.

**Criterion 6. The supervisor is aware of the risks that non-banking activities can pose to a banking group and has the means to take action to mitigate those risks.** The procedure by which the Bank of Russia issues permits to credit institutions to establish cross-border subsidiaries organizations and acquire the status of parent company in relation to operating nonresident persons is established by Bank of Russia Statute No. 290-P, August 4, 2006 "On the Procedure by Which the Bank of Russia Issues Permits to Credit Institutions Allowing Possession of Subsidiary Organizations in a Foreign State" (henceforth—Statute No. 290-P). According to the requirements of this Statute, in addition to complying with conditions established by law a credit institution must satisfy the following requirements:

- it must have operated for not less than three years from the date of state registration;
- it must comply with requirements imposed on participation in the system for insuring private deposits in banks of the Russian Federation;
- it must fulfill CBR reserve requirements;
- it must not have past-due monetary obligations with the CBR;
- it must not be in debt to the budget.

In accordance with Statute No. 290-P, when issuing permits to create foreign subsidiary organizations the CBR also takes into account the economic justifications for the plans of a bank to create a cross-border subsidiary, to include analyzing information submitted within the framework of the bank's business plan: the terms of the transaction, essential indicators needed to reveal the main purposes of the plan, the action program and anticipated results of the activity of the subsidiary organization, the system of risk management on a consolidated basis, and information on executive managers. In the case of acquisition of the status of parent company in relation to an operating nonresident person, the business plan must also contain the annual balance sheet of this legal entity, approved by an auditing organization or by an auditor by procedure established by the nonresident legal entity's host country, and the balance sheet for the most recent reporting date.

A plan to create a cross-border subsidiary is recognized to be justified if there are prospects that the subsidiary organization will exist for a long time as a financially sound organization. In addition the package of documents submitted to the CBR for a permit must include the decision of the bank's governance authority to create the subsidiary organization, a list of the founders (participants) of the subsidiary organization, and the bank's written consent to an examination of the subsidiary organization by the CBR.

The CBR does not issue permits to create a subsidiary organization in states (on territories)

	<p>classified by legislation as states (territories) not participating in international cooperation in anti-money laundering and financing of terrorism.</p> <p>Domestically there is no approval required to establish nonbank financial subsidiaries and the CBR lacks the authority to limit transactions between affiliates.</p>
Assessment	Materially noncompliant
Comments	Also graded MNC at the last review due to the lack of a requirement that banks seek prior CBR approval to make nonbank domestic investments. There is an aggregate percentage-of-capital limit of 25 for investments in banks and other entities. The CBR relies on the aggregate limit to monitor/minimize the risk of nonbank acquisitions on the bank. The lack of an ex-ante determination of an acquisition's possible impact on a bank prevents the CBR from being able to limit the exposure to the bank of undue risks. While ex-post the CBR may address risks through the supervisory process, it does not meet a critical object of this CP that is preventive in nature by an ex-ante acquisition review.
<b>Principle 6.</b>	<b>Capital adequacy.</b> Supervisors must set prudent and appropriate minimum capital adequacy requirements for banks that reflect the risks that the bank undertakes, and must define the components of capital, bearing in mind its ability to absorb losses. At least for internationally active banks, these requirements must not be less than those established in the applicable Basel requirement.
Description	<p><b>Criterion 1. Laws or regulations require all banks to calculate and consistently maintain a minimum capital adequacy ratio.</b> Laws, regulations or the supervisor define the components of capital, and ensuring that emphasis is given to those elements of capital available to absorb losses. To ensure stability of credit institutions, in accord with Article 62 of the Law on the Central Bank of Russia, the CBR is authorized to establish ten compulsory standards for banking groups, including towards capital. Article 67 defines that a bank's capital adequacy ratio is determined as the ratio between its total capital and the sum of its risk weighted assets. Similarly, Article 72 of the law authorizes the CBR to establish methods for calculating the capital of an institution and for determining the ratios for a credit institution's capital, assets and liabilities.</p> <p>The capital adequacy ratio of credit institutions is calculated using the methodology established by CBR Instruction 110-I, entitled "On Banks' Obligatory Normatives," Section 2.2. For banks with a capital of at least 180 million rubles the capital adequacy ratio is 10 percent; for banks with capital less than 180 million, the capital adequacy ratio is 11 percent. The capital adequacy standards are applied not only on the solo level but also on the level of banking (consolidated) group (i.e., up to holding company level). Capital adequacy standards which are applied on a consolidated basis are consistent with those established on solo level.</p> <p><b>Criterion 2. At least for internationally active banks, the definition of capital, the method of calculation and the ratio required are not lower than those established in the applicable Basel requirement.</b> Bank's capital (or "own funds") is defined by CBR Regulation 215-P, entitled "On the Methodology for Assessing Credit Organizations Own Funds (Capital)" as the sum of principal and supplemental capital, reduced by indicators featured in sub-sections 4 and 5. The principal or Tier I capital of a credit institution is defined as the sum of the elements listed in sub-section 2.1 Regulation 215-P, including, <i>inter alia</i>: (i) authorized or charter capital; (ii) share premiums ; (iii) profit confirmed by an external auditing and (iv) subordinated debt up to 15 percent.</p> <p>Supplemental or Tier II capital is defined as the sum of the elements listed in sub-sections</p>

<p>3.1—3.9 Regulation 215-P including, <i>inter alia</i>: (i) reserves which arise from the revaluation of bank's own premises in connection with the change in market values<sup>2</sup>; (ii) the current year's profit not yet confirmed by an external auditing; (iii) subordinated debt with original fixed term to maturity of over five years: (iv) and subordinated debt of over 10 years, whereby the Bank of Russia has the right to suspend payment in favor of creditors<sup>3</sup>.</p> <p>To be deducted from capital are elements listed in sub sections 4–5 Regulation 215-P including, <i>inter alia</i>: (i) intangibles; (ii) investment of capital nature in the credit institutions of the Russian Federation and in subsidiaries/affiliates ; (iii) losses of preceding years and of the current year; (iv) capital formed by investors with inappropriate assets (loans wherein the credit institution directly or indirectly assumes the risk of loss); (v) the amount of investments in and value of fixed assets (e.g., bank's own premises) exceeding the amount of a bank' capital.</p> <p>The capital adequacy risk weights are set by CBR Instruction No. 110-I.:</p> <ul style="list-style-type: none"> <li>• Group 1: 0 percent (e.g., claims on the Bank of Russia) and 2 percent (e.g., cash held in bank vaults and in transit);</li> <li>• Group 2: 20 percent (e.g., debt securities issued by local authorities of the Russian Federation funded in Rubles, claims on banks incorporated in certain OECD countries</li> <li>• Group 3: 50 percent (e.g., credit claims on the sovereign or Russian Federation constituent members denominated and funded in foreign exchange; credits and claims on central banks or governments with a country score of "3".</li> <li>• Group 4: 100 percent (all other assets);</li> <li>• Group 5: 150 percent (e.g., claims on central banks and governments of countries rated "7").</li> </ul> <p>Furthermore, Regulation 215-P, Section 3.11.1 imposes quantitative limits on the sources of capital, and on the ratio of Tier I capital to Tier II capital. Namely, the aggregate amount of subordinated debt may not exceed 15 percent of Tier I capital. Section 3.11.2 includes a provision that under certain conditions the amount of Tier II capital may not exceed 100 percent of Tier I capital.</p> <p><b>Criterion 3. The supervisor has the power to impose a specific capital charge and/or limits on all material risk exposures.</b></p> <p>As laid out in Instruction 110-I, Annex 1, section 8957, loans to the bank's related parties are deemed to be of higher risk and thus must be calculated with a risk weight co-efficient of 1.3 (rather than 1.0 or 100 percent risk weighting for most other loans).</p> <p>A 150 percent risk weight is assigned to loans in jurisdictions rated 7 under the OECD published Export Credit Agencies ratings. In the second-half of 2011, the 150 percent category will also be applied to nonperforming loans.</p> <p>Capital is required for operational and market risk based on the Basel II simplified approach.</p>
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<sup>2</sup> Such revaluation may be included in Tier II capital only once in three years. Bank premises revaluation is to be conducted in accordance with strict valuation rules and such increases are to be approved by the bank's external auditor before reflected on the bank's balance sheet.

<sup>3</sup> Subordinated debt to be included in a bank's Tier II capital must meet strict criteria established by the Law on credit organizations' insolvency (bankruptcy) and Regulation 215-P. Subordinated debt may be included in a bank Tier II capital only if it meets these criteria. Appropriate verification (legal expertise) of the subordinated debt contract is conducted by the Bank of Russia at its respective territorial branches.

	<p><b>Criterion 4. The required capital ratio reflects the risk profile of individual banks. Both on-balance sheet and off-balance-sheet risks are included.</b> The amount of capital as set by regulation reflects the bank's individual risk profile but the CBR lacks the ability to alter the requirements to reflect individual bank's risk taking based on supervisory judgment. Also, it should be noted that minimum capital adequacy ratios established by Instruction No. 110-I are in all cases higher than the minimum recommended by Basel I. Finally, Appendices 2 and 3 of Instruction 110-I require that the capital adequacy ratio calculation includes credit risk for conditional credit obligations or off-balance-sheet accounts, including derivative contracts.</p> <p><b>Criterion 5. Capital adequacy requirements take into account the conditions under which the banking system operates.</b> Consequently laws and regulations in a particular jurisdiction may set higher capital adequacy standards than the applicable Basel requirement. In accordance with Instruction No. 110-I (as laid out in Criterion 1 above) the CBR applies different bank capital adequacy levels, which in all cases are higher than the minimum recommended by the Basel Committee on Banking Supervision.</p> <p><b>Criterion 6. Laws or regulations give the supervisor authority to take measures should a bank fall below the minimum capital ratio.</b> Article 73 of the CBR Law authorizes the CBR to inspect credit institutions, instruct them to correct violations discovered in their activities and impose sanctions.</p> <p>The CBR has the right to apply up to eight sets of corrective measures, as established by Article 74 of the CBR Law, in the event a bank violates federal laws, regulations or orders of the CBR. Further to which, in accord with Article 20, Section 10 of the BL (395-I) the CBR is obliged to revoke a bank's license if its bank's capital adequacy ratio falls below 2 percent.</p> <p><b>Criterion 7. Where the supervisor permits banks to use internal assessments of risk as inputs to the calculation of regulatory capital, such assessments must adhere to rigorous qualifying standards and be subject to the approval of the supervisor.</b> If banks do not continue to meet these qualifying standards on an ongoing basis, the supervisor may revoke its approval of the internal assessments. Not applicable, as the CBR does not permit use of the internal models for regulatory capital purposes.</p>
Assessment	Largely compliant
Comments	Also graded <b>largely</b> compliant in 2007. Russia meets the CP-6 essential criteria and has partially implemented the Basel II standardized simplified approach. However, the CBR lacks the legal authority to implement Pillar 2. Also subordinated debt is permitted in Tier I with a 15 percent limit. The CBR also lacks authority to implement capital limits based on an individual bank's risk undertaking profile. Legislation is being drafted to amend the CBR Law and permit Pillar 2 implementation.
<b>Principle 7.</b>	<b>Risk management process.</b> Supervisors must be satisfied that banks and banking groups have in place a comprehensive risk management process (including Board and senior management oversight) to identify, evaluate, monitor and control or mitigate all material risks and to assess their overall capital adequacy in relation to their risk profile. These processes should be commensurate with the size and complexity of the institution.
Description	<b>Criterion 1. Individual banks and banking groups are required to have in place comprehensive risk management policies and processes to identify, evaluate, monitor, and control or mitigate material risks.</b> The supervisor determines that these processes are adequate for the size and nature of the activities of the bank and banking group and are periodically adjusted in the light of the changing risk profile of the bank or banking group and external market developments. If the supervisor determines that the risk management processes are inadequate, it has the power to require a bank or banking group to strengthen them.

Overall, risk management is assessed by the CBR as a process of decision making, execution, and control. In accordance with Article 75 of the CBR Law, the supervisory body analyzes activities of credit institutions to determine potential situations which could jeopardize the interests of depositors and creditors and the soundness of the banking system. Article 44 of the Deposit Insurance Law establishes requirements for credit institutions on comprehensive risk management systems.

The assessment of bank risk management systems is made through, *inter alia*, a weighted point method described in Directive No. 1379-U, which establishes procedures by which the Bank of Russia can assess the state of risk management and internal control systems of credit institutions.

Accordingly, the procedures utilized by the CBR are a series of compliance questions featured in appendices PU4 and PU5 of Directive 1379-U which concern the components of risk management and internal control systems of banks. Answers to questions set forth in appendices 4 and 5 to Directive No. 1379-U are assessed by assigning values thereto on a four-point scale:

1. Yes (permanently, always, to the full extent);
2. Largely (as a rule, sufficiently completely);
3. Partially (yes in part, in some cases, insufficiently completely);
4. No (never, under no circumstances).

The CBR conducts on-site inspections of credit institutions within the framework of its ongoing bank supervisory responsibilities. The approach used during on-site inspections to assess the internal controls in credit institutions and risk management systems are set forth in CBR Letter 47-T, entitled "On Methodological Recommendations on Conducting Inspections and Assessing Organization of Internal Controls in Credit Institutions" and through Letter 26-T, entitled "On Methodological Recommendations on Conducting Inspections of the Bank Risk Management System in a Credit Institution (a Branch Thereof)".

The bank's risk management system is inspected as part of the on-site assessment, consistent with the scale and conditions of a credit institution's activity. In accord with the recommendations offered in 26-T, the following are considered: compliance of internal bank risk management practices with requirements of Russian Federal legislation and CBR regulations / recommendations; procedures which support the institution's division(s) responsible for risk management; how recommendations are generated and management decisions taken; and the role of the board of directors, including the independence of the risk management function to assess risks.

The methodology for the supervisory assessment of banks' activities, including the assessment of the quality of corporate governance is established in Directive No. 2005-U. The Directive provides a holistic approach to the assessment of risk management and internal audit systems. Based on the analysis, banks are rated from 1–5 based on risk indicators.

When cases of shortcomings in the system of bank risk management are detected through either the on- or off-site supervision, the CBR has the right to implement measures provided by the BL and the CBR Law against the institution, to include the right to order the bank to correct violations, and recommend improvements to its risk management system.

**Criterion 2. The supervisor confirms that banks and banking groups have appropriate risk management strategies that have been approved by the Board.** The supervisor also

confirms that the Board ensures that policies and processes for risk-taking are developed, appropriate limits are established, and senior management takes the steps necessary to monitor and control all material risks consistent with the approved strategies.

According to Article 11.1 of the BL, banks are obliged to establish a board of directors. Furthermore, CBR Directive 1176-U, entitled "On Business Plans of Credit Institutions," requires bank to submit a business plan that explains, *inter alia*, internal principles of risk management and measures to be taken to minimize financial difficulties.

As referenced earlier, Directive 1379-U permits the CBR to verify through inspection that a bank has developed and utilizes internal documents on management of material risks inherent to banking (credit, market, country, liquidity, operational, etc.). The bank is to evaluate foreign exchange position limits and that such established limits are regularly observed. These risks should be assessed on a regular basis and reported to the board of directors accordingly.

Supporting Directives 1176-U and 1379-U, the CBR issued recommendation Letter 119-T entitled "On Modern Approaches to Organizing Corporate Governance in Credit Institutions". This recommends, *inter alia*, that approval of internal written policies concerning bank risk management be placed under the authority of the board of directors.

**Criterion 3. The supervisor confirms that risk management strategies, policies, and processes are properly documented, reviewed, and updated, communicated within the bank and banking group, and adhered to in practice.** The supervisor determines that exceptions to established policies, processes, and limits receive the prompt attention of and authorization by the appropriate level of management and the Board.

The CBR assesses a bank's risk management system in accordance with Directive 1379-U, which requires the CBR to verify that the bank possesses and utilizes internal written policies and procedures on the management of material risks inherent to banking. In keeping with the requirements of Directive 1376-U, a bank is to submit a monthly report to the CBR on "Information on Internal Controls in a Credit Institution" (Form 0409639), which documents the functioning of the bank's system of internal controls.

Further to which, according with Regulation 242-P, a credit institution must adopt internal procedures addressing, *inter alia*: accounting; risk management; credit and deposit policies; lending to related persons; the management of accounts and deposits; an interest rate policy; settlements for both cash and non-cash transactions; foreign exchange; securities; bank guarantees; cash operations; internal regulations on anti-money laundering and financing of terrorism; and an information security policy. Accordingly, CBR territorial offices have the right to request information on the organization of the system of internal controls.

The CBR evaluates how a bank board of directors determines whether: (i) decisions have been adopted consistent with its approved corporate development strategy; (ii) whether large and/or atypical credits or other banking operations, inconsistent with their approved strategy, are submitted to the board of directors, and (iii) more generally if relevant internal procedures are observed.

Additionally, in accord with CBR recommendation Letter 11-T, entitled "On the List of Issues Addressed by Credit Institutions in Their Assessment of the Status of Corporate Governance", banks undertake a (voluntary) annual self-assessment of corporate governance. Further to which, internal control related assessments made during the on-site inspection (in accord with Letter 47-T) are to determine the bank's compliance with internal methods, programs, regulations, policies, and procedures, and established limits and to

make an assessment of internal control reports and specifically whether the institution has in operation a system for the coordination and approval of any transactions exceeding established limits.

**Criterion 4. The supervisor determines that senior management and the Board understand the nature and level of risk being taken by the bank and how this risk relates to adequate capital levels.** The supervisor also determines that senior management ensures that the risk management policies and processes are appropriate in the light of the bank's risk profile and business plan and that they are implemented effectively. This includes a requirement that senior management regularly reviews and understands the implications (and limitations) of the risk management information that it receives. The same requirement applies to the Board in relation to risk management information presented to it in a format suitable for Board oversight.

**Through its onsite reviews** The CBR determines that a bank's board of directors and senior management understand the nature of risks being taken on by the bank. Among the recommendations offered by the CBR in 119-T is a suggestion that: (i) a bank's board of directors authorize the priority areas of its activities; (ii) approve a maximum aggregate risk level (risk-appetite) for the credit institution and risk tolerances by sector, region, etc); (iii) risk limits are in place for all other operations; (iv) measure the consequences of major strategic initiatives against the maximum permissible aggregate level of risk the credit institution takes; and (v) develop sufficient internal procedures and correspondingly, devote resources necessary to enforce and report upon such policies.

As the CBR assesses the organization of a bank's risk management system, it verifies on-site at the institution whether it possesses full and accurate records of the management decisions taken, including the risks thereof, and that such records are reflected in the current condition of the bank.

**Criterion 5. The supervisor determines that banks have an internal process for assessing their overall capital adequacy in relation to their risk profile, and reviews and evaluates banks' internal capital adequacy assessments and strategies.** The nature of the specific methodology used for this assessment will depend on the size, complexity, and business strategy of a bank. Non-complex banks may opt for a more qualitative approach to capital planning.

According to Regulation 11-T a bank's board of directors should monitor the adequacy of the economic capital of the bank to its risk appetite. Information on an institution's internal procedures for assessing overall capital adequacy are to be submitted monthly to the CBR using form (0409639) entitled "Information on Internal Controls in a Credit Institution" which requires information on documents regulating the bank's system of internal controls.

In the course of on-site inspections conducted, utilizing the recommendations provided through 26-T and 31-T, the CBR assesses how an institution's Board of Directors receives and uses information provided, how management decisions are taken and whether the analytical work done considers (new) bank risks, and how internal control recommendations were generated and reported on the basis of its analysis. See criterion 7.7 for a summary of reports recommended to be provided the board of directors ahead of their meetings.

**Criterion 6. Where banks and banking groups use models to measure components of risk, the supervisor determines that banks perform periodic and independent validation and testing of the models and systems.**

According to Statute No. 242-P a credit institution's internal control department, which is to

report to the board of directors, periodically verifies the effectiveness of the bank's methodology (including models) for measuring risks. Institutions are also recommended, through 119-T to appoint qualified staff to be responsible for making a regular determination of the effectiveness of risk management models currently employed and continue to develop new methods for revealing, measuring and mitigating the level of bank risks.

Such institution staff would undertake periodic reviews of the models used to assess risks, test the quality of such models, and whether these have been externally validated, the model's assumptions are aligned with the board's current risk limits and the CBR's reporting requirements. In practice however, only the larger banks have qualified full-time staff focused on risk management compliance.

**Criterion 7. The supervisor determines that banks and banking groups have adequate information systems for measuring, assessing, and reporting on the size, composition and quality of exposures.** It is satisfied that these reports are provided on a timely basis to the Board or senior management and reflect the bank's risk profile and capital needs.

Banks are obliged to report regularly to the CBR a number of financial and prudential reports (see CP21.1 for a partial listing), which generally assure the supervisor of adequate information. The CBR recommendation 119-T suggests that board of directors and executive directors alike develop a system for the collection and dissemination of financial and operational data on a bank's credit activities so as to support sound management decisions on all material bank risks of the institution.

Furthermore, 119-T recommends that the board of directors receive in advance of its meetings, reports on the following key risk management issues:

- financial indicators of the credit institution's activity, including an analysis of the adequacy of capital to cover risks envisaged by the institution;
- the quality of loans and adequacy of reserves against possible losses;
- concentrations of credits and investments by sector, borrower, region, etc;
- an assessment of the quality of bank risk management;
- a review of lending and other banking operations involving shareholders and executive directors with a supporting risk assessment;

In the course of its on-site inspections, a summary is made of, amongst other information, supervisory information received on regular (daily) by the bank's board of directors, of information on bank risks taken by the credit institution and other information on the current status of the credit institution needed for management decisions.

Thus, when undertaking an assessment of a bank's risk management system, in accordance with Directive 1379-U, the CBR inspection verifies that the bank has relative to its size and risk exposure adequate regular management reports on the size, quality and composition of credits (both existing and proposed) as part of its decision making process.

**Criterion 8. The supervisor determines (sets requirements on) the need for banks to have policies and processes in place to ensure that new banking products and major risk management initiatives are approved by the Board or a committee of the Board.**

In accordance with the recommendations in 119-T, the board of director is to consider possible negative alternatives in the development of new banking products and also to measure the possible consequences of decisions against the maximum aggregate level of risk that may be taken by the credit institution.

	<p>Letter No. 119-T also recommends that the board of directors carefully analyze information needed to keep abreast of the financial condition of the institution, its position on the market, and on prevailing trends in the banking sector and possible changes in legislation or regulation pertaining to the institution.</p> <p>However, the CBR lacks the authority to set required standards for the management of risk in areas of corporate governance, internal risk assessments and internal capital adequacy assessment requirements. At present standards are issued in the form of recommendations.</p> <p>In the course of its on-site inspections, the CBR assesses an institution's policies and procedures for the review and approval of new banking products and any other important initiatives undertaken. In particular, this assessment is influenced by the on-site inspector's analysis of the participation of the board of directors in the review and approval of the institution's credit strategy, the frequency and effectiveness of its interaction with risk management, the volume and quality of information provided to the board of directors, including information on mechanisms for lowering the level of risks (such as a hedging, insurance, securitization of assets, etc..).</p> <p><b>Criterion 9. The supervisor determines that banks and banking groups have risk evaluation, monitoring, and control or mitigation functions with duties clearly segregated from risk-taking functions in the bank, and which report on risk exposures directly to senior management and the board.</b></p> <p>In accordance with Directive 1379-U, the CBR in its assessment of the organization of the system of risk management, utilizes a series of detailed indicators to determine, <i>inter alia</i>, that divisions responsible for assessing the level of the risks are independent from risk-taking activities.</p> <p>To amplify on the above Directive, the CBR utilizes Letter 119-T to recommend banks' board of directors improve the organizational and control functions related to risk management. Accordingly, it is recommended to appoint bank staff to coordinate its risk management and perform the following duties:</p> <ul style="list-style-type: none"> <li>• analyze the effectiveness of methods currently used for identifying, measuring and mitigating levels of bank risks, and developing new methods;</li> <li>• assess the potential for losses through modeling or stress testing, transmitting the results to the attention of the board of directors;</li> <li>• Develop and submit for consideration proposals on measures aimed at reducing the level and structure of risks, including proposals on hedging or other operations to mitigate risks.</li> </ul> <p><b>Criterion 10. The supervisor issues standards related to, in particular, credit risk, market risk, liquidity risk, interest rate risk in the banking book and operational risk.</b></p> <p>The CBR has issued regulations, directives and guidance support standards for credit, market, liquidity, interest rate and operational risks.</p>
Assessment	Largely compliant
Comments	<p>Grading remains the same. Required legislation to address deficiencies noted at the last review have not been implemented.</p> <p>The existing risk management regulatory framework is complex and multi-faceted. The CBR has issued numerous regulations, instructions and recommendations which directly or indirectly support banks' strengthening their internal risk management processes.</p>

	<p>In sum, on-site inspection of a bank's internal control system verify that the institution's internal documents contain procedures for informing the directors about both internal and external factors which influence increasing the level of bank risks, and that their established risk management and reporting procedures are adhered to correctly.</p> <p>In an implicit acknowledgement that the existing risk management regime is not sufficiently robust, the CBR is endeavoring to improve the bank's risk management regulatory regime. First, <b>legislative amendments are needed</b> to strengthen the basic requirements on the functions and composition of the board of directors and to define the concept "independent directors" who may be elected to an institution's board of directors. In addition, amendments to, to permit the CBR to assess corporate governance, risk management and audit in banks <b>are also needed</b>. Currently, the CBR lacks authority to enforce guidance issued through its supervisory letters.</p> <p>If approved, these envisaged new risk management requirements would more clearly define the responsibilities of the board of directors towards developing and overseeing management of the banks' entire risk profile and the policies supporting the participation of (independent) directors in overseeing risk management decision-making.</p>
<p><b>Principle 8.</b></p>	<p><b>Credit risk.</b> Supervisors must be satisfied that banks have a credit risk management process that takes into account the risk profile of the institution, with prudent policies and processes to identify, measure, monitor and control credit risk (including counterparty risk). This would include the granting of loans and making of investments, the evaluation of the quality of such loans and investments, and the ongoing management of the loan and investment portfolios.</p>
<p>Description</p>	<p><b>Criterion 1. The supervisor determines by inspection, and then periodically confirms, that a bank's Board approves, and periodically reviews, the credit risk management strategy and policies and methods for assuming, identifying, measuring, controlling, and reporting on credit risk (including counterparty risk).</b> The supervisor also determines, and periodically confirms, that senior management implements the credit risk strategy approved by the Board and subsequently develops the aforementioned policies and processes.</p> <p>CBR Regulation 242-P directs that on-site inspections be made of the entire internal control system and specific operations, including compliance with internal methods, rules, policies, procedures, and established limits. This applies to all banking operations, particularly towards lending. Through its periodic on-site inspections (and supported by ongoing off-site supervision) the CBR evaluates banks' internal credit policy documents and determines how credit and other processes are monitored, violations reported and addressed by the Board of Directors. Significant attention is paid during on-site inspections to analyzing methods used to assess report and mitigate credit risks.</p> <p>Regulation 242-P specifies, <i>inter alia</i>, the goals of internal control, the management of asset risk, which is defined to include: (i) the identification, measurement, and determination of acceptable risk levels; (ii) the systematic monitoring of bank risks; and (iii) the adoption of measures to maintain bank risks at a level that does not jeopardize the financial soundness of the credit institution and the interests of its creditors and depositors.</p> <p>Supporting the Regulation are CBR recommendations 102-T entitled "On Methodological Recommendations on Inspecting Loans, Loan Debt, and Debt Equated Thereto" and 167-T entitled "On Methodological Recommendations on Inspecting Transactions of Credit Institutions (Branches Thereof) with Bills."</p> <p>Additionally, to further its on-site assessment of credit risk management, the CBR issued recommendation 26-T, which recommends that appropriately authorized written procedures</p>

address credit policy and the methodology for risk assessment, the institution's compliance with requirements of CBR regulations and the scope of observance to the institution's policies.

**Criterion 2. The supervisor requires, and periodically confirms, that such policies and processes establish an appropriate and properly controlled credit risk environment, including:**

- a well-documented strategy and sound policies and processes for assuming credit risk;
- well-defined criteria and policies and processes for approving new exposures as well as renewing and refinancing existing exposures, identifying the appropriate approval authority for the size and complexity of exposures;
- effective credit administration policies and processes, including continued analysis of a borrower's ability and willingness to repay under the terms of the debt, monitoring of documentation, legal covenants, contractual requirements and collateral, and a classification system that is consistent with the nature, size and complexity of the bank's activities or, at the least, with the asset grading system prescribed by the supervisor;
- comprehensive policies and processes for reporting exposures on an ongoing basis;
- comprehensive policies and processes for identifying problem assets;
- prudent lending controls and limits, including policies and processes for monitoring exposures in relation to limits, approvals and exceptions to limits.

The identification, monitoring, and assessment of credit risks and formation of loss reserves are regulated by Regulations 254-P and 283-P. According to which, the on-site inspectors are to verify the Board of Directors adopt written policies for the assessment of the quality and classification of assets and any conditional credit obligations which must be included within the requirements of the credit policies of the institution. Accordingly, a bank is obligated to put in place written policies supporting, *inter alia*:

- the methods used to assess the financial position of a borrower, main sources used for deriving information on this issue;
- procedure and frequency of determining the fair value and liquidity of the loan's security;
- a comprehensive system of credit risk assessment making it possible to classify assets, including off-balance sheet commitments into one of five quality categories;
- criteria and procedures for the assessment and documentation of loans, other assets, and conditional credit obligations;
- procedures for the formulation and execution of loan loss reserves;
- procedures for making and executing decisions to write off loans which cannot realistically be collected, after the institution has taken all necessary legal steps to realize on the collateral.

Apart from the regular review of connected loans when undertaking an on-site inspection, in line with the on-site inspection terms of reference developed by the off-site supervision department, the initial focus is upon those borrowers for which data are contained in the monthly report form 0409118 "Data on Large Credits." CBR recommendation 102-T targets that a representative sample of not less than 70 percent of the total volume of loans, including at least the 30 largest borrowers groups, are to be evaluated at each on-site inspection. Equally, the Board of Directors' meeting minutes are routinely evaluated during

the on-site inspection to determine how engaged the Board of Directors are in the credit risk management function and in acting upon any credit risk related recommendations put forward from the bank's division responsible for assessing compliance.

In the course of its on-site inspection, the CBR regularly utilizes the recommendations featured in 26-T to confirm the presence of internal documents addressing: (i) credit policy, to assess its compliance with CBR regulations; (ii) that the methodological support is in place to support the systematic assessment of credit risks; (iii) that compliance with internal credit policies is routinely monitored; (iv) that the credit risk management is suitably resourced and independent of the institution's loan origination functions.

**Criterion 3. The supervisor requires, and periodically confirms, that banks make credit decisions free of conflicts of interest and on an arm's length basis.**

In accord with CBR Regulation 242-P, a bank must provide for employees' official duties in such a way as to preclude conflicts of interest and conditions which may give rise to such conflicts, including conflicts of interest between an institution and its customers. An institution is required to establish procedures for the identification and monitoring of areas of potential conflicts of interest.

Importantly however, the right of Directors' to vote on the approval of their own credits is not expressed prohibited by regulation: please refer to CP11.4 for a more full explanation. Additionally, the regulations do not make lending to related parties at preferential terms a violation. The CBR in Letter 102-T recommends to banks that lending to related parties be done on market terms but the recommendation is not enforceable but through moral suasion.

Item 3.6 of Regulation No. 254-P requires that a bank must determine the size of its loan loss reserves in the event that a loan is made to a related party in excess of 1 percent of the bank's capital (Tier 1+ Tier 2). In addition, a bank is required to classify loans to related parties no higher than the third category if information about the borrower's financial condition is not available for a period of more than one quarter.

In accord with the approved inspection terms of reference and CBR recommendation 102-T, specific aspects of a bank's credit and interest rate policies towards related party loans are thoroughly reviewed during on-site inspections. CBR Letter recommendation 86-T entitled "On Methodological Recommendations for the Model Structure and Content of a Lending Institution (Branch) Inspection Report" requires an inspection report contains, amongst other elements: (i) a separate assessment of the credit risks and group concentration for connected borrowers; (ii) off-balance sheet commitments; (iii) related parties of the institution, including subsidiary and parent borrowers groups. On-site inspectors compare terms and conditions of insider loans to market terms.

Additionally, the following credit risk components are to be assessed during an on-site inspection, as recommended by Letter 26-T: (i) compliance with a bank's internal credit policy documents; (ii) compliance with the requirements of the CBR; (iii) guidelines developed for determining lending limits for large borrowers and group of connected borrowers.

Finally, Board of Directors' meeting minutes are scrutinized during the on-site inspection to, *inter alia*; identify voting patterns, possible conflicts of interest and how such may have been addressed at the Board meeting.

Item 3.6 of Regulation No. 254-P requires that a bank must determine the size of its loan

	<p>loss reserves in the event that a loan is made to a related party in excess of 1 percent of the bank's total (Tier 1+ Tier 2) capital. In addition, a bank is required to classify loans to related parties no higher than the third category if information about the borrower's financial condition is not available for a period of more than one quarter.</p> <p><b>Criterion 4. The supervisor has full access to information in the credit and investment portfolios and to the bank officers involved in assuming, managing, controlling and reporting on credit risk.</b></p> <p>Regulation 254-P establishes the supervisor's right of access information used by a bank to evaluate the quality of loans, including the assessment of borrowers' financial condition. In practice, both on-site and off-site the Bank of Russia's full access to bank records is not impeded.</p>
Assessment	Largely compliant
Comments	<p>Grading remains the same.</p> <p>The CBR has sufficient legislative and regulatory authority to enable the regular monitoring of banks' credit risk exposures through a robust reporting and inspection regime. The periodic on-site inspection of banks is designed to, <i>inter alia</i>, assess credit risk and loan loss provisioning processes. However, as mentioned above, the CBR lacks authority to enforce recommendations issued through its supervisory letters.</p> <p>EC-3 is not complied with as CBR lacks the regulatory framework to be able to require lending to related parties be done at market terms and sanction banks that do not comply.</p>
<b>Principle 9.</b>	<b>Problem assets, provisions and reserves.</b> Supervisors must be satisfied that banks establish and adhere to adequate policies and processes for managing problem assets and evaluating the adequacy of provisions and reserves.
Description	<p><b>Criterion 1. Laws, regulations or the supervisor require banks to formulate specific policies and processes for identifying and managing problem assets.</b> In addition, laws, regulations or the supervisor require periodic review by banks of their problem assets (at an individual level or at a portfolio level for credits with homogenous characteristics) and asset classification, provisioning, and write-offs.</p> <p>The assessment and monitoring of problem loans and formation of adequate loan loss provisions are set forth in the Law on the CBR, the Law on Banks and through Bank of Russia regulations 254-P and 283-P. Banks are required to undertake a regular assessment of credit risks, including problem loans and other impaired assets. The classification of assets and determination of loan loss provisions are to be reported monthly to the CBR.</p> <p><b>Criterion 2. The supervisor confirms the adequacy of the classification and provisioning policies and processes of a bank and their implementation; the reviews supporting this opinion may be conducted by external experts.</b></p> <p>The CBR, in accord with Article 73 of the CBR Law, performs, <i>inter alia</i>, an assessment of the integrity of its asset classification methodology and size of reserves established. Recommendations 102-T and 167-T serve to guide the on-site inspection of banks to determine the soundness of the loan classifications review process and the adequacy of assigned loan loss provisions.</p> <p>Furthermore, recommendation 26-T determines that institutions have satisfactory internal procedures in place on, <i>inter alia</i>, credit policies, the classification of loans, problem asset resolutions.</p> <p><b>Criterion 3. The system for classification and provisioning takes into account off-</b></p>

**balance sheet exposures.**

In accordance with Regulation 283-P, chapter 3, banks are to establish loan loss provisions for contingent liabilities, which are to be classified according to their credit equivalence.

**Criterion 4. The supervisor determines that banks have appropriate policies and processes to ensure that provisions and write-offs reflect realistic repayment and recovery expectations.**

In accordance with Regulation 242-P, a bank inspection is to include the internal control system as well as individual operations to confirm whether internal processes, internal audit (control) reporting procedures and established limits are being observed. The CBR on-site inspector determines, in accord with Regulation 254-P, the existence and quality of internal documents supporting the loan loss provisions established and using 283-P, considers the merits of any decision taken to charge-off as irrecoverable a loan.

The adequacy of assessing loan loss provisioning is undertaken in accordance with recommendation 102-T, wherein the following key questions are to be addressed in the course of an analysis of a bank's records of charged-off assets:

- has the institution approved, written procedures in place to support any decisions taken on charging off non-performing loans;
- does the board of directors or executive board have responsibility for decision-making on the recognition of losses of bad loans;
- are the institution's procedures regarding charge-offs in line with the requirements of CBR regulation 254-P.

Further, during the on-site inspection a determination is made of the rationale for the charge-off of a loan, whether the document supports the lack of recoverability of the loan and the timeliness of the recording of such a charge-off.

**Criterion 5. The supervisor determines that banks have appropriate policies and processes, and organizational resources for the early identification of deteriorating assets, for ongoing oversight of problem assets, and for collecting on past due obligations.**

Item 3.1 of Regulation 254-P requires policies and practices supporting banks' on-going risk assessment, asset classification and evaluation of loans. Thus, a bank is required to report, *inter alia*, on the level of classified loans and related loan loss provisions. Similar reporting requirements are contained in item 1.8 of Regulation 283-P regarding other assets and contingent liabilities.

Further to which, in accordance with Regulation 242-P, the internal control system of lending institutions must include oversight of a bank's risk management systems and its assessment of banking risks. Compliance with this requirement is verified and reported through the on-site inspection.

Amongst the evaluations of loan quality undertaken during on-site inspections, in accordance with recommendation 26-T, are determinations of the bank's: (i) compliance with internal documents dealing with credit policy; (ii) the performance of regular monitoring of bank borrowers; (iii) a clear assignment of staff responsible for managing past due obligations; (iv) monthly reporting of the estimated fair value of collateral; (v) the quantity and quality of resources assigned to the organization and reporting of problem asset management.

**Criterion 6. The supervisor is informed on a periodic basis, and in relevant detail, or has access to information concerning the classification of credits and assets and provisioning.**

Banks submit monthly information about the quality of their loan book in accord with the requirements of Regulation 254-P, utilizing report form 0409115 "Information about the quality of loans, loan and equivalent debt". Information about other assets, contingent liabilities and other operations that carry the risk of losses, as the size of both calculated and actual provisioning, are reported via form 0409155 "Information about provisioning."

**Criterion 7. The supervisor has the power to require a bank to increase its levels of provisions and reserves and/or overall financial strength if it deems the level of problem assets to be of concern.**

In accordance with Article 72 of the CBR Law, as supervisor the CBR has the right to, *inter alia*, evaluate the soundness of a bank's classification of loans and loan loss provisioning. Moreover, Article 73 provides the authority to require a bank to reclassify a loan and to make any corresponding adjustment in the amount of its loan loss provisions. Supervisory reports made available during the assessment and interviews with market participants indicate that the CBR makes frequent use of its authority.

**Criterion 8. The supervisor assesses whether the classification of the credits and assets and the provisioning is adequate for prudential purposes. If provisions are deemed to be inadequate, the supervisor has the power to require additional provisions or to impose other remedial measures.**

As authorized by Regulations 283-P and 254-P, if the classification of assets is determined to be inadequate, the CBR is authorized to apply sanctions to banks, which may include an order requiring the bank to add additional loan loss provisions and/or place the asset in a different classification category.

**Criterion 9. The supervisor requires banks to have appropriate mechanisms in place for periodically assessing the value of risk mitigates, including guarantees and collateral. The valuation of collateral is required to reflect the net realizable value.**

Collateral values are reported in the calculation of loan loss provisions at fair (realizable) value, which is to be determined by a bank at least once per quarter, using either its own staff or an independent appraiser. Furthermore, Regulation 254-P requires that collateral pledged is considered by banks in the calculation of its loan loss provisions.

For the purpose of calculating a loan loss provision, collateral is divided into two quality categories, based on its liquidity. The most liquid types of collateral, deemed to be in the first category, are recognized at its full value for the calculation of the reserve. Less liquid forms of collateral, deemed to be in the second category, are only eligible to be included at one-half the recorded value. Similarly, guarantees are accepted in the calculation of the loan loss provision at up to 50 percent of the capital of the guarantor, but only as confirmed by an audit.

**Criterion 10. Laws, regulations or the supervisor establish criteria for assets to be identified as impaired, e.g. loans are identified as impaired when there is reason to believe that all amounts due (including principal and interest) will not be collected in accordance with the contractual terms of the loan agreement.**

Regulations 254-P and 283-P provide criteria which are required to be utilized for the classification and maintenance of loan loss provisions. All loans and contingent liabilities are

	<p>to be classified in one of five quality categories: for each Category of asset a corresponding loan loss provision is determined within a defined range:</p> <ul style="list-style-type: none"> <li>• Category I—standard loans, 0 percent loan loss provision;</li> <li>• Category II—substandard, between 1–20 percent loan loss provision;</li> <li>• Category III—doubtful, between 21–50 percent loan loss provision;</li> <li>• Category IV—problem, between 51–100 percent loan loss provision;</li> <li>• Category V—irrecoverable, 100 percent loan loss provision.</li> </ul> <p>The classification of loan loss provisions is determined through an assessment of the financial condition of the borrower and/or a determination of the probability that the borrower and/or contract counterparty cannot fulfill its obligations. The CBR views as NPLs those loans placed in Categories IV and V.</p> <p>The deterioration of the quality of a borrower is determined by the worsening of the borrower’s financial condition (such as the restructuring or re-financing of a credit) as well as delinquency indicators: more than five days late for loans made to enterprises (legal entities) and more than 30 days for loans made to individuals. The analysis of a borrower’s financial condition and procedures for calculating financial indicators are determined by each bank, depending on the sector and scope of the borrower’s activities.</p> <p><b>Criterion 11. The supervisor determines that the Board receives timely and appropriate information on the condition of the bank’s asset portfolio, including classification of credits, the level of provisioning and major problem assets.</b></p> <p>Regulation 254-P, section 3.1.3 requires that information used by a bank to evaluate the quality of loans (including an assessment of the borrower’s financial condition) be made available to the board of directors. In accord with Regulation 242-P, the on-site supervisor determines that asset quality information is regularly reported to the bank’s board of directors.</p> <p>Banks’ credit risk management is assessed by on-site inspectors in accord with recommendation 26-T, considering the following:</p> <ul style="list-style-type: none"> <li>• the presentation of reports to the board of directors on the implementation of credit policies at the bank;</li> <li>• the internal control function’s proper classification of loans and similarly, justification for the level of provisioning chosen;</li> <li>• the scope, quality and frequency of credit risk reporting to the executive board and board of directors.</li> </ul> <p><b>Criterion 12. The supervisor requires that valuation, classification and provisioning for large exposures are conducted on an individual item basis.</b></p> <p>Regulation 254-P allows for the valuation, classification and provisioning of loans both on an individual basis (for larger loans) and on a portfolio basis (for smaller loans). Banks may establish a loan loss provision on a portfolio of small, uniform loans (the Bank of Russia establishes a limit in Article 5 of 254-P of 0.5 percent of a bank’s capital for each such loan).</p>
Assessment	Largely compliant
Comments	Upgraded from MNC. The upgrade is based on the fact that the system for loan classification and provisioning meets minimum standards but an issue of full implementation remains. The current level of system provisions is below that required by the CBR standards. A review of reports of examination and follow-up correspondence/discussions

	<p>between CBR and bank management revealed that the CBR during its onsite examinations requests increased provisioning as needed. Recognizing that current levels do not meet the standard established, now that the level of overdue loans is declining the CBR, through its onsite visits, is requiring banks to increase provisioning and plans to issue further provisioning requirements.</p>
<b>Principle 11.</b>	<p><b>Exposures to related parties.</b> In order to prevent abuses arising from exposures (both on balance sheet and off balance sheet) to related parties and to address conflict of interest, supervisors must have in place requirements that banks extend exposures to related companies and individuals on an arm's length basis; these exposures are effectively monitored; appropriate steps are taken to control or mitigate the risks; and write-offs of such exposures are made according to standard policies and processes.</p>
Description	<p><b>Criterion 1. Laws or regulations explicitly provide, or the supervisor has the power to provide, a comprehensive definition of "related parties." This should consider the parties identified in the footnote to the Principle. The supervisor may exercise discretion in applying this definition on a case by case basis.</b> At the highest level, the concept of related parties is defined through Article 4 of Federal Law 948-1, entitled "On Competition and the Restriction of Monopolies in Commodity Markets." The definitions of parent, subsidiary, and dependent companies are contained in Articles 105 and 106 of the Civil Code of the Russian Federation.</p> <p>The CBR Law, Article 64, <i>inter alia</i>, defines related borrowers as dependent upon one another or having a parent-subsidiary relationship. Similarly, Article 4 of the Law on Banks defines what constitutes a "banking group," a "banking holding" and "significant influence."</p> <p>Instruction 110-I defines related parties of a bank as individuals and legal entities capable of influencing decisions which carry credit risk. Persons related to a bank may include, <i>inter alia</i>: stockholders of the bank who are not classified as related parties and who control 5 percent or more of the bank's equity, and their related parties; insiders (bank officers) who are not classified as related parties.</p> <p>In addition, to further expand its understanding of possible related party relationships, the CBR also evaluates information from bank's annual (published) financial statements, a number of which are compiled in accordance with IFRS standards. Specifically, considering information on the organization of financial and non-financial risk management, the ownership structure, operations with related parties, etc.</p> <p><b>Criterion 2. Laws, regulations or the supervisor require that exposures to related parties may not be granted on more favorable terms (i.e., for credit assessment, tenor, interest rates, amortization schedules, requirement for collateral) than corresponding exposures to non-related counterparties.</b> In accord with Bank of Russia recommendation 2-T entitled "On a Bank's Performance of Transactions with Related Parties and the Assessment of Risks Associated with Such Transactions," banks should have internal procedures in place to prohibit extensions of credits to related parties (including contingent liabilities) on terms that are more favorable than those for granted to non-related borrowers. Insider loans are reviewed during on-site inspections and an internal rate of return developed for each to determine if the overall terms are below then current market rates. However, the CBR lacks the authority to penalize the bank for noncompliance. Additionally, the CBR lacks authority to penalize directors personally for noncompliance, even with regulations.</p> <p><b>Criterion 3. The supervisor requires that transactions with related parties and the write-off of related-party exposures exceeding specified amounts or otherwise posing special risks are subject to prior approval by the bank's Board. The supervisor</b></p>

**requires that Board members with conflicts of interest are excluded from the approval process.** In accord with Section 8.7.2 of Bank of Russia Regulation 254-P, the write-off of loans provided bank to shareholders and/or their related parties which exceeds 1 percent of the institutions' capital is possible in the event the decision is taken by the board of directors and when supported by an authorized state body (e.g., the court bailiff) confirming that recovery of the loan is not possible. The latter condition is said to be troublesome, thereby precluding many such transactions. Nonetheless, a 100 percent provision can be made.

**Criterion 4. The supervisor requires that banks have policies and processes in place to prevent persons benefiting from the exposure and/or persons related to such a person from being part of the process of granting and managing the exposure.** In accordance with the recommendations laid out in 2-T, banks should have internal procedures in place to prohibit the approval of loans to insiders and other related parties with the participation or voting for approval of those persons who have an interest in the decision. However, there is no explicit regulatory prohibition in place to preclude directors voting on their own loans.

**Criterion 5. Laws or regulations set, or the supervisor has the power to set on a general or case by case basis, limits for exposures to related parties, to deduct such exposures from capital when assessing capital adequacy, or to require collateralization of such exposures. When limits are set on aggregate exposures to related parties, those are at least as strict as those for single counterparties, or groups of connected counterparties.** In accordance with Article 62 of the CBR Law Bank, the CBR may establish the levels and required ratio for the maximum level of loans (including off-balance sheet guarantees) provided by a bank to its shareholders. Through Instruction No. 110-I, limits are established on the aggregate exposures to certain categories of related parties.

As it regards connected credit exposures (including off-balance sheet guarantees) the following key ratios are prescribed and reported monthly to the Bank of Russia:

- N6: Aggregate size of loans to any one borrower and/or connected group is limited to 25 percent of bank's capital;
- N7: Aggregate large credit exposures limited to 800 percent of bank's capital.
- N9.1: Aggregate credits to shareholders holding more than 5 percent of the bank's stock limited to 50 percent of bank's capital.
- N10.1: Aggregate size of loans to bank insiders (directors, executive officers) is limited to 3 percent of bank's capital. Limit is only applied to the physical person and not aggregated with other connected parties of the insider.

Regulation 215-P requires that capital be reduced by the amount of total loans and guarantees provided the bank's shareholders and insiders (executive officers), less any provisions created.

**Criterion 6. The supervisor requires banks to have policies and processes to identify individual exposures to related parties as well as the total amount of such exposures, and to monitor and report on them through an independent credit review process. The supervisor confirms that exceptions to policies, processes and limits are reported to the appropriate level of senior management and, if necessary, to the Board, for timely action. The supervisor also confirms that senior management monitors related party transactions on an ongoing basis, and that the Board also provides oversight of these transactions.** In accord with Regulations 242-P and 254-P, when performing on-site

	<p>inspections at a bank, inspectors should confirm compliance with requirements regarding the identification, measurement, and determination of the maximum exposure to related parties. In accordance with Letter 2-T and letter 77-T, the CBR recommends bank internal policies and processes be established to monitor the performance of credit risks on related-party transactions.</p> <p>The following are evaluated in the on-site inspection of the management of credit risk, in the process of inspections in accordance with Letter No. 26-T: (i) internal documents dealing with credit policy; (ii) methodological guidelines used in the assessment of credit risk; (iii) compliance with established lending limits; (iv) the quality, scope and timeliness of reporting to the board of directors; and (v) the overall organization of the management of credit risk at a lending institution on an ongoing basis.</p> <p>Relevant provisions of recommendation 119-T suggest the board of directors appoint independent directors to better ensure a more objective decision-making process regarding the review of business plans, including credit and/or investment policy and oversight of (large) of transactions in which insiders or shareholders persons are considered.</p> <p><b>Criterion 7. The supervisor obtains and reviews information on aggregate exposures to related parties.</b> In accordance with Instruction 110-I, reporting forms 0409134 “Calculation of equity (capital)” and 0409135 “Information on required ratios” (as featured in CP11.5) are received monthly and evaluated by off-site supervision; on-site supervision is alerted to deteriorating trends and otherwise determines that processes and internal reporting mechanisms are in place during its inspections</p>
Assessment	Materially Noncompliant
Comments	<p>Graded LC at the last review. The definition of connected borrowers and related parties in legislation is narrow<sup>4</sup> and does not cover situations when influence and connection can be exerted by economic means, for instance current limitations on the legislative framework also limit the CBR’s powers to issue regulations on related parties’ transaction with the bank and do not allow professional supervisory judgment in establishing relationships. The CBR has sought to address some of these deficiencies by issuing recommendations but these are not enforceable. Related party lending has been a major source of bank failure and the nature of banking business in the country is conducive to related party exposure, therefore, the deficiencies are considered significant.</p> <p>Related-party transactions within banks and their subsidiaries are addressed through Federal law and CBR instructions and recommendations. And whilst the CBR can presently determine the financial position of banks’ subsidiary level holdings, it cannot require submission of related enterprise records at the vertical or horizontal (above or beside) level which may be connected to banks’ owners. This key impediment to the CBR’s ability to evaluate economic or financial risks emanating from a group structure (above and beside the bank) needs to be more broadly defined so the CBR can better identify and mitigate risks through such ‘connected’ lending within related economic groups.</p>

<sup>4</sup> According to the Core Principles 2006 Methodology, related parties include, inter alia, “the bank’s subsidiaries and affiliates, and any party that the bank exerts control over or that exerts control over the bank. It may also include the bank’s major shareholders, directors, senior management and key staff, their direct and related interests, and their close family members, as well as corresponding persons in affiliated companies.” Connected counterparties include “natural persons as well as a group of companies related financially or by common ownership, management or any combination thereof”

	<p>Equally, the CBR’s existing powers towards “related” borrowers are not in the form of supporting laws or regulations.<sup>5</sup> The current ability of the CBR to identify connected borrowers on the basis of a ‘legal’ relationship prevents consideration of other, potentially binding “economic” relationships between connected parties.</p> <p>The CBR is aware of the limitations and has proposed legal amendments to address:</p> <ul style="list-style-type: none"> <li>• Article 4 of the BL to broaden its definition of ‘related parties’ specifying criteria for placing persons in the ‘related parties’ category, as currently the CBR has only advisory recommendations in effect (Letter No. 2-T). This Article will contain the definition of “banking group”, “banking holding” and “other related parties”.</li> <li>• Amendment of Article 72 of the CBR Law so that a normative ratio for lending to related parties (group of lending parties) could be introduced; limited to 20% of a bank’s capital.</li> <li>• Also, the proposed amendment of Article 72 of the CBR Law would introduce a definition of an “independent credit review process” and outline the requirements of credit institutions before, during and after granting the loan and would require further segregation of decision-making between the originating and monitoring or reporting on loans.</li> </ul> <p>If amendments are approved, the supervisor would have authority to require banks to have the necessary information system in place for the identification of credit risk operations with related parties, determine the total amount of such transactions and the regular monitoring through the independent credit review process. In addition, the CBR would be able to apply the definition of connected parties to the large exposure limit and introduce an additional ratio entitled “Maximum exposure to a group of connected debtors” limited to 25 percent of a bank’s capital.</p> <p>The enforcement authority of the CBR is also deficient to enforce related party regulations as it lacks the power to sanction directors individually.</p>
<p><b>Principle 12.</b></p>	<p><b>Country and transfer risks.</b> Supervisors must be satisfied that banks have adequate policies and processes for identifying, measuring, monitoring and controlling country risk and transfer risk in their international lending and investment activities, and for maintaining adequate provisions and reserves against such risks.</p>
<p>Description</p>	<p><b>Criterion 1: Supervisors must be satisfied that banks have adequate policies and processes for identifying measuring monitoring and controlling country risk and transfer risk in their international lending and investment activities and for maintaining adequate provisions and reserves against such risk.</b> Article 1.2.1 of Regulation 242-P states that the internal control systems of a bank shall also address the management of bank risks, in general. The regulation does not specifically mention country risk and transfer risk. Also the DIL, in Article 44 requires banks to have systems for managing banks risks in general. In the context of bank inspections, the CBR reviews banks’ management of a number of risks. The methodology of this CBR review is laid down in Regulation 1379-T and 26-T (Guidance for on-site inspectors). Regulation 242-P requires banks to specifically adopt a number of internal risk management guidelines, including general bank risk management, credit and deposit policy, lending to related parties, interest rate policy, foreign exchange operations, securities, AML/CFT, and security. Country and transfer risk are not specifically singled out as a risk area.</p>

<sup>5</sup> The “related borrower” concept is broadly defined in the CBR Law and similarly, “groups” are broadly defined in the Law on Banks.

	<p>However, the CBR uses a list of countries, listed in Regulation 1317-U and defined as offshore zones, and has Regulation 1584-U on Provisions for Operations with Residents of Offshore Zones, exposure to which must be monitored and for which a provision must be made. The provisions run through the P&amp;L account, but are not tax deductible. The criteria for placement on the list are (i) weak disclosure regimes in those countries, and (ii) weak banking supervision. The list divides the countries into three categories; according to the degree they meet these two criteria. Category III draws a provision of 50 percent, category II of 25 percent, and for category I no provision is required. The list is a combination of a similar US State Department List, the FSB list of non-cooperative jurisdictions and the FATF list. The list is heavily oriented toward integrity and AML/CFT concerns, not toward country and transfer risk, as a number of obvious countries are not on the list. For the operations with counterparts that are residents of countries that are on the list of Regulation 1317-U, detailed reports are available, showing types of transactions, amounts, originators, and destination countries.</p> <p><b>Criterion 2: The supervisor confirms that banks have information systems, risk management systems and internal control systems that accurately monitor and report country exposures and ensure adherence to established country exposure limits.</b> See Criterion 1. Through the abovementioned regulations the CBR requires banks to have adequate risk management and reporting systems, as part of a sound internal control system. Country risk and transfer risk are not excluded from these requirements but are not mentioned specifically either. There are no regulatory limits on country risk and transfer risk.</p> <p><b>Criterion 3: There is supervisory oversight of the setting of appropriate provisions against country and transfer risk.</b> There are different international practices which are all acceptable as long as they lead to risk based results. These include:  (i) The supervisor (or some other official authority) decides on appropriate minimum provisioning by setting fixed percentages for exposures to each country. (ii) The supervisor (or some other official authority) sets percentage ranges for each country, and the banks may decide within these ranges which provisioning to apply for the individual exposures. (iii) The bank itself (or some other body such as the national bankers' association) sets percentages or guidelines or even decides for each individual loan on the appropriate provisioning. The provisioning will then be judged by the external auditor and/or by the supervisor. See Criterion 2. No provisioning levels are set by the CBR for country and transfer risk. However, (see Criterion 1) special provisions for operations with residents of offshore zones must be made by banks.</p> <p><b>Criterion 4: The supervisor obtains and reviews sufficient information on a timely basis on the country risk and transfer risk of individual banks.</b> Information is collected to enable the CBR to aggregate the country risk in individual institutions.</p>
Assessment	Materially Noncompliant
Comments	Grade remains the same. As mentioned at the last FSAP, the CBR is considering amending Regulation 254-P to address country and transfer risk. The current system does not impose country risk limits or provisions, except for operations with residents of offshore zones. The CBR issued recommendations to banks on the management of country risk based on the approaches specified in the BCBS document "Management of Banks' International Lending (Country Risk Analysis and Country Exposure Measurement and Control)". However, it does not address provisioning requirements for country or transfer risk.
<b>Principle 18.</b>	<b>Abuse of financial services.</b> Supervisors must be satisfied that banks have adequate policies and processes in place, including strict "know-your-customer" rules, that promote high ethical and professional standards in the financial sector and prevent the bank from being used, intentionally or unintentionally, for criminal activities.

Description	<p><b>Criterion 1: Laws and regulations clarify the duties, responsibilities and powers of the banking supervisor and other competent authorities accomplishing the supervision of a bank's internal control functions and application of the relevant laws and regulations regarding criminal activities:</b> Article 7(9) of Law 115-FZ against money laundering and the financing of terrorism, the CBR is charged with monitoring the implementation of the AML/CFT law with regard to the recording, storing and submission of information on operations subject to mandatory monitoring and also monitoring the internal control organization. The CBR has issued Regulation 242-P, which states in Article 2.2.2 that banks shall have a high-ranking unit responsible for anti-money laundering activities in the bank. Regulation 47-T Annex 3, which gives a questionnaire for on-site inspectors, provides that inspections review whether the bank has policies and processes for the detection and elimination of irregularities by the internal control unit, and a special person responsible for anti-money laundering activities. The CBR has a special unit for compliance by banks with AML/CFT rules.</p> <p><b>Criterion 2: The supervisor must be sure that the bank has in place adequate policies and procedures for maintaining high ethical and professional standards and preventing the bank from being used, intentionally or unintentionally, for criminal purposes. This includes the prevention and detection of criminal activities and the reporting of such suspected activities to the appropriate authorities:</b> The CBR has issued a number of regulatory instruments to implement the provisions of the AML/CFT legislation: (i) Letter 99-T providing guidance to banks how to structure their internal control function to combat money laundering and terrorist finance, (ii) Regulation 1485-U, on training of bank staff, (iii) Regulation 1486-U on requirements for AML/CFT officers in a bank. By Article 7 (1) paragraphs 1 and 3, the FIU is designated as the authority that receives banks' mandatory reports on financial operations that meet certain criteria, as well as those on suspicious transactions. The procedure for submitting this information to the FIU is laid down in Regulation 321-P, on the process for submitting AML/CFT information. The CBR has a special unit for AML/CFT compliance by banks, and is responsible for developing methodologies for inspection of banks on AML/CFT policies and practices. Also the CBR's regional offices are involved in AML/CFT compliance reviews. AML/CFT training is provided to CBR headquarters and regional staff.</p> <p><b>Criterion 3: In addition to reporting to the financial intelligence unit (FIU) or other specialized authorities, banks must report to the banking supervisor suspicious activities and incidents of fraud when they are material to the safety, soundness or reputation of the bank.</b> In accordance with subparagraph 4, paragraph 1 and paragraph 3, Article 7 of the AML/CFT Law, credit organizations are obligated to submit to authorities information on operations with money or other property that are subject to mandatory control, as well as operations regarding which there is suspicion that such operations are being accomplished for the purpose of legalization (laundering) of income obtained by criminal means or for the financing of terrorism. In accordance with CBR Regulation 161-T, <b>80-T, 111-T, 137-T, 129-T</b> on prevention of questionable operations of banks, (or) systematic activities, in significant volumes, should be directed by the Bank of Russia regional offices to the Chairman of the Bank of Russia. The CBR elaborates methodology for identification of suspicious transactions. Currently it is mandatory to check cash transactions over 600.000 R." Anti-smurfing" software has been developed by the CBR to detect transaction patterns to circumvent cash transaction reporting rules. Banks have discretion to decide whether a transaction is suspicious and there is no deadline for reporting. However, once it has been decided that a transaction is suspicious a report must be filed with the FIU no later than on the working day following the date of detection of such transactions.</p>
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**Criterion 4: The supervisor must be sure that banks establish "know-your-customer" (KYC) policies and processes which are well documented and communicated to all relevant staff.** Such policies and processes must also be integrated into the bank's overall risk management system. The KYC management program, on a group-wide basis, has the following basic elements: (i) Standards of customer acceptability, which identify business relationships that the bank will not accept; (ii) Customer identification, verification and due diligence program; this encompasses verification of beneficial ownership and includes risk-based reviews to ensure that records are relevant and truthful; (iii) Policies and processes to monitor and recognize unusual or potentially suspicious transactions, particularly of high-risk accounts; (iv) Escalation to the senior management level of decisions on entering into business relationships with high-risk accounts, such as those for politically exposed persons, or maintaining such relationships when an existing relationship becomes high-risk; (v) Clear rules on what records must be kept on customer identification and individual transactions and their retention period. Such records should have at least a five-year retention period: CBR Regulation 262-P sets out rules for the identification of bank customers, which include rules for establishing the identity of beneficiaries of the client in case of transactions, and prescribes the documents clients must submit to the banks. Regulation 28-I sets rules for establishing the identity of the beneficial account holder when opening an account. Also documentation must be collected by the bank on the identity of the representative opening the account on behalf of another person. In the cases indicated in the article 7 (5.2) of Law 115-FZ credit organizations are entitled to refuse to conclude a contract or open a bank account (deposit) with/for a natural or juridical person:

- if the following are not available at their addresses: the juridical person, its permanent managerial body, another body or person entitled to act in the name of the juridical person without a power of attorney;
- if the natural or juridical person fails to present documents confirming the information specified in the present article or presents unreliable documents;
- if information is available to the effect that the natural or juridical person is involved in terrorist activity, such information having been received in accordance with the present Federal Law.

Banks must inform the authorities in cases where the opening of an account is refused. Also information is provided on transactions that appear without obvious economic rationale, or are atypical for the customer. Documents with customer information must be retained for at least five years from the date the relationship with the customer is terminated. Regulation 262-P states that banks must be extra vigilant when engaging in operations with high risk operations or clients. The CBR has issued recommendations in Regulation 92-T to banks on how to obtain customer information, in the context of the KYC principle. Customer information must be regularly updated, in accordance with Regulation 262-P. The CBR has proposed to strengthen the rules on high risk individuals.

**Criterion 5: The supervisor must be sure that the bank has established due diligence policies and processes regarding correspondent banking.** Such policies and processes include (i) gathering necessary information about their correspondent banks to better understand the nature of their business, customer base, and how they are supervised, (ii) not establishing or continuing correspondent relationships with foreign banks that do not have adequate controls against criminal activities or that are not effectively supervised by the relevant authorities, or with those banks that are considered to be shell banks: Article 7 of the AML Law 115-FZ prohibits banks from relations with banks without fixed establishments in their states of licensing (shell banks). They are also obliged to take steps not to engage in relations with banks that are suspected of being used by other banks without fixed establishments in their country of licensing (shell banks). Regulation 262-P also requires

banks to request information from their counterparts, as specified in Attachment 2 to the regulation. This includes information on the measures taken by the correspondent bank on its anti-money laundering/combating terrorist finance measures.

**Criterion 6: The supervisor periodically confirms that banks have sufficient controls and systems in place for preventing, identifying, and reporting potential abuses of financial services, including money laundering.** In accordance with Regulation 103-T, on implementation of the AML Law 115-FZ, the CBR conducts inspections of credit organizations and their branches, and receives reports on banks' compliance with the AML/CFT Law and CBR AML/CFT regulations. These aspects are covered in full scope as well as through targeted inspections

Every inspection must look at a number of key elements: customer due diligence and terrorist lists. Other aspects are also covered. The law mentions the categories of transactions that are to be reported.

**Criterion 7: The supervisor has adequate enforcement powers (regulatory and/or criminal prosecution) to take action against a bank that does not comply with its obligations related to criminal activities:** The CBR can apply any of its enforcement actions under Article 74 CBL. The type of response is chosen depending on, inter alia, the type of violation committed, the degree of severity of the violation. Regulation 59-I elaborate on the remedial toolkit available to the CBR in AML/CFT cases. The measures include, in particular, instructions to eliminate discovered violations, fines, the requirement to replace the manager, and limiting or prohibiting the conduct of individual operations by credit organizations. The CBR may revoke a license in the event of a bank's repeated violation during one year of the requirements of Articles 6 and 7 (with the exception of paragraph 3, Article 7) of the AML/CFT Law.

**Criterion 8: The supervisor must be sure that a bank has (i) requirements for internal audit and/or external experts to independently evaluate the relevant risk management policies, processes, and controls.** The supervisor must have access to their reports; (ii) established policies and processes to designate compliance officers at the management level and to a special officer to whom potential abuses of the bank's financial services (including suspicious transactions) shall be reported; (iii) adequate screening policies and processes to ensure high ethical and professional standards when hiring staff; (iv) ongoing training programs for their staff on KYC and methods to detect criminal and suspicious activities: Regulation № 242-P requires that banks ensure the ongoing functioning, independence and impartiality of the internal control unit, professional competence of its manager and employees. They should create conditions for unimpeded and effective performance of its functions, which should include verifying the implementation of AML/CFT policies. Based on Regulation 1379-U, the CBR inspects whether this is achieved.

Paragraph 2 of Article 7 of the AML/CFT Law requires that banks appoint special officers responsible for implementing AML/CFT rules, and to take other internal organizational measures as needed. A dedicated compliance officer (or unit) is appointed who (which) is responsible for development and implementation of internal control regulations for AML/CFT. He/she is also responsible for organizing the submission of information to AML/CFT authorities. Based on the AML/CFT Law, the Bank of Russia establishes qualification requirements for compliance officers.

Paragraph 2 of Regulation 1486-U, the compliance officer must have university level legal or economic education and at least one year's experience in managing a department or other bank subdivision. In the absence of this education he/she should have at least two years' work experience in the area of AML/CFT or at least two years' experience in managing a

credit organization subdivision.

Paragraph 3 of Regulation 1486-U, requires that employees of the compliance unit in a bank must have university level education and at least six months' work experience in a bank, and in the absence of university education—at least one year's experience working in the area of AML/CFT or at least one year's experience working in an operational division of a bank.

Regulation 92-T contains recommendations for credit organizations on the "know-your-employee" (KYE) principle. It provides qualification requirements for new employees, and for assessing, selecting and placing personnel. These include criteria with regard to personality characteristics of employees with reference to the nature of the position.

Regulation 1485-U requires a bank to develop AML/CFT training programs that prepare staff for work with the particular features of the bank's activities, the particular features of its customers, and the degree (level) of risk of its customers. The compliance officer receives training at least twice a year. Training of other AML/CFT staff is conducted at least once a year. Bank staff's knowledge of AML/CFT must be tested at least once a year. Regulation 92-T (Attachment 2) recommends for the observance of the KYE principle that banks conduct (refresher) training, to understand the CBR's requirements, internal processes of the bank, including bookkeeping, managing bank risks, and AML/CFT.

**Criterion 9: The supervisor determines that banks have clear policies and processes for staff to report any problems related to the abuse of the banks' financial services to either local management or the relevant dedicated officer or both.** The supervisor also confirms that banks have adequate management information systems to provide managers and the dedicated officers with timely information on such activities: Regulation 99-T assigns the responsibility of monitoring the AML/CFT policies and practices in the bank to the CEO. In accordance with Regulation 99-T, the compliance officer receives from managers and staff of the bank all necessary information and documents relevant to AML/CFT. The bank's staff shall provide the compliance officer or his unit all necessary assistance in performing his functions. Regulation 99-T requires that bank staff, including the compliance officer, who learns of instances of AML/CFT violations committed by bank staff shall immediately report these facts in writing to their immediate supervisor and internal control unit.

**Criterion 10: Laws and regulations require that a member of a bank's staff who reports suspicious activity in good faith, either internally or directly to the relevant authority, cannot be held liable:** Paragraph 8, Article 7 of the AML/CFT Law stipulates that submission by bank staff at their initiative of information and documents to AML/CFT authorities to comply with AML/CFT requirements, is not a violation of official, banking, tax, commercial, or payments secrets. Also, part 3, Article 9 of the AML/CFT Law, confirms that providing information and documents at the request of the AML/CFT authorities for AML/CFT investigation purposes is not a violation of professional secrecy obligations. In addition, part 6, Article 26 BL stipulates that banking secrecy does not cover information provided by banks to AML/CFT authorities.

**Criteria 11: The supervisor must inform the financial intelligence unit and, if applicable, other competent authority of any suspicious operations. In addition, it also shares, directly or indirectly, with relevant judicial authorities information related to suspected or actual criminal activities:** Article 9 of the AML/CFT Law requires the CBR to provide to the FIU information and documents relevant to possible AML/CFT breaches. To implement this requirement, the CBR has concluded an agreement with the FIU. The CBR has also concluded a cooperation agreement with the Ministry of Internal Affairs, which provides for the exchange of information to help identify and prevent AML/CFT offenses in the financial area. In addition, in accordance with Regulation 86-P, the CBR immediately

	<p>notifies the prosecutor's office of violations in the financial and economic areas. Regulation 86-P also provides examples of banking operations and transactions which could indicate the commission of a financial or economic crime.</p> <p><b>Criteria 12: The supervisor, directly or indirectly, cooperates with relevant domestic and foreign financial sector supervisory authorities or shares with them information related to suspected or actual criminal activities, when this information is needed for supervisory purposes.</b> As banking supervisory and regulatory authority, the CBR cooperates with foreign bank supervisory authorities in the area of AML/CFT. Article 51 CBR Law stipulates that the CBR has the right to request foreign banking authorities to provide supervisory information on banks, and has the right to provide supervisory information to foreign authorities, with the exception of information about specific transactions and clients. The receiving supervisory authority should ensure that the information will be kept confidential to the satisfaction of the Russian authorities. The CBR is in turn obliged to respect the confidentiality constraints of foreign states. The CBR's activities in the AML/CFT area focus on implementing the 40th Recommendation of the FATF Forty Recommendations, stipulating the need for the countries to create conditions which would, to the maximum possible extent, guarantee that competent authorities provide international cooperation to their foreign counterparts on AML/CFT matters.</p> <p>Cooperation between the CBR and banking supervisory authorities of foreign states is also accomplished through agreements (memoranda of understanding) in the area of banking supervision. Regarding AML/CFT, these MOUs call for information exchange in the following priority areas: (i) holdings of banks across jurisdictions, (ii) patterns and methods of money laundering and the financing of terrorism, discovered during the performance of supervisory functions; (iii) on national AML/CFT legislation and regulation, (iv) on experience in identification, conduct of customer due diligence and discovery of actual AML/CFT operations, and (v) on the observance of AML/CFT rules by international banks, and any sanctions applied to them in this area.</p> <p>The CBR has signed MOUs with banking supervisory authorities of a number of states.</p>
Assessment	Largely Compliant
Comments	<p>The supervisors do not have the authority to directly share <b>transactional bank</b> client information with other agencies and regulators, at home or abroad, which constitutes a serious deficiency. Proposed legislation will address this issue. However, it can share such information with the FIU. Also, the CBR is aggressive and very successful in closing banks that are involved in money laundering. A review by FATF was published in 2008.</p>
<b>Principle 23.</b>	<p><b>Corrective and remedial powers of supervisors.</b> Supervisors must have at their disposal an adequate range of supervisory tools to bring about timely corrective actions. This includes the ability, where appropriate, to revoke the banking license or to recommend its revocation.</p>
Description	<p>The powers of the Bank of Russia to bring about corrective measures at banks are specified in the following laws: (i) the CBR Law; (ii) the Law on Banks; (iii) the Law on Bankruptcy of Banks; and (iv) the Law on Deposit Insurance. These laws are supplemented by a substantial number of CBR issued by-laws.</p> <p>The key regulations and directives are: measures to be taken against institutions for violating prudential norms (59-I); measures to prevent insolvency (126-I); the temporary administration for managing credit institutions (279-P); procedures on revoking licenses for banking operations (226-P) which are elaborated on through a large number of other Bank of Russia Directives, Instructions and Recommendations.</p>

**Criterion 1. The supervisor raises supervisory concerns with management or, where appropriate, the Board, at an early stage, and requires that these concerns are addressed in a timely manner.** Where the supervisor requires the bank to take significant remedial actions, these are addressed in a written document to the Board. The supervisor requires the bank to submit regular written progress reports and checks that remedial actions are completed satisfactorily. Concerns identified through on-going off-site supervision, periodic on-site inspections or market information is communicated to the bank through the relevant Territorial office of the CBR.

In the event remedial actions are deemed necessary as a result of Bank of Russia supervision, a written order is sent and the bank's Board of Directors must approve a plan of action for improving its financial position or reorganize the bank. In accord with 126-I, the Board of Directors is to submit a plan to the relevant Territorial office within 30 calendar days thereafter.

The Bank of Russia is able to regularly monitor remedial actions taken through its on-line "Remedial Measures Database". This custom developed software enables the Bank of Russia to determine progress on correcting enforcement actions at any bank through sorting information by institution, Territorial office or type of regulatory violation. To date however, anti-money laundering violations are not incorporated into the database. This off-site process is supplemented by targeted on-site inspections, very often organized to confirm progress / completion of reforms underlying the ordered remedial actions.

**Criterion 2. The supervisor participates in deciding when and how to effect the orderly resolution of a problem bank situation (which could include closure, or assisting in restructuring, or merger with a stronger institution).** Article 75 of the CBR Law may be used to address bank safety and soundness concerns in circumstances where the bank's situation threatens the legal interests of the depositors and/or the stability of the banking system. In the event of violation of laws and prudential norms, the CBR has the right to undertake a series of corrective measures envisaged by Article 74 to rehabilitate a bank.

In accord with Article 74 (5) of the CBR Law and Articles 17 and 18 of the Law on Bankruptcy of Banks, if the credit institution fails to take measures to prevent its insolvency, or if the actions taken fail to sufficiently improve its condition, the CBR has the right to appoint a temporary administrator to manage the credit institution for a period not to exceed six months. The procedures for the appointment, performance and termination of the activities of the temporary administration is set forth in Regulation 279-P. In practice however, the CBR has not appointed a Temporary Administrator (before the revocation of a license) for several years, as in most cases it is clear that this would serve no purpose and prompt liquidation is inevitable.

The main objective of the temporary administration is to preclude bankruptcy if practical, determine in more detail the financial condition of the bank, and put in place measures to improve its financial condition. Whilst the temporary administrator is in place, the powers of the executive bodies of the credit organization may be limited or suspended by the Bank of Russia in accord with Articles 21 and 22 of the Law on Bankruptcy of Banks and Regulation 279-P.

In the event the powers of the executive bodies are suspended during the temporary administration, the administrator undertakes an examination of the bank, evaluates the grounds for revoking its banking license, develops measures to improve the financial position of the bank, ensures preservation of its property, ascertains the creditors and the scope of their claims on its financial liabilities and takes measures to recover the debts owed.

The decision to terminate the activities of the temporary administration shall be made by the CBR in the event the issues which served as the basis for the appointment of the temporary administrator are corrected. However, if by the time of expiration of the authority of the temporary administration, the reasons for which it was appointed still persist, the temporary administration shall submit to the CBR a petition to revoke the institution's license to perform banking services.

The rationale for revoking the license for banking operations is laid out in Article 20 of the BL; the procedure for which is set forth in Regulation 226 –P. The procedure of a petition to revoke the institution's banking license representation, which is made to the CBR by its Territorial Branches is regulated by the Directive 1332-U.

Upon revoking the license of a bank, the CBR must appoint a temporary administrator as a conservator, who must be an official of the CBR. The temporary administrator shall administer the bank during the liquidation, and exercise its powers in accordance with paragraph 4 of Article 18 of the Law on Bankruptcy of Banks. The conservator is to perform the same functions and have the same powers as were provided the original temporary administrator when the authority of the executive bodies was suspended. However, the conservator will not have responsibility to develop measures to improve the financial condition of the institution.

**Criterion 3. The supervisor shall have available to it an appropriate range of supervisory tools for use when, in the supervisor's judgment, a bank is not complying with laws, regulations or supervisory decisions, or is engaged in unsafe or unsound practices, or when the interests of depositors are otherwise threatened.** These tools include the ability to require a bank to take prompt remedial action and to impose penalties. In practice, the range of tools is applied in accordance with the gravity of the situation. In the event of a violation of laws and/or by-laws of the Bank of Russia is identified within a bank, the Bank of Russia has the right to apply measures laid out in Article 74 of the Central Bank Law and Article 19 of the Law on Banks. Accordingly, the Bank of Russia has the right to: (i) require that a violating bank correct the discovered violations; (ii) impose penalties of up to 0.1 percent of the minimum size of the charter capital; (iii) suspend the right of the bank to perform certain operations for up to six months.

In the event the bank fails to fulfill an order of the CBR to eliminate the violations, or if in the event the violations or other practices pose a serious threat to the interests of depositors, Article 74 permits the Bank of Russia to exercise the following measures: (i) charge the institution a fine of up to 1 percent of its capital, (ii) demand the institution undertake a restructuring and/or resignation of top managers and members of the board of directors; (iii) change the regulatory requirements for up to six months; (iv) impose a ban on specific banking operations for up to one year; (v) appoint a temporary administrator for up to six months and (vi) suspend its right to re-organize if a reorganization would trigger conservatory action against the bank, and (vii) impose a change in the reporting requirements of a bank (letter 419, dated February 28, 1997).

More generally, the CBR has the right to take action as envisaged by Articles 75 and 76 of the CBR Law when its analysis of a bank indicates that its existing situation threatens the legal interests of the depositors and/or the stability of the banking system of the Russian Federation.

**Criterion 4. The supervisor should have available a broad range of possible measures to address such scenarios as described in Essential Criterion No. 3 above; the supervisor provides clear prudential objectives or sets out the actions to be taken,**

**which may include restricting the current activities of the bank, withholding approval of new activities or acquisitions, restricting or suspending payments to shareholders or share repurchases, restricting asset transfers, barring individuals from banking, replacing or restricting the powers of managers, Board directors or controlling owners, facilitating a takeover by or a merger with a healthier institution, providing for a temporary administration of the bank, and revoking or recommending the revocation of the banking license.** As illustrated above, in accord with Articles 74 and 75 of the CBR Law, and Directive 59-I the CBR has the right to apply numerous sanctions, including the right to deny a bank to expand its activities if the bank is believed to be financially unstable or otherwise does not comply with the requirements established by federal laws. If a bank is considered financially unstable or represents a material threat to the interests of its depositors, the CBR has the right to restrict the institution from the following activities:

- attracting **new or increasing existing** deposits from individuals and/or legal entities, including through sales of its own securities to them, extend new interbank loans and open deposit accounts to customers who are not shareholders of the bank;
- opening accounts with correspondent banks and non-banking credit organizations;
- issuing guarantees, performing transactions for the sale and purchase of foreign exchange; transferring funds to the Russian Federation budget entities.

If a bank is a participant of the Deposit Insurance System (article 44 of the Law on Household Deposit Insurance, directives 1476-U, 1483-U, 1655-U) and does not comply with DIS participation requirements for three consecutive months, the Bank of Russia shall be obliged:

- to require the bank submit a request to terminate its right to attract household deposits;
- to prohibit the bank to attract (new) household deposits and open new bank accounts until the prohibition on the right to attract deposits is terminated, or banking license is revoked. .

The CBR may prohibit a bank that is not eligible for participation in the deposit insurance system from attracting deposits from individuals. A bank that is not a member of the deposit insurance scheme can only accept deposits from legal entities (enterprises).

Finally, the CBR may revoke a bank's license on the basis of any of the ten grounds set forth in the first part of Article 20 of the BL. Moreover, according to the second part of Article 20, the CBR is obliged to revoke a credit institution's license in the event of the following:

- if the capital adequacy ratio of the credit institution falls below 2 percent;
- if the amount of the bank's own capital is lower than the minimal level of capital set by the CBR as of the date of the registration of the bank. This reason shall not be used as grounds for revocation of the banking license of the credit organization within the first two years after the issuance of the license for performing banking operations;
- if the bank does not comply within the time established by the Law on Bankruptcy of Banks with the requirements of the CBR on bringing the amount of its authorized capital in accordance with the value of its own funds (capital);
- if the credit institution is unable to meet the demands of depositors and/or comply with the responsibilities of performing mandatory payments within 14 days after they become due. However, the aggregate of the amounts due must be at least the equivalent of 1000 minimum wages as set forth in the federal legislation;

Beginning January 1, 2007, four new grounds for the mandatory revocation of banking

licenses were introduced (paragraphs 5-8 of Part 2 of Article 20 of the Law on Banks). Each of which regard the bank's capital falling below prescribed levels when the institution does not submit an application to change its status to a non-bank credit institution.

CBR is entitled to withhold its consent to the purchase of a credit institution's stock (shares) in amounts exceeding 20 percent of the credit institution's stock (shares), in cases where:

- "the legal entity/buyer has been in business for less than three years;
- the buyer's unsatisfactory financial position has been established, including insufficient equity cash funds (assets) on the part of a legal entity/buyer, or the buyer's net assets (equity funds) are inadequate to purchase the amount of credit institution stock (shares) indicated in the petition, or the credit institution and buyer have not met the Bank of Russia's mandatory reserve requirements;
- the preliminary consent of the antimonopoly agency is lacking, if such consent is required under Russian Federation law;
- court decisions have entered into force that establish instances where the purchaser (including one who is part of a group of entities) who is purchasing stock (shares) in a credit institution has committed unlawful actions in a bankruptcy or deliberate and/or fictitious bankruptcy;
- otherwise provided by federal law.
- "CBR denies its consent to the purchase of stock (shares) in a credit institution if a court has previously found that the person purchasing the credit institution's stock (shares) was guilty of inflicting losses on any credit institution while performing his/her duties as member of the board of directors (supervisory board), sole executive, deputy sole executive, and/or member of the collegial executive body of a credit institution (Instruction No. 130-I)."

**Criterion 5. The supervisor has the power to take measures, should a bank fall below the minimum capital ratio, and seeks to intervene at an early stage to prevent capital from falling below the minimum. The supervisor has a range of options to address such scenarios.** Grounds for taking action to prevent insolvency (bankruptcy) of credit institution are established in article 4 of the Law on Insolvency (Bankruptcy). Unless stipulated otherwise in the Federal Law, Bankruptcy shall be instituted if the bank:

- was unable to prevent a more than 20 percent reduction in its capital, compared to its maximal amount achieved over the last 12 months whilst also violating mandatory standards established by the Bank of Russia;
- violates the capital adequacy ratio as established by the CBR;
- violates by more than 10 percent the current liquidity requirement as established by the CBR.
- permits a decrease in the amount of its capital below the authorized capital at the end of the month.

In addition to the remedial powers referenced in Article 20 of the BL, in accord with the Law on Bankruptcy of Banks and Directive 1260-U, if the level of a credit institution's own capital at the end of the month falls below the level of its (original) authorized capital, the CBR is to direct the credit institution to bring the amount of its authorized capital in accordance with the value of its own funds (capital).

When the criteria for bankruptcy are met by a bank, it is required to notify the CBR as to

	<p>when it will hold a general meeting of shareholders, sessions of the Board of Directors, and the status on large transactions, including those associated with purchases of shares in other organizations. The bank's right to issue dividends is suspended until authorized by the CBR.</p> <p><b>Criterion 6. The supervisor applies penalties and sanctions not only to the bank but, when and if necessary, also to management and/or the Board of Directors, or individuals therein.</b> As shown above, the CBR has a range of powers to apply remedial actions towards a bank which violate regulations or otherwise is financially unstable. The CBR does not have the right to penalize or otherwise sanction individual bank directors at open banks, although it may order the restructuring of the board and/or the management.</p>
Assessment	Largely compliant
Comments	<p>Through a broad base of legislative powers, thoroughly supported by numerous by-laws, the CBR has a wide range of available enforcement remedies to address a bank's circumstance.</p> <p>However importantly, articles 74 and 75 of the Central Bank Law do not include, <i>inter alia</i>, the following key measures as recommended by the Basel Committee for Bank Supervision (Guidelines for Working with Weak Banks):</p> <ul style="list-style-type: none"> <li>• suspend<sup>6</sup> some or all of the shareholders from participation in the management of the credit organization, including their right to vote or accept dividends;</li> <li>• establish limits on salaries and bonuses paid out to directors and key bank personnel;</li> <li>• require additional capital levels to be maintained against the risks specific to the bank;</li> <li>• require prior consent of the supervisory authority to incur a major expenditure or take on a new liability;</li> </ul> <p>While the CBR has the right to impose fines on the credit institution based on Article 74 of the Central Bank Law, it cannot sanction individual bank directors and officers (at non-intervened banks).</p> <p>Appropriate powers should be provided the CBR to administratively sanction (and/or remove if necessary) persons affiliated with banks: this is more efficient and expedient and would have a strong signaling effect to deter others.</p>
<b>Principle 24.</b>	<b>Consolidated supervision.</b> An essential element of banking supervision is that supervisors supervise the banking group on a consolidated basis, adequately monitoring and, as appropriate, applying prudential norms to all aspects of the business conducted by the group worldwide.
Description	<p><b>Criterion 1: The supervisor is familiar with the overall structure of banking groups and has an understanding of the activities of all material parts of these groups, domestic and cross-border.</b></p> <p><b>Criterion 2: The supervisor has the power to review the overall activities of a banking group, both domestic and cross-border.</b> The supervisor has the power to supervise the foreign activities of banks incorporated within its jurisdiction: Article 4(9) CBL and Article 4 BL provides the CBR with the basic authority to supervise bank groups on a consolidated basis. The CBR has also issued a number of regulations on the exercise of consolidated supervision: 191-P on consolidated reports, 246-P on the preparation of consolidated reports, 197-P on reporting by holdings, <b>327-P</b> on reporting by "affiliated persons" defined as persons who are able to influence the bank's operations, 242-P on internal controls, 290-P on CBR approval of foreign subsidiaries of Russian banks, <b>2172-U</b> on publication of consolidated accounts, <b>2332-U</b> on bank reporting, 1363-U.</p> <p>Currently, consolidated supervision over banking (consolidated) groups (hereinafter groups)</p>

<sup>6</sup> When not under temporary administration, as laid out in Article 74 of the Law on the Central Bank.

is performed by the CBR's territorial offices where the parent of the group is located. Consolidated supervision is performed remotely, based on an analysis of the consolidated reports submitted by the group, and other available information regarding the group's activities. On-site work is not envisaged. However, the off-site information is strengthened by the mandatory annual audited financial statements, other information collected during on-site inspections, solo-information on other group banks reported through the regional branches of the CBR.

In accordance with the relevant provisions of the BL (Article 4), **a banking group and holding company are defined as** (i) banking groups, in which one (the principal) bank has the ability to significantly influence directly or indirectly (through a third party) another bank's actions, (ii) a bank holding, defined as a conglomerate of legal entities with participation of a bank, where a non-bank has the ability to significantly influence directly or indirectly (through a third party) decisions made by another bank. Regulation 191-P states that "consolidated reporting groups" consist of non-credit organizations influenced, directly or indirectly, by a principal bank in the group.

The CBR compiles data on the financial condition of groups including risks accepted by the group and the group's financial performance, included in consolidated financial statements, contains information on the group's activity as a whole, as well as that of each of the affiliates, including foreign affiliates.

**Criterion 3: The supervisor has a supervisory framework that evaluates the risks that non-banking activities conducted by a bank or banking group may pose to the bank or banking group:**

The definition of non-banking activities in the Russian laws and regulations relates to financial activities, i.e., other activities than deposit taking and lending, and including for instance leasing, fund management, factoring, guarantees, etc... According to article 5 of the BL it is forbidden for banks to perform manufacturing commercial and assurance activities.

The data on banking and non-banking transactions performed by the bank is collected by the CBR as a part of official reporting, statement inspection audits, audit organization summaries, during direct contacts with representatives of credit organizations, as well as by other means (for example, from mass media sources). Data on transactions with group entities are collected as part of consolidated financial reporting (for example, in accordance with the BL. In addition, consolidated reports from participating credit organizations must also include reports of participating financial and non-financial organizations), as well as ongoing contacts with representatives of a group's principal bank and (or) its affiliated banks.

Analysis of the activities of banks and groups reveals segments of the market where main (banking and non-banking) transactions of the credit organization or a group are concentrated, and determines their viability. Also included is an analysis of the financial performance of the bank, the group overall and of its separate participants, with the goal of locating the most risky transactions, and any correlation between of efficiency of the bank or group and the profitability of individual banking and non-banking transactions.

**Criterion 4: The supervisor has the power to impose prudential standards on a consolidated basis for the banking group.** The supervisor uses its power to establish prudential standards on a consolidated basis to cover such areas as capital adequacy, large exposures, exposures to related parties and lending limits. The supervisor collects consolidated financial information for each banking group:

The CBR applies the following mandatory standards to groups: (i) a single borrower limit of 25 percent of group own funds (H-6), with a cumulative maximum of 800 percent of own

funds, (ii) limits to lending to shareholders of 50 percent, with a maximum per shareholder of 25 percent, (iii) capital adequacy of the group, at 10 or 11 percent, depending on the level of capital of the group, (iv) aggregate lending to insiders of 3 percent of group capital. The groups report to the CBR on capital adequacy, risk exposures and foreign exchange risk on a consolidated basis every quarter.

**Criterion 5: The supervisor has arrangements with other relevant supervisors, domestic and cross-border, to receive information on the financial condition and adequacy of risk management and controls of the different entities of the banking group.** See the description on Core Principle 1(6).

At the current time exchange of information with federal agencies of the executive branch authorized to monitor the activities of financial and insurance organizations will need to be addressed as a new agency has been formed merging insurance and securities.

In order to exercise global consolidated supervision, the CBR receives data from foreign regulatory agencies on the financial conditions of the foreign subsidiaries of Russian groups, and on their risk management systems, as well as the opinion of the host regulatory agency on the quality of parental oversight of the subsidiary, also based on on-site visits. The CBR provides similar information to foreign regulatory agencies subsidiaries of foreign banks. Furthermore, global consolidated supervision over the respective subsidiaries is discussed by the CBR with foreign regulatory agencies during reciprocal working visits. The CBR and foreign regulatory agencies have also concluded MOUs on cross-border regulation of banks, stipulating, among other things, information exchange procedures. Also see the description section for CP 1 (6).

The CBR Law authorizes the CBR to request data or documents on credit organizations from foreign supervisors, in the course of their regulatory functions. The CBR can also provide such data or documents to the foreign regulatory agencies, with the important exception on individual transactions of credit organizations and their clients. The latter decreases the effectiveness of cross-border supervisory cooperation.

**Criterion 6: The supervisor has the power to limit the range of activities the consolidated group may conduct and the locations in which activities can be conducted; the supervisor uses this power to determine that the activities are properly supervised and that the safety and soundness of the bank are not compromised:**

The CBR has the power to limit banks setting up establishments abroad. It can refuse permission if it considers the enterprise not viable, for instance based on analysis of the business plan, or inadequacy of risk management systems. On the other hand, there is no requirement for banks to obtain approval for equity holdings in domestic financial or nonbank enterprises. On the basis of Article 11 BL, the CBR can however; refuse approval of the acquisition of 20 percent or more of shares in another credit institution, if the acquiring bank is not in good financial condition, or has for instance violated anti-monopoly rules. The CBR can apply Article 75 to counter threats to depositors or the banking system, including when such a threat is created by an action or omission of a group. Acquisition of a non-financial entity is not subject to approval, however.

**Criterion 7: The supervisor determines that management is maintaining proper oversight of the bank's foreign operations, including branches, joint ventures and subsidiaries.** The supervisor also determines that banks' policies and processes ensure that the local management of any cross-border operations has the necessary expertise to manage those operations in a safe and sound manner and in compliance with supervisory and regulatory requirements:

Regulation 242-P stipulates that the internal control within a group is implemented the same way as within a credit organization. Regulation 242 also requires management control over banking transaction risks abroad, such as country risk, or transfer risk. Also see Core Principles 7 on risk management and Principle 17 on internal control.

Inspections include gathering information on risks arising from activities abroad, including transactions of affiliate organizations. Also, the CBR maintains direct contact with the representatives of the banks on their risks abroad. The CBR also has access to IFRS data produced by the banks with foreign establishments (consolidated and solo).

**Criterion 8: The supervisor determines that oversight of a bank's foreign operations by management (of the parent bank or head office and, where relevant, the holding company) includes: (i) information reporting on its foreign operations that is adequate in scope and frequency to manage their overall risk profile and is periodically verified; (ii) assessing in an appropriate manner compliance with internal controls, and (iii) ensuring effective local oversight of foreign operations:** For the purposes of consolidated risk management and supervision, there should be no hindrance in host countries for the parent bank to have access to all the material information from their foreign branches and subsidiaries. Transmission of such information is on the understanding that the parent bank itself undertakes to maintain the confidentiality of the data submitted and to make them available only to the parent supervisory authority:

Regulation 191-P requires that participants of a group (credit and noncredit organizations) must submit to the principal credit organization timely quarterly reports required for generation of consolidated financial statements, as well as for calculation of capital and prudential values of a group. The principal credit organization has no authority to divulge data received from legal entities, participating in a group, regarding their activity, except in cases provided for in the legislation of the Russian Federation, or in cases related to tasks of publishing consolidated financial statements. The principal bank in the group, along with consolidated reporting, also submits to the CBR reports of the participants of a group, while verifying their authenticity and completeness. Once every year the consolidated financial statements must be confirmed by an external audit organization. The CBR also has the opportunity to verify the data of a group participant, including non-residents, in view of the solo and consolidated reports filed by banks. Internal controls within a group are regulated in Regulation 242-P and are analogous to methods of internal audit of each of the credit organizations. In addition to complying with the general rules of internal control the principal bank of a (consolidated) group must also have internal policies and processes for risk identification, measurement and control for the entire group overall and its individual participants, and distribute these policies and processes to all participants of a group.

**Criterion 9: The home supervisor has the power to require the closing of foreign offices, or to impose limitations on their activities, if (i) it determines that oversight by the bank and/or supervision by the host supervisor is not adequate relative to the risks the office presents; and/or (ii) it cannot gain access to the information required for the exercise of supervision on a consolidated basis:**

Article 75 CBR Law allows the CBR to impose measures envisaged in Article 74 of the present Federal Law if there is a threat to depositors' and/or creditors' interests or a systemic threat. Inter alia, it has the right to require that the credit organization undertakes to restructure itself, including the changes to the structure of its assets. Also, inadequate reporting provides a direct basis for application of measures under Article 74 CBL.

**Criterion 10: The supervisor confirms that oversight of a bank's foreign operations by management (of the parent bank or head office and, where relevant, the holding**

	<p><b>company) is particularly close when the foreign activities have a higher risk profile or when the operations are conducted in jurisdictions or under supervisory regimes differing fundamentally from those of the bank's home country:</b></p> <p>Regulation 242-P allows the CBR to determine whether the group has adequately identified the risks in the group. This regulation also requires that the management of the group be informed about the risk profile of the consolidated group on a regular basis. Regulation 1584-U on provisions for transactions with offshore centers requires provisions for certain categories of countries with elevated integrity risk. Also, the CBR is in the process of developing criteria to identify high risk clients.</p>
Assessment	Materially noncompliant
Comments	<p>Also graded MNC at the last review. The CBR collaborates with home supervisors to the extent permitted by law. The CBR performs consolidated supervision over banking groups and credit institutions. Under proposed amendments to the CBR Law the supervisory authority will be extended to bank holding companies. It is currently limited to banks and banking groups.</p> <p>The amendments will provide the CBR with the authority to supervise nonbank members of a group if they are not regulated by another federal regulator. The Proposed amendments will also expand the definition of direct and indirect influence to closely match international standards (see footnote 4). The CBR will also be able to establish regulations, and reporting standards for banking groups and bank holding companies.</p> <p>The amendments will also address the issue of exchange of transaction related data by the CBR to foreign supervisors by granting CBR the needed authority.</p> <p>The draft law will also allow the CBR to disallow or limit transactions by a bank-participant of a group with connected parties or reorganization of group assets where such transactions may lead to financial instability of banks that are members of a group.</p> <p>More specifically, the amendments will:</p> <ul style="list-style-type: none"> <li>• Expand the authority of the CBR with respect to banking holdings, namely: establishing the authority to set rules for holdings with respect to preparation of consolidated financial reports, their submission to the CBR and disclosure to interested parties; prudential standards, methodology for calculation of own funds, as well as the right to initiate, coordinated with other regulatory entities, remedial measures to the top entity of banking holdings, in case their illegitimate activities are discovered;</li> <li>• Clarify the authority of the CBR to take remedial measures against banks for violations on a consolidated basis. These measures would include the right to impose restrictions on transactions with the parent company and other group entities, holdings or affiliated parties, and on other types of activities, including non-banking, if these imply higher risk.</li> <li>• Secure information exchange capabilities between the principal organizations of banking groups, banking holdings and other participants to include information on client transactions of their clients and correspondents. This is needed in order to eliminate a legal conflict, as current legislation obligates groups and holdings to provide to the head organization information on their activities, but limit the content of such information;</li> <li>• Expand the content of information exchange between the CBR and foreign regulatory agencies, by adding parent entities (holdings) of banks and other group entities to the list of institutions on which the CBR may provide information to foreign central banks or regulators.</li> <li>• Secure the right of the CBR to request from other domestic regulatory agencies information they obtained in their supervisory functions, inter alia where it refers to information obtained during inspections.</li> </ul> <p>The Draft Law has been submitted to the Duma.</p>

**APPENDIX. PRINCIPLES ASSESSED IN 2007 NOT COVERED IN THE 2011 TARGETED ASSESSMENT**

<p><b>Principle 1. Objectives, autonomy, powers, and resources</b>  An effective system of banking supervision will have clear responsibilities and objectives for each agency involved in the supervision of banks. Each such agency should possess operational independence and adequate resources. A suitable legal framework for banking supervision is also necessary, including provisions relating to authorization of banking establishments and their ongoing supervision; powers to address compliance with laws as well as safety and soundness concerns; and legal protection for supervisors. Arrangements for sharing information between supervisors and protecting the confidentiality of such information should be in place.</p>	
Description	
Assessment	Largely compliant
Comments	
<b>Principle 1(1).</b>	<b>Responsibilities and objectives.</b> An effective system of banking supervision will have clear responsibilities and objectives for each authority involved in the supervision of banks.
Description	<p><b>Criterion 1: responsibilities and objectives:</b></p> <p><b>Applicable laws and regulations:</b> Law 86 FZ on the Central Bank of the Russian Federation (CBL), Articles 4 (5, 9), and 56; Art. 41 of the Law on Banks and Banking (BL). Art. 4 (5, 9) specifies that the central bank is the body responsible for banking regulation and supervision. Article 56 goes on to specify that the main goals of banking regulation and supervision are the maintenance of the stability of the Russian banking system and the protection of the interests of depositors and creditors. Art. 41 BL confirms that the CBR shall supervise the activities of credit institutions.</p> <p><b>Criterion 2: framework of minimum prudential standards:</b></p> <p>Arts. 7 and 62 CBL; also, a broad range of binding prudential directives, instructions, and non-binding guidance have been issued by the Central Bank of the Russian Federation (CBR) on the complete scope of prudential supervision, starting with bank licensing, and covering capital, capital adequacy, limits on single borrower and related party exposures, open exchange positions, reporting, assessment of business plans, fitness and propriety of managers, Board members and shareholders, provisions, remedial and enforcement action. Additionally laws have been issued on bank bankruptcy and deposit insurance. See the website of the CBR, which contains a non-limitative list of regulations. Altogether, some 2500 regulatory instruments have been issued, in the form of Instructions, Norms, and Directives [See <i>Principle 1(3), criterion2</i>], as well as extensive non-binding guidance.</p> <p><b>Criterion 3: regular updates to maintain relevance:</b> The headings of each of the laws and regulations show the dates at which amendments were made. These provide evidence of frequent adjustments to incorporate new insights and international standards. Currently, adjustments are being prepared or have already been introduced to incorporate the revised Basel Core Principles and other new supervisory developments, for instance in the area of exchange of supervisory information, risk based supervision, corporate governance. In 2005 the government and the CBR adopted a “Strategy for Development of the Banking Sector of the Russian Federation in the Period to 2008 (Statement of the Government and the Central Bank of the Russian Federation, 983-P, - P 13, 01-01/1617, April 5, 2005). A number of elements of the Strategy were based on the findings of the 2003 FSAP. The CBR’s Guidelines for the Single State Monetary Policy in 2007 also contains a table V.4 of “Principal measures planned by the Bank of Russia to upgrade Russia’s Banking System,</p>

	<p>Banking Supervision, Financial Markets and the Payment System in 2007.” Although these have not all been adopted on schedule, they evidence an awareness of the need to stay abreast of current supervisory developments.</p> <p><b>Criterion 4: public information on the financial strength and performance of the Russian banking industry:</b></p> <p>Articles. 25 and 57 CBL require that the CBR issues an annual report to Parliament no later than July 15 of each year, and that it shall publish consolidated statistical information on the banking system. The Annual Report also includes an analysis of the situation of the Russian banking system. A separate report specifically on the developments in the banking sector is issued in June of every year. Moreover, a monthly statistical bulletin is issued, which includes banking statistics. The CBR bulletin, “Vestnik Banka Rossii” is issued almost on a weekly basis, publishes the text of new regulations and regularly contains articles on banking issues. The Annual report contains an anonymous overview of enforcement actions taken against banks.</p>
Assessment	Compliant
Comments	Implementation of the action plans included in the Strategy for the Development of the Banking Sector to 2008 and the Guidelines for the Single State Monetary Policy in 2007, mentioned above should receive high priority. This can make regulations, and in particular supervisory practice, more effective and substantially bring them closer to international standards on a number of points.
<b>Principle 1(2).</b>	<b>Independence, accountability and transparency.</b> Each such authority should possess operational independence, transparent processes, sound governance and adequate resources, and be accountable for the discharge of its duties.
Description	<p><b>Criterion 1: Operational independence, accountability and governance are laid down in law and publicly disclosed; no evidence of government or industry interference which compromises the operational independence of the CBR authority, or its ability to obtain and deploy the resources to carry out its mandate; the head of the supervisory agency can be removed from office during his/her term only for reasons specified in the law; the reasons for removal should be publicly disclosed.</b></p> <p><b>Criterion 2: The supervisor publishes objectives and is accountable through a transparent framework for the discharge of its duties in relation to those objectives</b></p> <p>Article 75 of the Constitution of the Russian Federation, Articles. 1, 2, 5, 7, 12, 13, 14 CBL. The Constitution establishes, and thus protects the mandate and constitutional position of the CBR. Article 75, while it mentions the responsibility of the CBR for the stability of the ruble, does not directly mention financial stability. Art. 3 CBL mentions the stability of the ruble, the development and consolidation of the banking system, and the payment system as objectives of the CBR’s activity. Financial sector stability is not mentioned explicitly. Art. 56 CBL mentions as a more limited objective the stability of the banking sector as one of the main goals of banking supervision. A decision of the Constitutional Court of the Russian Federation No. 268-O of October 14, 2000 confirms the authority of the CBR to exercise banking supervision and does not exclude the use of these powers in the interest of financial stability. The judgment confirms that the constitutional mandate of the CBR also extends to banking regulation and supervision. Art. 1 CBL stipulates that the CBR shall exercise its functions “independently of other federal bodies, bodies in the constituent republics of the federation, and of local government bodies”. Art. 7 CBL states that the CBR shall issue rules and regulations “under its own authority.”</p> <p>Art. 12 CBL creates the “National Bank Council” (NBC), which consists of 12 persons and is made up as follows: one CBR representative, two representatives of the Federal Council (regional representation) of the Federal Assembly, three from the Duma (house of</p>

representatives) of the Federal Assembly, three from the President's office and three from the Government. The members of the NBC elect a chairman from their midst by simple majority. Decisions are taken by simple majority vote of those present in the meeting, provided a quorum of seven is in attendance. Art. 13 CBL stipulates that the NBC discusses the Annual Report of the CBR, and has "yea or nay" power with regard to total CBR staff expenditure, total capital expenditure of the CBR, and total other operating costs. The NBC does not have line-item budget authority in formal terms, and can only approve or reject the CBR budget. Article 2 CBL states that the CBR has its own sources of income. CBR staff is not aware of any cases in which the NBC refused to approve a budget or additional proposed expenditures. The NBC approves or rejects the accounting rules for the CBR's accounts and can order an audit of the CBR. The NBC considers policy intentions of the CBR with regard to the improvement of the Russian banking system.

Article 14 CBL states that the Duma, by majority vote, appoints and dismisses the Chairman of the CBR, upon recommendation by the President of the Federation, for a fixed term of four years. It also appoints and dismisses the members of the Board of the CBR, upon recommendation of the CBR Chairman, agreed with the President.

The Chairman of the CBR can be removed from office only at the proposal of the President on the following grounds: (i) expiry of his/her statutory term of office, (ii) incapacity to carry out his/her duties, as confirmed by the State Medical Commission, (iii) at his/her own request, (iv) conviction of a criminal act, and (v) violating any of the laws pertaining to the CBR.

Art. 5 CBL also specifies that the CBR is accountable to the Duma, to which it must submit its Annual Report no later than July 15 of each year. The Chairman of the CBR submits the report to the Duma, and makes a presentation to the Duma on the annual report, as well as on the "Guidelines for the Single State Monetary Policy." The Duma decides on the adoption of the Annual Report, as well as on the annual "Guidelines for the Single State Monetary Policy." The Duma can also hold hearings on the activity of the CBR with participation of CBR officials and staff, and can obtain ad hoc information from the CBR. The Chairman and high officials of the CBR can be summoned to the Duma to explain the CBR's policies and actions. The media regularly discuss the actions and policies of the CBR.

Written questions from the Duma and Federation Council must be mandatorily be answered within 15 days after submission by the plenary Duma or Federation Council, and within 30 days when submitted by an individual member of either of these bodies.

Notwithstanding its independent regulatory authority, the CBR has no right of legislative initiative. Any draft law on banking and financial issues, while the content may be prepared by the Government of the Russian Federation, or in some cases the CBR, needs to be submitted to the Duma. Proposals are therefore subject to a consultation and agreement process between the CBR and the Government, in particular the Ministry of Finance, before they can be submitted.

The head of the banking supervision function of the CBR is a member of the CBR Board of Directors. The composition and functioning of the Board of Directors is laid down in Articles 16-19 CBL. The Board consists of twelve members. Decisions are taken by simple majority provided (i) a quorum of seven members is present, as well as (ii) the Chairman of the CBR or his designated replacement. The Board drafts the Guidelines for the Single State Monetary Policy, for submission to the NBC, President, the Government and the Duma. It also approves the annual report and the financial statements of the CBR, for submission to the NBC and the Duma. It sets the banking regulations, as well as the accounting and reporting system for banks. The Board also establishes the quantitative levels of the

prudential standards, as well as provisioning procedures.

Article 56 of the CBL determines that the regulatory and supervisory functions of the CBR will be discharged through the Banking Supervision Committee (BSC). The BSC is made up of nine members: besides the chairman and his/her replacement the BSC consists of the representatives of the departments of banking regulation and supervision, licensing and financial rehabilitation, oversight of exchange operations, the legal department, the Main Inspectorate of Banks, the directorate for data safety, and the Moscow Territorial Office of the CBR. The BSC meets at least once a month, and in practice weekly, and in the meantime functions as a decision making body on supervisory issues. It also coordinates the functions of the banking supervision units of the CBR. The chairman of the BSC is appointed by the chairman of the CBR from the members of the Board of Directors. The functions of the BSC are elaborated in the Rules on the BSC (CBR Board of Directors, August 10, 2004).

The BSC prepares decisions of the Board on new supervisory methods, new regulations, actions against banks, keeps the Board and the Chairman informed on supervisory developments, prepares decisions on banks' admission to the deposit insurance system, on imposing temporary administration, granting and withdrawal of licenses, and prepares the analysis of banking activities as envisaged in Article 75 CBL, with a view to identifying potential threats to creditors, depositors and to the banking system and to proposing appropriate actions.

**Criterion 3: The supervisory authority and its staff have credibility based on their professionalism and integrity.** Total supervisory staff at the CBR, including regional branches, amounts to some 4500, of which almost 600 are based at the CBR headquarters. The CBR recruitment policies for professional level supervisory staff require a university degree in economics, law or finance as well as one year's experience in the financial sector. The CBR also conducts an integrity check of the candidates. At the end of 2006, of the professional supervisory staff at the CBR, 96 percent had a university education, 80 percent was under 50 years of age, and 93 percent had more than three years experience in the banking sector. Internal training courses are offered at six month intervals. New developments in the supervisory area are the subject of special training courses. Examples include the new international financial reporting standards (IFRS). A new course has also been set up, with curricula of six or twelve months, to train supervisory staff that wish to become a coordinating supervisor ("curator") for individual supervised institutions, as a "single point of contact" for all CBR interactions with that institution. This 6 or 12 month course will be given by the Moscow Academy of Finance. Several years ago, the CBR required supervisors to undergo extensive refresher training. At the end of 2006 almost 800 supervisors had completed this training. Basel II is not expected to require considerable large scale additional training, as the CBR intends to implement the simplified standardized approach for credit risk, and the basic indicator approach to operational risk. Also market risk rules will be based on the standardized approach. At the end of 2006, 30 percent of CBR supervisory staff have undergone training in developing personal confidence, persuasion skills, presentational skills, and cooperation in the workplace.

**Criterion 4: Adequate budgetary means.** The supervisor is financed in a manner that does not undermine its autonomy or independence and permits it to exercise effective supervision. This includes a budget that provides for staff in sufficient numbers and with skills commensurate with the size and complexity of the institutions supervised, salary scales that allow it to attract and retain qualified staff, the ability to commission outside experts with the necessary professional skills and independence and subject to the necessary confidentiality restrictions to conduct supervisory tasks, a training budget and

	<p>program that provide regular training opportunities for staff; a budget for computers and other equipment necessary for analysis of the banking industry and assessment of individual banks and banking groups; a budget that allows for appropriate on-site work.</p> <p>Although the Department of Regulation and Supervision does not have a budget separate from the CBR budget, it participates in the annual CBR budgetary process. It considers itself adequately funded, to include also adequate IT. Staff salaries are sufficiently competitive to enable the CBR to attract qualified staff, although still below private financial sector salaries. Merit supplements and some social perks can also be given. CBR salary scales are not publicly disclosed. As mentioned above, the NBC has the right of final rejection or approval of the CBR budget with regard to staff expenses. The Duma does not consider the CBR budget.</p> <p>Article 2 CBL specifies that the CBR has its own income from which to finance its operations. The CBR retains 50 percent of its profits. The remainder is transferred to the state budget.</p> <p>There have been no difficulties to fund training, IT and travel budgets to performs the CBR's supervisory functions, notwithstanding NBC oversight over its expenses. The CBR is authorized to attract ad-hoc external expertise to assist in the performance of its duties, and has the financial means to do so when necessary.</p>
Assessment	Largely compliant
Comments	<p>CBR staff can exercise their duties without interference from the industry or political pressure. CBR officials on occasion take unpopular positions in the performance of their duties. The CBR is currently under pressure in the media and in parliament with regard to basic conditions for the proper exercise of its functions, such as the ability to exercise professional judgment in the exercise of its duties. To the CBR's credit, this pressure has not led to substantially modified or weak policies.</p> <p>Also given the procedure for appointment or dismissal of the Chairman of the CBR, the budgetary power of the NBC, with its small minority representation of the CBR, the role of the president's office in the appointment and dismissal of the Chairman and Board members of the CBR, the CBR needs to be sensitive to political developments. In reality the CBR probably cannot escape a certain level of "self-censorship" and "preventive caution" in its actions. This could inhibit the CBR in its policies and actions. A heavier representation of the CBR in the NBC could be considered. Under the current structure the CBR does not even necessarily have the chairmanship of the NBC, and can easily be outvoted by political representatives with broader agenda's that by definition do not coincide with the CBR's narrow mandate.</p> <p>Notwithstanding the independence laid down in the CBL, it would be beneficial if the government and President's office could on occasion speak up in support of the CBR's actions and policies and its operational independence, for instance with regard to the closing of weak banks. In such cases it could refer to the CBR's function as the guardian of public deposits and financial stability. See Principle 1(2) Criterion 2.</p> <p>Of course, supervisory operational independence and the use of professional judgment must always be balanced by appropriate mechanisms of accountability.</p>
<b>Principle 1(3).</b>	<b>Legal framework.</b> A suitable legal framework for banking supervision is also necessary, including provisions relating to authorization of banking establishments and their ongoing supervision.
Description	<b>Criterion 1: The law identifies the authorities responsible for granting and withdrawing banking licenses.</b> Articles 4 (8) and 59 CBL stipulate that the CBR is the bank licensing authority and has authority to suspend and withdraw licenses. Also see

	<p>Articles 12 and 13 BL.</p> <p>Article 74 (8) CBL states that the CBR may withdraw the license as a sanction against a delinquent or, on the basis of Article 75 CBL, unsafe and unsound institution. Article 20 BL provides grounds for the revocation of a license. The CBR has the <b>power</b> to revoke a license in the following cases: unreliable information in the licensing application; non-usage of the banking license for over a year; significantly unreliable reporting, filing of prudential returns more than 15 days overdue, banking operations not included in the license, non-compliance with laws and regulations, money laundering, non-payment of obligations on several occasions over one year, filing of a bankruptcy claim; repeated non-submission of updated information for the register of banks, non-compliance with mortgage credit documentation requirements, non-elimination of regulatory delinquencies within one year.</p> <p>The CBR <b>is obliged</b> to withdraw the banking license when capital adequacy falls below 2 percent of risk weighted assets, capital falls below the statutory minimum, combined with inability to restore solvency when threatened by bankruptcy, cannot meet payments above a certain minimum amount within 14 days of the due date, and in a number of other cases where capital decreases to an unacceptable level, enumerated in Article 20 BL.</p> <p><b>Criterion 2: Powers to set prudential rules without having to change the law.</b> The CBR's main regulatory powers are laid down in Articles 57 and 62 CBL. Prudential standards can take the form of Instructions, Norms, Directives, none of which require the legislative process. Also non-binding guidance can be issued. The regulations and other regulatory instruments are published in the CBR publication "Vestnik Banka Rossii." Consultations are held in a timely way with banking industry representatives, sometimes already in the technical drafting stage. For instance when preparing the draft regulation on the simplified standardized approach of Basel II the CBR convened a technical group with bankers, auditors and CBR staff. Public consultation drafts are placed on the CBR website. Actual discussions are held only with federal and regional level banking sector representatives, but anyone can inform the CBR of their views. The deadline for public comments is between one and three months.</p> <p><b>Criterion 3: Power of the CBR to obtain any information from banks, in any form.</b> Articles 57 and associated regulations on consolidated reporting by banks, as well as Article 43 BL oblige banks to submit periodic reports. Article 73 CBL provides the CBR the right to go on-site and obtain any necessary information from wherever in the banking organization. Also see Article 2.5 of Regulation 105-I which specifies the information inspectors may obtain from a bank. Article 3 of regulation 105 I confirms that the staff of the credit institution is obliged to assist the inspectors in retrieving information.</p>
Assessment	Compliant
Comments	<p>The system of rules and regulations is very voluminous and not easy to navigate. Improvements have been made by including in the laws and regulations references to related rules, but continued attention should be given to making the system more easily accessible, also in the interest of CBR staff that need to apply the rules in practice. This also helps improve business conditions for new entrants into the sector, in particular for foreign banks, and can help lower compliance costs for banks, as well as for regulators and supervisors. Examples of countries with relatively accessible systems of banking laws and regulations include Germany, France, the Netherlands and the UK.</p>
<b>Principle 1(4).</b>	<b>Legal powers.</b> A suitable legal framework for banking supervision is also necessary, including powers to address compliance with laws as well as safety and soundness concerns.
Description	<b>Criterion 1: The law and regulations enable the supervisor to assess compliance with laws and the safety and soundness of banks under its supervision.</b> The laws and

	<p>regulations permit the supervisor to apply qualitative professional judgment in safeguarding the safety and soundness of the banks within its jurisdiction. Articles 74 and 75 of the CBL provide a wide range of powers to take corrective action against banks. Article 74 addresses infractions of laws, regulations, reporting deadlines and reporting veracity. After the use of moral suasion, or immediately, if moral suasion is not considered an option, the CBR can require correction, and impose a fine against the bank or conduct of business restrictions. If a bank does not execute the CBR's orders or the infraction creates a "real threat" to depositors or creditors, the CBR can impose a fine, require measures to strengthen the bank's financial position, including a restructuring of the asset side of the balance sheet, replace managers, reorganize the bank, impose special prudential requirements, ban it from performing specific banking activities, appoint a temporary administrator, impose a ban against ongoing reorganization of the bank, and withdraw the license.</p> <p>Article 75 provides powers to take actions as described under Article 74, when, after due analysis, the CBR determines that the lawful interests of depositors and creditors are threatened, or/and the stability of the Russian banking system. These criteria are cumulative (both need to be met at the same time) or may be applied separately. In practice this is a matter of professional judgment of the supervisory body.</p> <p>Article 20 BL provides a number of grounds for the withdrawal of the banking license (see above under CP 1(3), criterion 1).</p> <p>Instruction 59-I further systematizes the use of corrective action against banks. Two types of measures are envisaged: preventive and compulsory. Preventive measures are taken when the irregularities are still in an early stage, when the breach does not jeopardize the interests of depositors and creditors, and the bank's management shows a cooperative and responsible attitude. 59-I outlines the procedures to be followed in applying corrective measures.</p> <p>Compulsory measures are taken in case of breaches of rules and regulations, and when according to the judgment of the CBR a real threat is perceived to the interests of depositors and creditors. Compulsory measures can include fines against the institution. Fines against individual managers and/or Board members are not possible at this time under supervisory rules. Measures can include a ban on opening of additional branches, replacement of managers, imposition of temporary administration, and withdrawal of the banking license after less intrusive measures have proven to be ineffective.</p> <p>Article 44 of the Law on Deposit Insurance (177-FZ) also allows the CBR to apply a degree of professional judgment in applying the criteria for admission of a bank to the deposit insurance system. In this context, the CBR for instance decides whether a bank's financial stability is deemed sufficient by the CBR, using a CAMELS-like methodology. Also, Regulation 766-U on the Estimation of the Financial Condition of a Credit Institution, for example in Article 2.1, allows the CBR to assess whether a danger to the interests of depositors exists, or may exist. Also Article 75 CBL implies the use of professional judgment.</p> <p>Although the use of professional judgment is not explicitly sanctioned in Russian law and regulations, courts have generally upheld decisions of the CBR in which the CBR used professional judgment.</p>
Assessment	Largely compliant
Comments	The CBR has put forward proposals to amend the CBL to provide a more firm legal basis for the use of professional judgment. It is reviewing international good practice in this area. The CBR recognizes that as a general rule effective supervision is not possible without a judicious use of professional judgment, to be able to give an appropriate interpretation of the

	rules and regulations. In particular when assessing the general safety and soundness of an institution, and when a breach of specific regulations is not evident, professional judgment is indispensable. Attempts to regulate and quantify each imaginable risk would be unworkable for banks as well as supervisors. Of course this freedom to use professional judgment needs to be balanced by appropriate accountability mechanisms, and the CBR needs to be able to substantiate its concerns, if necessary in court.
<b>Principle 1(5).</b>	<b>Legal protection.</b> A suitable legal framework for banking supervision is also necessary, including legal protection for supervisors.
Description	<p><b>Criterion 1: The law provides protection to the supervisory authority and its staff against lawsuits for actions taken and/or errors made while discharging their duties in good faith.</b> Article 15 of the Russian Civil Code enables a bank to sue the CBR for damages when caused by actions or omissions of CBR staff committed in the exercise of their responsibilities. Article 50 of the CBL confirms this. While no other explicit rule protects the CBR nor any other state agency against all liability, for instance also covering gross negligence, bad faith or abuse of administrative authority, individual CBR officials or supervisory staff are not liable for damages caused by their actions or omissions resulting from the legitimate exercise of their functions. Claims for damages need to be addressed—and are in fact addressed—to the CBR and not to the individual staff member, although harassment lawsuits cannot be totally prevented. Over the past years the CBR has withdrawn hundreds of banking licenses, and was sued in only a very small number of cases, which were concluded in favor of the CBR. Exceptions exist when damages are caused by actions or omissions of the official or staff member as a result of criminal acts, bad faith, gross negligence, or to serve personal interests. If in such cases the CBR would be held liable, the CBR can in theory sue the staff member to obtain redress. This is supported by Article 1081 of the Civil Code and Article 238 of the labor Code. Clearly, the CBR can also take normal administrative disciplinary measures against the official or staff members. A temporary administrator of a bank appointed by the CBR can be held liable based on Article 20 of the Law on Bankruptcy of Banks.</p> <p><b>Criterion 2: Supervisory authorities and their staff are adequately protected against the costs of defending their actions.</b> The CBR is capable of carrying the cost of its own legal defense. The CBR legal department will be instrumental in preparing the defense by providing expertise on the financial-legal aspects of the case. The CBR individual officials and staff members will be represented in court by outside legal counsel, as is required under Russian law on civil procedure. There is no set practice for the protection of individual officials or staff members against the cost of legal defense in case a suit—however poorly founded—is brought against them. In practice the CBR will take over the cost of the defense, and staff is fully confident that they will not suffer financially and do not feel inhibited in the exercise of their functions.</p>
Assessment	Compliant
Comments	It would be advisable to have at least a written internal CBR guideline whereby the CBR undertakes to finance the legal defense of individual officials and staff in case they are sued personally for acts or omissions committed in the exercise of their responsibilities in good faith. The expenses should be financed from the start of the procedure, and not be limited to reimbursement after the case has been concluded. Otherwise, the staff member or official would still be forced to advance considerable sums for his/her defense. The fear of high legal expenses could be an impediment to the free fulfillment of their tasks. Should it ultimately appear that the official or staff member has committed a criminal act or has been grossly negligent, or acted in bad faith, the CBR could have the option to take recourse against the staff member. In due course an explicit legal provision that individual CBR officials or staff members cannot be held personally liable for damages caused in the good

	<p>faith exercise of their supervisory duties, would provide useful additional protection. This could help clarify in advance to potential plaintiffs that a case brought against individual officials or staff would have no chance of success, unless based on criminal activity, gross negligence or bad faith, and that actions should be brought against the CBR as an institution.</p>
<b>Principle 1(6).</b>	<b>Cooperation.</b> Arrangements for sharing information between supervisors and protecting the confidentiality of such information should be in place.
Description	<p><b>Criterion 1: Arrangements, formal or informal, are in place for cooperation and information sharing among all domestic authorities with responsibility for the soundness of the financial system, and there is evidence that these arrangements work in practice.</b> Under current legislation, the CBR is obliged to provide information, including confidential, to courts and arbitration courts, the State Accounts Chamber, to tax and customs authorities and to the public prosecutor, investigative authorities, and the AML/CFT authority (FIU). An effective framework exists for the two-way exchange of information with other state agencies involved in oversight of financial institutions. These agencies include the Federal Tax Service, the Ministry of Internal Affairs, the Federal Anti-Monopoly Service, the Federal State Statistical Services, the Federal Financial Monitoring Service (the AML/CFT Financial Intelligence Unit (FIU), the Russian Federal Financial Market Service. In particular, close cooperation has been established with the Deposit Insurance Agency State Corporation, based on an Agreement on Coordination of Activity and Sharing of Information. Information is shared electronically. The CBR also responds to ad-hoc written requests for information from these agencies. Article 26 BL stipulates that the CBR shall guarantee the secrecy of transactions, accounts and deposits. Article 57 CBL also includes a reciprocal obligation of the CBR to keep confidential any information it receives in the context of these information exchange arrangements.</p> <p><b>Criterion 2: Arrangements, formal or informal, are in place, where relevant, for cooperation and information sharing with foreign financial sector supervisors of banks and banking groups of material interest to the home or host supervisor, and there is evidence that these arrangements work in practice.</b> Information exchange with foreign supervisors is based on Article 51 CBL. This provision effectively bars the exchange of client information with foreign authorities. It states that the CBR has the right to provide information to foreign authorities which does not contain information on the operations of individual credit institutions and their clients.</p> <p>Notwithstanding, the CBR has concluded 22 MoUs on information exchange with foreign supervisory agencies, which are publicly disclosed on the CBR website. Negotiations for additional MoUs are underway with a number of other countries, also from the G 10. However, these agreements will require the ability to exchange institution and client specific information in order to be truly effective. The CBR has signed MoUs with several EU member states.</p> <p>Also without an agreement the CBR will be as cooperative as possible and exchange information upon request. Also, the CBR meets with home country supervisors of banks with subsidiaries in Russia. In 2006–2007, such meetings were held for instance with supervisors of China, United Kingdom, the Netherlands, Finland, Austria, Hungary and Estonia. In 2005 and 2006 Russia also participated in meetings with EU bank supervisory authorities, organized by Finland. Also the Netherlands, Austria, Hungary, Czech Republic, Estonia, Germany, Italy, Norway, Slovakia, and Sweden participated. Also see the description section on BCP 25.</p> <p><b>Criteria 3 and 4: The supervisor may provide confidential information to another domestic or foreign financial sector supervisor.</b> The supervisor is required to take</p>

	<p>reasonable steps to ensure confidentiality of the information released or received, will be used only for supervisory purposes, and be kept confidential. Article 51 CBL prohibits provision of information on individual client transactions to foreign financial sector supervisor. Russian law provides for arrangements for the exchange of information with domestic authorities with responsibilities outside the field of financial supervision. Article 51 CBL allows the CBR to take account of the legitimate confidentiality needs of foreign authorities from which it receives information. This can include restrictions specifying that the information may only be used for supervisory purposes and must not be shared with other agencies or individuals. The CBR does not provide to third parties information received from a foreign banking supervisor without permission from the other supervisor. Russian legislation may make exceptions to this principle, however. Courts, arbitration courts, the State Accounts Chamber, tax and customs authorities, prosecutors and AML/CFT authorities may request information, also received from foreign authorities, unless under foreign legislation requested information cannot be shared. The abovementioned agencies are however, based on their own laws, and also bound to confidentiality.</p>
Assessment	Largely compliant
Comments	<p>Many elements are in place that can form the basis of a good system of information exchange going forward. However, the current inability under Article 51 of the CBL to exchange institution specific and client information leaves a large gap to be closed. A change in legislation is needed to achieve this.</p>
<b>Principle 2.</b>	<p><b>Permissible activities</b> The permissible activities of institutions that are licensed and subject to supervision as banks must be clearly defined, and the use of the word “bank” in names should be controlled as far as possible.</p>
Description	<p><b>Criterion 1: The term bank is clearly defined in laws or regulations.</b></p> <p>The definition of a bank is laid down in Article 1 BL. A bank is authorized to take retail deposits, perform settlement functions and invest/lend for its own account. Also non-bank credit institutions are licensed and supervised. These institutions may not serve natural persons, but are authorized to take wholesale deposits, keep settlement accounts for legal persons and make investments and loans. They may however make loans to, and invest in natural persons and their activities. Non-bank credit institutions are also defined in Article 1 BL.</p> <p><b>Criterion 2: Permissible activities of licensed and supervised institutions are clearly defined by supervisors or in laws and regulations. Criterion 4: Taking of deposits from the public is generally reserved for institutions that are licensed and subject to supervision.</b></p> <p>Articles 1 and 5 BL specify which banking activities are permissible to licensed banking institutions: deposit taking, investing and lending, payments and settlements, keeping accounts for customers, collection services, foreign exchange dealing, taking precious metals in deposit and investing them, providing guarantees, and money transfers. Credit institutions may also issue sureties on behalf of third persons, receiving assignments of claims, fund management, leasing, safe box rentals, consulting and information services. Credit institutions may not operate a production or commercial enterprise, nor insurance, although these activities can be conducted by a sister-corporation under a common holding. Article 6 LB also specifies that banks may exercise securities activities, such as buying, selling, providing settlement and custodial services for, managing and performing other securities activities. A significant number of banks were not admitted to the deposit insurance system when it was introduced, and therefore had to cease taking deposits from the public. Some of these institutions sued the CBR, but lost in all cases.</p>

	<p><b>Criterion 3: The use of the word “bank” and any derivations such as “banking” in a name is limited to licensed and supervised institutions in all circumstances where the general public might be misled.</b></p> <p>Article 7 BL states that “no legal entity in the Russian Federation, except for those who received a banking license from the CBR may use the word “bank” or “credit organization” in its name or indicate in any other way that the legal entity may carry out banking operations. Exceptions are the CBR, the Bank for Development and Foreign Economic Activity. The latter is not supervised. It is ruled by a separate law and is funded by the Ministry of Finance.</p> <p>There is no established system to monitor the illegitimate use of the word “bank”. The CBR relies on external sources for media, and other sources. The CBR also regularly receives information about registered credit institutions and other legal entities from the Unified State Register of Legal Entities maintained by the Federal Tax Service. In the past few years, the CBR has encountered three cases of unauthorized use of the word “bank.” In these cases, letters from the CBR sufficed to have the enterprise cease this practice. If needed the CBR will refer such cases to the prosecutor’s office.</p> <p><b>Criterion 5: The supervisor publishes and keeps current a list of licensed banks and branches of foreign banks operating in its jurisdiction. Article 59 CBL specifies that the CBR shall keep the Book of State Registration of Credit Institutions.</b> It is publicly disclosed at least once a year through the CBR publication “Vyestnik Banka Rossii.” Deletions and additions to this list are released by the CBR within a month and are posted daily on the CBR website. Reports on state registration of credit institutions are released in the “Vyestnik”. The annual Banking Supervision Report of the CBR also provides quantitative data on the licensing and de-licensing of credit institutions. Banks are required to place a copy of their license in a publicly visible place on their premises.</p>
Assessment	Compliant
Comments	
<b>Principle 3.</b>	<p><b>Licensing criteria</b></p> <p>The licensing authority must have the right to set criteria and reject applications for establishments that do not meet the standards set. The licensing process, at a minimum, should consist of an assessment of the banking organization’s ownership structure, directors and senior management, its operating plan and internal controls, and its projected financial condition, including its capital base; where the proposed owner or parent organization is a foreign bank, the prior consent of its home country supervisor should be obtained.</p>
Description	<p><b>Criterion 1: The licensing authority could be the banking supervisor or another competent authority. If the licensing authority and the supervisory authority are not the same, the supervisor has the right to have its views considered on each specific application.</b> In addition, the licensing authority provides the supervisor with any information that may be material to the supervision of the licensed institution.</p> <p>Articles 4, 56 and 59 CBL and 12, 13, 15 and 41 BL state that the CBR is the bank licensing authority. It is also the supervisory authority. See above.</p> <p><b>Criterion 2: The licensing authority has the power to set criteria for licensing banks.</b> These may be based on criteria set in laws or regulations:</p> <p>Articles 10, 11.1, 14-17 BL, articles 4 and 56 CBL lay down the broad principles, while CBR Regulations 109-I, 271-P, 252-P, 218-P and 268-P lay down highly detailed licensing criteria and procedures. In addition, the CBR has issued guidance on the preparation and</p>

submission of business plans in Recommendation 1176-U.

Based on Regulation 109-I, applicants need to show among others financial and business reputation information on the founders of the bank, the ownership structure of the bank, including information on the group, as appropriate. Founders must be fully current in any tax payments. The founders must present a business plan. Management and Board members must meet fit and proper qualifications, including the absence of a criminal record. Senior managers must have a higher legal or economic education and a working experience of no less than one year as a manager of a department or other division of a credit organization engaged in banking operations, and in the absence of a special education, managing experience in such a division of no less than two years. The CBR requires that the bank have secure premises to be allowed to perform operations in valuables. The founders must show that the bank complies with the minimum statutory capital requirements for credit institutions.

**Criterion 3: The criteria for issuing licenses are consistent with those applied in ongoing supervision.**

During on-site reviews, inspectors review whether the criteria are still met, but non-compliance with the original criteria is not directly a ground for withdrawal of the license. Measures can be taken, but only if the other grounds for taking action, as laid down in the CBL, and prudential standards are applicable. For instance, if a holder of 20 percent or more of the shares no longer meets the abovementioned criteria, the license cannot ipso facto be withdrawn. According to CBR staff, in 2007 to date 36 licenses have been withdrawn. The Federal Law "On Reimbursement by the CBR of Deposits of Natural Persons In Insolvent Banks not Participating in the Deposit Insurance System" stipulates that the CBR reimburses natural persons' deposits bankrupt banks that had not been admitted to the deposit insurance system.

**Criterion 4: The licensing authority has the power to reject an application if the criteria are not fulfilled or if the information provided is inadequate.**

The authority of the CBR to reject applications for banking licenses is clearly established in Article 16 BL.

Reasons to refuse a license application include lack of fitness and propriety of senior managers, chief accountant and their deputies, unsatisfactory financial position of shareholders, tax delinquency, unsatisfactory business reputation of the Board members, inadequate documentation to accompany the application. Foreign banks need to present inter alia proof of consent of their home supervisory authority. In recent years only a few domestic applications for banking licenses have been received. Some six applications have been turned down. Recently the large majority of new licenses have been granted to subsidiaries of foreign owned banks. Over 2006, 63 banking licenses have been revoked.

**Criterion 5: The licensing authority determines that the proposed legal, managerial, operational, and ownership structures of the bank and its parent company will not hinder effective supervision both on a solo and consolidated basis:**

While the laws and regulations require submission of detailed information on the structure and governance of the group, there is no explicit requirement that the structure of the bank be assessed from the point of view of effective group supervision on a consolidated basis, and that any opaqueness or unduly complex structure be a ground for refusal of a license. Regulation 271-P Article 4 requires that information on the divisional structure and management of banks shall be entered into a database held at the regional CBR branch

level.

**Criterion 6: The licensing authority identifies and determines the suitability of major shareholders including the ultimate beneficial owners, and others that may exert significant influence.** It also assesses the transparency of the ownership structure and the sources of capital.

Only shareholders with stakes higher than 20 percent can be vetted. Shareholders with interests of more than 1 percent are required to inform the CBR of their acquisition. Holders of 20 percent or more of stock in a credit institution need to obtain permission from the CBR to obtain these shares. Criteria include a stable financial situation and business activity for at least three years. In accordance with Regulation 268-P, a founder or shareholder with more than 20 percent of the shares of a credit institution shall also have sufficient own resources to contribute to the charter capital of the credit organization and have a stable financial position. Grounds on which permission can be refused by the CBR include an unsatisfactory financial position, violation of anti-monopoly rules, conviction of fraudulent bankruptcy, or having caused damage to a credit institution where the acquirer of the shares had been employed earlier. Financial suitability of shareholders is assessed also on the basis of the financial stability of related entities. Regulation 218-P determines that the financial situation of the shareholder is considered satisfactory if the financial situation is stable, if solvency and liquidity are adequate, and his business activity is profitable. The financial situation of the shareholder is considered unsatisfactory if he has been declared bankrupt, has tax arrears, has other financial obligations that are more than ten days overdue, and has no physical assets. If none of these disqualifications apply, the financial condition may also be found insufficient on other grounds (Regulation 218-P, Article 20). There is no requirement that the shareholder's financial position be sufficient to provide additional funds to the bank if needed. The requirements of a stable financial position and sufficient own resources are also applied to the shareholders-natural persons (268-P).

Through application of Regulation 1379-U, by which the CBR assesses the eligibility of banks to join the deposit insurance system (Law 177 FZ), inter alia the following information needs to be submitted to the CBR according to Appendix III: identity of persons having direct substantial influence on the bank's management, through voting rights attached to shareholdings, trustee relationships, agency contracts or other relationships, or exerts indirect substantial influence (through third persons) on decision-making. If the score on the transparency indicator in Appendix 3 is insufficiently high, the application will be denied by the CBR.

**Criterion 7: A minimum initial capital amount.**

Per amendment of January 2007, Article 11 BL sets the minimum initial capital of a bank at the equivalent of € 5 million. Banks with a lower level per January 2007 are grandfathered, provided that own resources (capital) does not decrease below the level of January 2007. If a bank with own resources (capital) below the Ruble equivalent of €5 million per January 1, 2007 allows own resources to fall below the January 1 2007 level for three consecutive months (unless this results from a change in the own funds calculation methodology) the bank's license must be withdrawn, unless the bank has asked the CBR to change its status to that of a non-bank. A regulatory indexation system for the conversion of the Euro amounts into rubles is in place.

**Criterion 8: The licensing authority, at the time of licensing, evaluates proposed directors and senior management as to expertise and integrity (fit and proper test) and any potential for conflicts of interest.** The fit and proper criteria include (i) skills and experience in relevant financial operations commensurate with the intended activities of a

bank, and (ii) no record of criminal activities or adverse regulatory judgments that make a person unfit to hold important positions in the bank.

Article 60 CBL authorizes the CBR to set fit and proper criteria for bank senior managers, Board members and chief accountants, and their deputies. These requirements are also applied to the managers and chief accountant of branches, and their deputies.

Questionnaires need to be filled out by candidates for these positions. Articles 14(8) and 16 BL provide further details. The questionnaire requires information about education and experience, as well the absence of a criminal record. According to Article 16 BL the license can be refused if the nominees lack a university level educational in law, economics or finance, or adequately senior banking experience, conviction of an economic crime, or administrative offence, dismissal from a previous position within two years prior to the nomination from a position in bank management, and an insufficient business reputation (which includes criteria with regard to professional and other qualities). Regulation 271-P establishes that regional CBR offices keep databases with additional information on banks senior managers. The CBR keeps track of the identities of senior managers and Board members that have been proven unsuitable.

**Criterion 9: The licensing authority reviews the proposed strategic and operating plans of the bank.** This includes determining that an appropriate system of corporate governance, risk management, and internal controls including those related to the detection and prevention of criminal activities as well as the oversight of proposed outsourced functions will be in place. The operational structure is required to reflect the scope and degree of sophistication of the proposed activities of the bank:

Article 14 BL requires that a business plan be submitted with the licensing application. Regulation 1176-U provides rules for compiling a business plan. The plan must provide inter alia the following information (Chapter 3 of Regulation 1176-U): goals, tasks and market policy of the bank, the management system, information on the founders of the bank, the bank's activities, and other indicators relevant to the bank's objectives. The financial projections shall be included in an appendix, as well as how the bank proposes to meet the prudential requirements. A SWOT analysis shall be included, as well as the results of market research, the IT plan, staffing, remuneration, the macroeconomic background to the activities of the bank, information on the risk management structure, the expected asset and liability structure of the balance sheet, and additional information.

Besides at the time of licensing, a business plan needs to be presented to the CBR when licenses for additional activities are required, and when a change of status e.g. from non-bank to bank or vice versa, is required, when a branch or subsidiary is set up in another state, or when the original business plan is substantially modified within a year. Information on corporate governance and internal control is also to be provided.

**Criterion 10: The licensing authority reviews pro forma financial statements and projections.** This includes an assessment of the adequacy of the financial strength to support the proposed strategic plan as well as financial information on the principal shareholders of the bank:

Regulation 1176-U, Article 3 requires that information be provided on the financial condition and the economic activity of founders with more than 20 percent of shares. The information should provide transparency of the structure of the group of founders and identify persons who, although not founders, have the possibility of directly or indirectly exerting essential influence on decisions made by the bank's management. Article 3.2 and 3.3 require a P&L prognosis; Article 3.3 moreover requires the main magnitudes of asset and liability operations and expected financial results. Article 3.3.5 requires that a calculation be

performed how the prudential ratios will be met and what the level of capital will be. Article 3.3.10 requires that information be provided on the group to which the bank belongs, which can be a group of legal and natural persons who have the power to substantively influence, directly or indirectly, the management of the bank.

If the business plan does not appear to show that the bank can be expected to be safe and sound, fulfill prudential requirements and meet legal requirements for the protection of depositors and creditors, the CBR may refuse the license.

The CBR reviews and comments on the business plan of the applicant at the level of the regional offices and at headquarters. It is assessed for its realism, given prognoses for the P&L statement, and competitive position. All CBR departments that have an interest are asked to comment, for instance the legal and security departments.

The CBR has issued Regulations 119-T and 11-T on corporate governance of banks. T-Regulations are in formal terms recommendations or “guidance”, but CBR staff consider these to be nearly as strong as formal regulations. The banks abide by them. Regulation 119-T explicitly recognizes the importance of corporate governance for banks, and intends to provide information on current good international practices. Regulation 11-T is a corporate governance annual self assessment questionnaire to be returned by banks to the CBR. No, or very few returns have been received yet, as the regulation was issued only in February 2007. The questionnaire addresses issues such as distribution of powers among governing bodies of the bank, approval process of a bank’s strategy, risk management coordination, prevention of conflicts of interest, relations with affiliated entities, code of ethics, disclosure policies, internal control monitoring.

**Criterion 11: In the case of foreign banks establishing a branch or subsidiary, before issuing a license, the host supervisor establishes that no objection (or a statement of no objection) from the home supervisor has been received.** For the purposes of the licensing process as well as ongoing supervision of cross border banking operations in its country, the host supervisor assesses whether the home supervisor practices global consolidated supervision:

Article 52 CBL stipulates that the CBR issues the permits for setting up affiliates of foreign banks. Article 17 BL stipulates that besides the regular documents required for a banking license, establishments of foreign banks additionally need to present written consent of the home supervisor. It is not possible to open a branch office of a foreign bank. There is no legal or regulatory requirement to assess whether the home supervisor exercises global consolidated supervision.

**Criterion 12: If the licensing authority or supervisory authority determines that the license was based on false information the license can be revoked:** Article 20 BL stipulates that the CBR may revoke a license if the information used when the license was issued has been found to be unreliable. Revocation for this reason has not taken place. The CBR prefers to take remedial action to bring the bank’s operations in line with the licensing requirements.

**Criterion 13: The Board, collectively, must have a sound knowledge of each of the types of activities the bank intends to pursue, and the associated risks.** Current laws and regulations do not impose expertise requirements on Board members individually. Current practice of the CBR does not assess whether the Board as a whole comprises the expertise needed to oversee the activities and associated risks incurred by the bank. However, inspectors review the notes of the Board meetings and are in a position to assess whether the Board as a whole adequately addresses risks. The issue presents itself

	differently in small or large banks. A larger issue is whether Board members have adequate time to be effective Board members.
Assessment	Largely compliant
Comments	<p>The CBR has prepared amendments to the CBL and BL to tighten the requirements for the senior managers, Board members, and the founders (shareholders) of credit institutions. The CBR wants to lower the threshold for approval of shareholders from 20 percent to 10 percent. Although the CBR is in practice able to obtain information about the shareholders on the basis of the Deposit Insurance Law (DIL), in theory this would limit the CBR's powers to the institutions covered by the DIL (some 200 institutions, with only a few percent of household deposits). However, the CBR has drafted amendments to bring the CBL and BL in line with the regime of the DIL.</p> <p>A licensing criterion requires that a banking group to which the applicant belongs should not be so complex that the economic rationale of the structure is unclear, and that it is too complex to supervise effectively (the "BCCI-criterion"). This criterion is also applied to the assessment of banking group and shareholders transparency in the context of the assessment of the bank's business plan (1176-U, Article 3.3.10).</p>
<b>Principle 4.</b>	<p><b>Transfer of significant Ownership</b> Banking supervisors must have the authority to review and reject any proposals to transfer significant ownership or controlling interests in existing banks to other parties.</p>
Description	<p><b>Criterion 1: The licensing authority could be the banking supervisor or another competent authority.</b> If the licensing authority and the supervisory authority are not the same, the supervisor has the right to have its views considered on each specific application. In addition, the licensing authority provides the supervisor with any information that may be material to the supervision of the licensed institution.</p> <p>Articles 4, 56 and 59 CBL and 12, 13, 15 and 41 BL state that the CBR is the bank licensing authority. It is also the supervisory authority. See above.</p> <p><b>Criterion 2: The licensing authority has the power to set criteria for licensing banks.</b> These may be based on criteria set in laws or regulations:</p> <p>Articles 10, 11.1, 14-17 BL, articles 4 and 56 CBL lay down the broad principles, while CBR Regulations 109-I, 271-P, 252-P, 218-P and 268-P lay down highly detailed licensing criteria and procedures. In addition, the CBR has issued guidance on the preparation and submission of business plans in Recommendation 1176-U.</p> <p>Based on Regulation 109-I, applicants need to show among others financial and business reputation information on the founders of the bank, the ownership structure of the bank, including information on the group, as appropriate. Founders must be fully current in any tax payments. The founders must present a business plan. Management and Board members must meet fit and proper qualifications, including the absence of a criminal record. Senior managers must have a higher legal or economic education and a working experience of no less than one year as a manager of a department or other division of a credit organization engaged in banking operations, and in the absence of a special education, managing experience in such a division of no less than two years. The CBR requires that the bank have secure premises to be allowed to perform operations in valuables. The founders must show that the bank complies with the minimum statutory capital requirements for credit institutions.</p> <p><b>Criterion 3: The criteria for issuing licenses are consistent with those applied in ongoing supervision.</b></p> <p>During on-site reviews, inspectors review whether the criteria are still met, but non-</p>

compliance with the original criteria is not directly a ground for withdrawal of the license. Measures can be taken, but only if the other grounds for taking action, as laid down in the CBL, and prudential standards are applicable. For instance, if a holder of 20 percent or more of the shares no longer meets the abovementioned criteria, the license cannot ipso facto be withdrawn. According to CBR staff, in 2007 to date 36 licenses have been withdrawn. The Federal Law "On Reimbursement by the CBR of Deposits of Natural Persons In Insolvent Banks not Participating in the Deposit Insurance System" stipulates that the CBR reimburses natural persons' deposits bankrupt banks that had not been admitted to the deposit insurance system.

**Criterion 4: The licensing authority has the power to reject an application if the criteria are not fulfilled or if the information provided is inadequate.**

The authority of the CBR to reject applications for banking licenses is clearly established in Article 16 BL.

Reasons to refuse a license application include lack of fitness and propriety of senior managers, chief accountant and their deputies, unsatisfactory financial position of shareholders, tax delinquency, unsatisfactory business reputation of the Board members, inadequate documentation to accompany the application. Foreign banks need to present inter alia proof of consent of their home supervisory authority. In recent years only a few domestic applications for banking licenses have been received. Some six applications have been turned down. Recently the large majority of new licenses have been granted to subsidiaries of foreign owned banks. Over 2006, 63 banking licenses have been revoked.

**Criterion 5: The licensing authority determines that the proposed legal, managerial, operational, and ownership structures of the bank and its parent company will not hinder effective supervision both on a solo and consolidated basis:**

While the laws and regulations require submission of detailed information on the structure and governance of the group, there is no explicit requirement that the structure of the bank be assessed from the point of view of effective group supervision on a consolidated basis, and that any opaqueness or unduly complex structure be a ground for refusal of a license. Regulation 271-P Article 4 requires that information on the divisional structure and management of banks shall be entered into a database held at the regional CBR branch level.

**Criterion 6: The licensing authority identifies and determines the suitability of major shareholders including the ultimate beneficial owners, and others that may exert a significant influence. It also assesses the transparency of the ownership structure and the sources of capital.**

Only shareholders with stakes higher than 20 percent can be vetted. Shareholders with interests of more than 1 percent are required to inform the CBR of their acquisition. Holders of 20 percent or more of stock in a credit institution need to obtain permission from the CBR to obtain these shares. Criteria include a stable financial situation and business activity for at least three years. In accordance with Regulation 268-P, a founder or shareholder with more than 20 percent of the shares of a credit institution shall also have sufficient own resources to contribute to the charter capital of the credit organization and have a stable financial position. Grounds on which permission can be refused by the CBR include an unsatisfactory financial position, violation of anti-monopoly rules, conviction of fraudulent bankruptcy, or having caused damage to a credit institution where the acquirer of the shares had been employed earlier. Financial suitability of shareholders is assessed also on the basis of the financial stability of related entities. Regulation 218-P determines that the

financial situation of the shareholder is considered satisfactory if the financial situation is stable, if solvency and liquidity are adequate, and his business activity is profitable. The financial situation of the shareholder is considered unsatisfactory if he has been declared bankrupt, has tax arrears, has other financial obligations that are more than ten days overdue, and has no physical assets. If none of these disqualifications apply, the financial condition may also be found insufficient on other grounds (Regulation 218-P, Article 20). There is no requirement that the shareholder's financial position be sufficient to provide additional funds to the bank if needed. The requirements of a stable financial position and sufficient own resources are also applied to the shareholders-natural persons (268-P).

Through application of Regulation 1379-U, by which the CBR assesses the eligibility of banks to join the deposit insurance system (Law 177 FZ), inter alia the following information needs to be submitted to the CBR according to Appendix 3: identity of persons having direct substantial influence on the bank's management, through voting rights attached to shareholdings, trustee relationships, agency contracts or other relationships, or exerts indirect substantial influence (through third persons) on decision-making. If the score on the transparency indicator in Appendix III is insufficiently high, the application will be denied by the CBR.

**Criterion 7: A minimum initial capital amount.** Per amendment of January 2007, Article 11 BL sets the minimum initial capital of a bank at the equivalent of €5 million. Banks with a lower level per January 2007 are grandfathered, provided that own resources (capital) does not decrease below the level of January 2007. If a bank with own resources (capital) below the ruble equivalent of €5 million per January 1, 2007 allows own resources to fall below the January 1 2007 level for three consecutive months (unless this results from a change in the own funds calculation methodology) the bank's license must be withdrawn, unless the bank has asked the CBR to change its status to that of a non-bank. A regulatory indexation system for the conversion of the Euro amounts into Rubles is in place.

**Criterion 8: The licensing authority, at the time of licensing, evaluates proposed directors and senior management as to expertise and integrity (fit and proper test) and any potential for conflicts of interest.** The fit and proper criteria include (i) skills and experience in relevant financial operations commensurate with the intended activities of a bank, and (ii) no record of criminal activities or adverse regulatory judgments that make a person unfit to hold important positions in the bank.

Article 60 CBL authorizes the CBR to set fit and proper criteria for bank senior managers, Board members and chief accountants, and their deputies. These requirements are also applied to the managers and chief accountant of branches, and their deputies.

Questionnaires need to be filled out by candidates for these positions. Articles 14(8) and 16 BL provide further details. The questionnaire requires information about education and experience, as well the absence of a criminal record. According to Article 16 BL the license can be refused if the nominees lack a university level educational in law, economics or finance, or adequately senior banking experience, conviction of an economic crime, or administrative offence, dismissal from a previous position within two years prior to the nomination from a position in bank management, and an insufficient business reputation (which includes criteria with regard to professional and other qualities). Regulation 271-P establishes that regional CBR offices keep databases with additional information on banks senior managers. The CBR keeps track of the identities of senior managers and Board members that have been proven unsuitable.

**Criterion 9: The licensing authority reviews the proposed strategic and operating plans of the bank.** This includes determining that an appropriate system of corporate

governance, risk management, and internal controls including those related to the detection and prevention of criminal activities as well as the oversight of proposed outsourced functions will be in place. The operational structure is required to reflect the scope and degree of sophistication of the proposed activities of the bank:

Article 14 BL requires that a business plan be submitted with the licensing application. Regulation 1176-U provides rules for compiling a business plan. The plan must provide inter alia the following information (Chapter 3 of Regulation 1176-U): goals, tasks and market policy of the bank, the management system, information on the founders of the bank, the bank's activities, and other indicators relevant to the bank's objectives. The financial projections shall be included in an appendix, as well as how the bank proposes to meet the prudential requirements. A SWOT analysis shall be included, as well as the results of market research, the IT plan, staffing, remuneration, the macroeconomic background to the activities of the bank, information on the risk management structure, the expected asset and liability structure of the balance sheet, and additional information.

Besides at the time of licensing, a business plan needs to be presented to the CBR when licenses for additional activities are required, and when a change of status e.g. from non-bank to bank or vice versa, is required, when a branch or subsidiary is set up in another state, or when the original business plan is substantially modified within a year. Information on corporate governance and internal control is also to be provided.

**Criterion 10: The licensing authority reviews pro forma financial statements and projections.** This includes an assessment of the adequacy of the financial strength to support the proposed strategic plan as well as financial information on the principal shareholders of the bank.

Regulation 1176-U, Article 3 requires that information be provided on the financial condition and the economic activity of founders with more than 20 percent of shares. The information should provide transparency of the structure of the group of founders and identify persons who, although not founders, have the possibility of directly or indirectly exerting essential influence on decisions made by the bank's management. Article 3.2 and 3.3 require a P&L prognosis; Article 3.3 moreover requires the main magnitudes of asset and liability operations and expected financial results. Article 3.3.5 requires that a calculation be performed how the prudential ratios will be met and what the level of capital will be. Article 3.3.10 requires that information be provided on the group to which the bank belongs, which can be a group of legal and natural persons who have the power to substantively influence, directly or indirectly, the management of the bank.

If the business plan does not appear to show that the bank can be expected to be safe and sound, fulfill prudential requirements and meet legal requirements for the protection of depositors and creditors, the CBR may refuse the license.

The CBR reviews and comments on the business plan of the applicant at the level of the regional offices and at headquarters. It is assessed for its realism, given prognoses for the P&L statement, and competitive position. All CBR departments that have an interest are asked to comment, for instance the legal and security departments.

The CBR has issued Regulations 119-T and 11-T on corporate governance of banks. T-Regulations are in formal terms recommendations or "guidance", but CBR staff consider these to be nearly as strong as formal regulations. The banks abide by them. Regulation 119-T explicitly recognizes the importance of corporate governance for banks, and intends to provide information on current good international practices. Regulation 11-T is a corporate governance annual self assessment questionnaire to be returned by banks to the

	<p>CBR. No, or very few returns have been received yet, as the regulation was issued only in February 2007. The questionnaire addresses issues such as distribution of powers among governing bodies of the bank, approval process of a bank's strategy, risk management coordination, prevention of conflicts of interest, relations with affiliated entities, code of ethics, disclosure policies, internal control monitoring.</p> <p><b>Criterion 11: In the case of foreign banks establishing a branch or subsidiary, before issuing a license, the host supervisor establishes that no objection (or a statement of no objection) from the home supervisor has been received.</b> For the purposes of the licensing process as well as ongoing supervision of cross border banking operations in its country, the host supervisor assesses whether the home supervisor practices global consolidated supervision:</p> <p>Article 52 CBL stipulates that the CBR issues the permits for setting up affiliates of foreign banks. Article 17 BL stipulates that besides the regular documents required for a banking license, establishments of foreign banks additionally need to present written consent of the home supervisor. It is not possible to open a branch office of a foreign bank. There is no legal or regulatory requirement to assess whether the home supervisor exercises global consolidated supervision.</p> <p><b>Criterion 12: If the licensing authority or supervisory authority determines that the license was based on false information the license can be revoked.</b> Article 20 BL stipulates that the CBR may revoke a license if the information used when the license was issued has been found to be unreliable. Revocation for this reason has not taken place. The CBR prefers to take remedial action to bring the bank's operations in line with the licensing requirements.</p> <p><b>Criterion 13: The Board, collectively, must have a sound knowledge of each of the types of activities the bank intends to pursue, and the associated risks.</b> Current laws and regulations do not impose expertise requirements on Board members individually. Current practice of the CBR does not assess whether the Board as a whole comprises the expertise needed to oversee the activities and associated risks incurred by the bank. However, inspectors review the notes of the Board meetings and are in a position to assess whether the Board as a whole adequately addresses risks. The issue presents itself differently in small or large banks. A larger issue is whether Board members have adequate time to be effective Board members.</p>
Assessment	Largely compliant
Comments	<p>The CBR has prepared amendments to the CBL and BL to tighten the requirements for the senior managers, Board members, and the founders (shareholders) of credit institutions. The CBR wants to lower the threshold for approval of shareholders from 20 percent to 10 percent. Although the CBR is in practice able to obtain information about the shareholders on the basis of the Deposit Insurance Law (DIL), in theory this would limit the CBR's powers to the institutions covered by the DIL (some 200 institutions, with only a few percent of household deposits). However, the CBR has drafted amendments to bring the CBL and BL in line with the regime of the DIL.</p> <p>A licensing criterion requires that a banking group to which the applicant belongs should not be so complex that the economic rationale of the structure is unclear, and that it is too complex to supervise effectively (the "BCCI-criterion"). This criterion is also applied to the assessment of banking group and shareholders transparency in the context of the assessment of the bank's business plan (1176-U, Article 3.3.10).</p>
<b>Principle 10.</b>	<b>Large exposure limits.</b> Supervisors must be satisfied that banks have policies and processes that enable management to identify and manage concentrations within the

	portfolio, and supervisors must set prudential limits to restrict bank exposures to single counterparties or groups of connected counterparties.
Description	<p><b>Criterion 1. Laws or regulations explicitly define, or the supervisor has the power to define, a “group of connected counterparties” to reflect actual risk exposure.</b> The supervisor may exercise discretion in applying this definition on a case by case basis.</p> <p>The definitions of parent, subsidiary, and dependent companies are contained in Articles 105 and 106 of the Civil Code of the Russian Federation. The Law on the Central Bank, Article 64, inter alia, defines related borrowers as dependent upon one another or having a parent—subsidiary relationship. Similarly, Article 4 of the Law on Banks defines what constitutes a ‘banking group,’ a ‘bank holding’ and ‘significant influence.’ Accordingly, a company is considered to be a subsidiary of another if the parent company or partnership is able to exert (sic) ‘a decisive impact’ on the decisions adopted by a company.</p> <p>In accord with Article 4 of the Law on Banks ‘significant influence’ is defined as the opportunity to control decisions made by the board of directors of a legal entity, the conditions under which it does business and/or in accordance with a contract between a banking group and/or a bank holding company to appoint the executive directors and/or more than half of the members of an executive board. As well, the definition captures the ability to determine the election of more than half of the members of the board of directors. Borrowers considered to be included in a group of connected borrowers are:</p> <ul style="list-style-type: none"> <li>• parts of a banking group or bank holding group;</li> <li>• close relatives of one another, as defined by federal law;</li> <li>• persons able directly or indirectly to exert a significant influence on decisions made by the management bodies of borrowers that are legal entities.</li> </ul> <p>Bank of Russia recommendation 106-T, entitled “On Calculation of the Ratio for the Maximum Exposure per Borrower or Group of Connected Borrowers” recommends that borrowers be treated as connected if they are linked economically in such a way that deterioration in the financial condition of one gives rise to a deterioration in the financial condition of another.</p> <p>Thus, the specific criteria that permit the Bank of Russia to consider borrowers as ‘connected’ are more oriented toward legal rather than economic relationships between parties. Moreover, the Bank of Russia is not authorized to consider possible risks emanating from above the bank (vertical) such as through a mixed financial-industrial holding company or alongside the bank (horizontal) such as ‘sister’ industrial enterprises controlled from the same holding company.</p> <p>Currently, the CBR determines the structure of the group and carries out upward consolidation within the scope provided it by current legislation (which encompasses bank subsidiary holdings). Non-financial equity holdings are included in this consolidation, which can lead to an unclear view of the banking within the group. Pending revisions to the existing law (see CP 24) would strengthen the Bank of Russia’s ability to access additional related group financial information.</p> <p><b>Criterion 2. Laws, regulations or the supervisor set prudent limits on large exposures to a single counterparty or a group of connected counterparties.</b> “Exposures” include all claims and transactions, on-balance sheet as well as off-balance sheet. The supervisor confirms that senior management monitors these limits and that they are not exceeded on a solo or consolidated basis.</p> <p>Article 62 of the Law on the Central Bank permits the Bank of Russia to set the maximum</p>

	<p>exposure limits. Accordingly, Regulation 110-I has been issued to prescribe key normative ratio requirements. As regards connected loan exposures (including off-balance sheet guarantees) the following ratios are to be reported monthly to the Bank of Russia:</p> <ul style="list-style-type: none"> <li>• N6: Aggregate size of loans<sup>7</sup> to any one borrower and/or connected group is limited to 25 percent of bank's capital;</li> <li>• N7: Aggregate large credit exposures<sup>8</sup> limited to 800 percent of bank's capital.</li> <li>• N9.1: Aggregate credits to shareholders holding more than 5 percent of the bank's stock limited to 50 percent of bank's capital.</li> <li>• N10.1: Aggregate size of loans to bank insiders (executive officers) is limited to 3 percent of bank's capital</li> </ul> <p>Through its periodic on-site inspections and on-going off-site supervision, the CBR regularly monitors banks' compliance with the above required ratios (as well as other measures) through receipt of report form 0409118 "Data on large exposures" and form 0409135 "Information on required ratios."</p> <p><b>Criterion 3. The supervisor determines that a bank's management information systems identify and aggregate on a timely basis exposure to individual counterparties and groups of connected counterparties.</b> The Bank of Russia determines through its periodic on-site inspections that a bank's risk management procedures and its information systems permit the timely identification, aggregation and reporting of loans and groups of connected borrowers. As well, banks are required to submit a monthly report, signed by the chief executive or chief financial officer.</p> <p>In accord with Regulation No. 242-P, the bank's internal compliance (or audit) department<sup>9</sup> is obliged to inform the board of directors of deficiencies or violations discovered regarding the management of risks and effectiveness of measures taken to mitigate such risk exposures.</p> <p><b>Criterion 4. The supervisor confirms that a bank's risk management policies and processes establish thresholds for acceptable concentrations of credit and require that all material concentrations be reviewed and reported periodically to the Board.</b> Apart from its existing regulations, instructions and recommendations, the Bank of Russia confirms, principally through its periodic on-site inspections, that a bank's risk management processes clearly define and limit risk concentrations (e.g., by borrower group, sector or economic region) and provide adequately for the ongoing supervision and reporting of all material risk concentrations.</p> <p>To that end, a bank's risk management system is reviewed during the on-site inspection, in accord with Letter No. 26-T, to determine if the following recommended measures are in place:</p> <ul style="list-style-type: none"> <li>• authorized written procedures for the assessment of banking related risks and the indicators used in this process;</li> <li>• analytic work supporting the risk assessments undertaken and the recommendations</li> </ul>
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<sup>7</sup> The aggregate limits on loans-to-one-borrower (N6) ratio is calculated to include securities provided as collateral.

<sup>8</sup> A large credit exposure is when the sum of credits and guarantees in favor of a single customer exceeds 5 percent of a bank's capital.

<sup>9</sup> In practice, only larger banks have established internal compliance (or audit) departments. Smaller banks would normally have one or more persons who include internal compliance within their job responsibilities.

	<p>delivered thereof;</p> <ul style="list-style-type: none"> <li>reporting requirements and practices regarding risk management related issues, both to employees, the executive directors and board of directors;</li> <li>how decisions are taken, recorded and followed thereafter on risk management related recommendations and reports submitted;</li> </ul> <p>The assessment of bank's risk management processes is amongst the central components of each comprehensive on-site inspection undertaken by the Bank of Russia. Accordingly, the risk management assessment occupies a substantial portion of the human resources assigned an on-site inspection.</p> <p><b>Criterion 5. The supervisor regularly obtains information that enables concentrations within a bank's portfolio, including sectoral, geographical and currency exposures, to be reviewed.</b> The supervisor has the power to require banks to take remedial actions in cases where concentrations appear to present significant risks.</p> <p>The Law on the Central Bank (Article 65) authorizes the Bank of Russia to maintain a register of large exposures of lending institutions (banking groups). Banks provide the Bank of Russia monthly reports on the calculation of required ratios using reporting forms 0490135 "Information about required ratios" and 0409118 entitled "Data on large exposures". Additionally, banks submit a quarterly report, form 0409302 entitled "Information about credits and debt on credits issued to borrowers in different regions," which provides information about the concentration of credit risks and a breakdown by sectors, regions and currencies.</p> <p>In accordance with Instruction No. 110-I, the Bank of Russia off-site supervision regularly monitors banks' compliance with required ratios through its 'Analysis of Financial Standing of Banks' (ASFB) software, available now to all 78 territorial offices and regional offices. This software includes, inter alia, compliance with requirements on the level of large exposures.</p> <p>In accordance with the provisions of Instruction No. 110-I, banks must comply with the required ratios (featured in BCP 10.2). Violation of the numerical value of a required ratio for a single day is treated as a failure to comply with the required ratio. In the event a bank fails to comply with a required ratio for six or more business days during any consecutive 30 business days, the Bank of Russia may take enforcement action against these banks.</p>
Assessment	Largely compliant
Comments	Issues concerning regulation of the (third party) concentrations of credit risk are addressed by the Bank of Russia within its existing legislative and regulatory framework. The normative ratios outlined in Criterion 2 are regularly reported, enabling the CBR to readily quantify large exposures at each bank. Both off-site supervision and on-site inspection carefully monitor the composition and size of the N7 ratio, which reflects the aggregate concentration of large credit exposures. This ratio, limited to 800 percent, was established in 1998.
<b>Principle 13.</b>	<b>Market risk.</b> Supervisors must be satisfied that banks have in place policies and processes that accurately identify, measure, monitor and control market risks; supervisors should have powers to impose specific limits and/or a specific capital charge on market risk exposures, if warranted.
Description	<b>Criterion 1: The supervisor determines that a bank has suitable policies and processes that clearly articulate roles and responsibilities related to the identification, measuring, monitoring, and control of market risk.</b> The supervisor is satisfied that policies and processes are adhered to in practice and are subject to appropriate Board and senior management oversight: CBR Regulation 89-P and 85-T lay

down rules for banks' assessment of market risk, based on the standardized approach in the Basel Committee's 1996 Market Risk Amendment to the 1988 Capital Accord. Regulation 89-P lays down the methodology for the calculation of market risk, covering portfolio risk, exchange rate risk, and interest rate risk. Options, futures and derivatives are also included. Under Regulation 110-I of the CBR's prudential standards, ratio N-1, market risk is included in the calculation of capital adequacy requirements.

The internal control regulations mentioned above under CP 12, criterion 1, provide rules on how the CBR verifies that identified risks are adequately managed. Regulation 26-T recommends that banks evaluate the following factors in their management of market risk: (i) has a specific unit or person been allocated to manage market risk; (ii) is the market risk management unit independent of the bank's market operations units; (iii) does the bank have internal market risk policies and procedures that have been approved at management level; (iv) are adequate management information systems in place to monitor market risk at the management level, and is management informed on an ongoing basis; (v) are the internal policies and procedures adhered to?

**Criterion 2: The supervisor determines that the bank has set market risk limits that are commensurate with the institution's size and complexity and that reflect all material market risks.** Limits should be approved by the Board or senior management. The supervisor confirms that any limits (either internal or imposed by the supervisor) are adhered to: Article 68 CBL states that the CBR regulates the amounts and calculation methods for interest rate, currency and other risks. Regulation 89-P regulates market risk, and Regulation 124-I regulates open foreign exchange positions and sets limits per currency and for the total open position. The CBR has not set limits for interest rate risk and portfolio risk. It is the CBR's experience that the banks themselves do use such limits internally.

In accordance with Guidance for on-site inspectors 26-T, in the course of on-site inspections, the following market risk aspects are examined: (i) whether intraday limits are opened for financial instruments and foreign exchange positions in the course of the business day, (ii) whether a threshold is set for losses, (iii) whether limits are set per employee, (iv) whether stop-loss mechanisms are in place, and their effectiveness monitored, (v) whether the limits are being observed, and (vi) whether policies and procedures for monitoring these risks are in place.

**Criterion 3: The supervisor is satisfied that there are systems and controls in place to ensure that all transactions are captured on a timely basis and that the banks' marked to market positions are revalued frequently using reliable and prudent market data (or in the absence of market prices, internal or industry-accepted models).** The supervisor requires banks to establish and maintain policies and processes for considering valuation adjustments/reserves for positions that otherwise cannot be prudently valued, including concentrated, less liquid and stale positions: In its inspections, the CBR assesses, in accordance with Guidance for on-site inspectors 26-T, whether market risk assessment is carried out on an ongoing basis, whether market indicators are followed and analyzed, and analytical work is done at the bank to follow broader market conditions and developments as well as economic developments, and whether this is reflected in instructions for dealers and in market and interest rate forecasts. The CBR also verifies whether databases of financial market indicators are maintained, and whether banks use appropriate interest rate risk models.

**Criterion 4: The supervisor determines that banks perform scenario analysis stress testing and contingency planning, as appropriate and periodic validation or testing of**

	<p><b>the system used to measure market risk.</b> The supervisor confirms that the approaches are integrated into the risk management policies and processes, and results are taken into account in the bank's risk taking strategy: The CBR has issued informational and advisory materials on stress testing "Approaches to the Organization of Stress Testing (Based on a Survey of International Financial Practice)". In accordance with Guidance for on-site inspectors 26-T, the CBR inspections review the market risk monitoring units, including the performance of stress tests, the timeliness of information provided to the bank's management, including information needed for decision making, and daily management information on market risk, including stress tests results. Also the presence of banks' contingency plans for sudden and large-scale market developments is reviewed. The CBR's authority to take remedial measures against deficiencies in market risk management is not strong enough.</p>
Assessment	Largely compliant
Comments	
<b>Principle 14.</b>	<p><b>Liquidity risk.</b> Supervisors must be satisfied that banks have a liquidity management strategy that takes into account the risk profile of the institution, with prudent policies and processes to identify, measure, monitor and control liquidity risk, and to manage liquidity on a day-to-day basis. Supervisors require banks to have contingency plans for handling liquidity problems.</p>
Description	<p><b>Criterion 1: The supervisor sets liquidity guidelines for banks.</b> These guidelines take into consideration undrawn commitments and other off-balance sheet liabilities, as well as existing on-balance sheet liabilities: Article 62 CBL gives the CRB authority to set prudential regulations, also on liquidity. Article 66 CBL provides the definitions of the numerator and denominator of the liquidity ratio. It has issued a regulation on prudential standards, Regulation 110-I, which includes three liquidity ratios: N-2 for immediate liquidity: 15 percent, N-3 at 50 percent for current liquidity: 30 days, and N-4 at 120 percent for long term liquidity. The CBR has issued recommendations on liquidity management in Regulation 139-T. This recommendation calls for (i) clear identification of units in the bank responsible for developing and implementing policy and decision making with regard to liquidity policy, (ii) a mandatory information system for the collection and analysis of information about a bank's liquidity status, (iii) descriptions of liquidity forecasting systems, (iv) asset/liability analysis and decision-making procedures, (v) liquidity stress testing, including a worst case scenario, (vi) liquidity provision contingency plans, (vii) analysis of the linkages between a bank's foreign exchange operations and its liquidity, its liquidity in foreign exchange, also per currency. Regulation 26-T also covers liquidity risk in its instructions for on-site inspections. It requires that inspectors review the presence of management-approved written policies and procedures for liquidity risk, as well as liquidity monitoring practices. During the current period of liquidity difficulties, the CBR has worked closely with the major banks with large foreign borrowings.</p> <p><b>Criterion 2: The supervisor confirms that banks have a liquidity management strategy, as well as policies and processes for managing liquidity risk which have been approved by the Board.</b> The supervisor also confirms that the Board has an oversight role in ensuring that policies and processes for risk-taking are developed to monitor, control and limit liquidity risk, and that management effectively implements such policies and processes: Through Regulation 119-T, the CBR has issued general guidance on corporate governance in banks, reflecting many elements of international good practice, which includes recommendations to provide for approval of the risk appetite and risk management policies and processes, review of risk limits, monitoring by executive bodies of the bank's risks. Regulation 139-T also makes recommendations on the monitoring of the quality and objectives of banks' risk management strategies. Regulation 26-T on on-site</p>

inspections stipulates that inspectors should review whether a management approved, written, internal strategy exists that defines liquidity risk management policies and the policy for monitoring the status of the bank's liquidity. This strategy should be updated in a timely way, as needed. The CBR may ask more frequent reporting of liquidity positions and conduct special visits to discuss funding and liquidity.

**Criterion 3: The supervisor determines that a bank's senior management has defined (or established) appropriate policies and processes to monitor, control and limit liquidity risk, implements effectively such policies and processes, and understands the nature and level of liquidity risk taken by the bank.** Also with regard to this point, the CBR's recommendations in Regulation 119-T on corporate governance in banks apply, as cited above. In the course of off-site supervision, through the liquidity reports submitted by the banks, as well as through on-site inspections, the CBR examines and evaluates banks' policies and procedures on liquidity management and monitoring and control of liquidity. The supervisor reviews the organization and effectiveness of the internal control function and liquidity risk management systems, including compliance with methodologies used by the banks. Attention is also given to measures taken by the Board to enforce the internal policies and processes. Based on Regulation 26-T, inspectors also review whether the bank has a special unit or dedicated staff responsible for the development of a liquidity risk management strategy. Existence of a management information system for liquidity risk is also checked, as well as management's and the Board's regular review of liquidity policies and practices. Regulation 1379-U on access to the deposit insurance system also requires in Appendix IV information on the implementation of liquidity management policies and procedures, including whether they are monitored on a permanent basis.

**Criterion 4: The supervisor requires banks to establish policies and processes for the ongoing measurement and monitoring of net funding requirements.** The policies and processes include considering how other risks (e.g., credit, market and operational risk) may impact the bank's overall liquidity strategy, and require an analysis of funding requirements under alternative scenarios, diversification of funding sources, a review of concentration limits, stress testing, and a frequent review of underlying assumptions to determine that they continue to be valid: Also see criteria 1-3. Regulation 1176-U on the business plans of banks, in article 3.3.4 requires that applicants for a license submit information on the management of risk, explicitly including liquidity risk. The CBR has been organizing meetings with the major Moscow banks with large foreign exchange borrowings to discuss liquidity adequacy. The CBR has been collecting daily reports from the interbank market to assess bank by bank availability of liquidity, rates and volumes of flows. The CBR has been checking prudential outcomes more frequently, even on a daily basis. The CBR assessed the liquidity situation of the major banks as stable. The CBR is expanding its toolkit to be able to provide liquidity more rapidly, e.g. through a wider range of acceptable collateral. The medium and smaller banks have access to liquidity via Sberbank, as was not fully the case during the 2004 liquidity problems. Banks are explaining to the CBR how they intend to meet their liquidity needs. The CBR expects rates to keep rising for some time, but that liquidity, also in foreign exchange, will remain available, as Russia remains an attractive market. Also, banks are in a much better condition now than in the past.

**Criterion 5: The supervisor obtains sufficient information to identify those institutions carrying out significant foreign currency liquidity transformation.** Where a bank or banking group's foreign currency business either directly or indirectly through lending in foreign currency to domestic borrowers is significant or where a particular currency in which the bank has material exposure is experiencing problems the supervisor requires the bank to undertake separate analysis of its strategy for each currency individually and where

	<p>appropriate set and regularly review limits on the size of its cash flow mismatches for foreign currencies in aggregate and for each significant individual currency: The CBR does not impose particular requirements on banks with regard to foreign currency liquidity. Regulation 1376-U, however, requires the most active banks to file data on foreign currency dealings on a daily basis through form 0409701, and they are subject to the regular open position limits. Most significant Russian banks have currency dealings in only a limited number of currencies, and have strategies to manage their liquidity in these currencies. Through the extensive prudential reporting and open position reporting and the daily information from the major banks the CBR can follow developments adequately. The CBR has been in contact with the major banks on their responses to the recent liquidity difficulties.</p> <p><b>Criterion 6: The supervisor determines that banks have contingency plans in place for handling liquidity problems including informing the supervisor:</b> The CBR currently has no specific regulations requiring banks to have contingency plans for liquidity. However, the CBR has had extensive consultations with banks about their liquidity needs in the current market conditions, and lender of last resort facilities is available to banks on the interbank market and from the CBR. Also see above under criteria 4 and 5.</p>
Assessment	Compliant
Comments	<p>The CBR is currently developing a modified approach to liquidity supervision, taking into account new international insights on liquidity supervision, including guidance developed by the Basel Committee. Strict liquidity ratios are no longer in line with good international practice and do not provide sufficient control of liquidity risk, and limit the effectiveness of supervisory intervention in the area of liquidity. The CBR applies a combination of qualitative and quantitative requirements (so called hybrid approach) for liquidity risk regulation in the Russian banking sector. In the practice of on- and off-site supervision some more sophisticated methods of liquidity risk management are used and banks provide to CBR a reporting form on liquidity based on cash flow (form 0409125). The quantitative ratios used by the CBR allowed to indicate liquidity tensions in a number of banks during the recent financial markets turmoil.]</p> <p>This reflects a shift to a more content based approach, based on a qualitative and quantitative analysis of the risks taken by a bank, the potential impact on a bank's financial stability and depositors' and creditors' interests. The CBR has drafted a set of recommendations for banks' liquidity management; including a recommendation that banks develop a Board-approved Liquidity Management Strategy.</p>
<b>Principle 15.</b>	<p><b>Operational risk.</b> Supervisors must be satisfied that banks have in place risk management policies and processes to identify, assess, monitor and control/mitigate operational risk. These policies and processes should be commensurate with the size and complexity of the bank.</p>
Description	<p><b>Criterion 1: The supervisor requires individual banks to have in place risk management policies and processes to identify, assess, monitor, and mitigate operational risk.</b> These policies and processes are adequate for the size and complexity of the bank's operations and the supervisor confirms that they are periodically adjusted in the light of the bank's changing risk profile and external market developments. The CBR has no specific binding regulations on operational risk management in place at this time, but has issued recommendations through regulations 76-T on "The Organization of Operational Risk at Lending Institutions", and 92-T on "The Organization of Legal Risk and Reputational Risk". Also, inspectors review banks' operational risk practices in accordance with Regulation 26-T. On-site inspections review whether a bank has a basic policy on operational risk.</p> <p><b>Criterion 2: The supervisor requires that banks' strategies policies and processes for the management of operational risk have been approved and are periodically</b></p>

**reviewed by the Board.** The supervisor also requires that the Board oversees management in ensuring that these policies and processes are implemented effectively: Russia intends to implement the Basic Indicator approach to operational risk under Basel II, which requires a flat capital charge of 15 percent of gross revenue. In 2006 the CBR conducted a survey among banks on operational risk. Roughly 1160 (93 percent) banks responded, 10 percent of which stated not to see any problem in operational risk. Some 180 banks are interested in the more advanced approaches to operational risk. Most reported cases involve fraud (external and internal) for severity of losses and/or execution, delivery & process management for number of loss events. The CBR is aware of the need for outreach to the banks on operational risk. Regulation 76-T defines operational risk and recommends that a lending institution place the following issues under the authority of the supervisory Board: (i) approval of the basic principles of the operational risk management strategy, (ii) adapting the organizational structure where needed to lower operational risk, (iii) assuring that the internal control system is adapted to the detection and management of operational risk—e.g., by creating a special unit for operational risk, (iv) putting in place business continuity plans, and (v) assessment of the effectiveness of operational risk management. In more general terms, Regulation 119-T on corporate governance in banks, in more general terms, recommends that the Board of directors monitors the identification and management of banking risks—operational risk is not explicitly mentioned—for instance prior to the introduction of new banking services. It also recommends approval by the Board of directors of a policy to limit banking risks on all operations and monitoring of the implementation of such a policy.

**Criterion 3: The supervisor is satisfied that the approved strategy and significant policies and practices for operational risk are implemented effectively by management.** Inspectors verify that the written risk management policies, including where applicable operational risk, are followed in the bank. The questionnaires attached to Regulation 1379-U on eligibility for the deposit insurance fund require information about banks internal policies for management of inter alia operational risk which have been approved by the banks' management. The questionnaires also ask whether operational risk is estimated on an ongoing basis.

**Criterion 4: The supervisor reviews the quality and comprehensiveness of the bank's business resumption and contingency plans to satisfy itself that the bank is able to operate as a going concern and minimize losses including those that may arise from disturbances to payment and settlement systems in the event of severe business disruption.** In accordance with Regulation 242-P on internal controls, Article 3.7, banks are required to have business continuity plans in place to address any potential disruptions and business continuity problems, which are to be listed, and especially address breakdowns in automated systems and their back-up. Recommendations regarding the preparation of business continuity plans are provided in Regulation 76-T, and the CBR is preparing additional recommendations. In accordance with Regulation 26-T, inspectors review whether a bank has contingency plans in place to assure its continued operation in case of a breakdown.

**Criterion 5: The supervisor determines that banks have established appropriate information technology policies and processes that address areas such as information security and system development and have made investments in information technology commensurate with the size and complexity of operations.** Regulation 242-P on internal control requires in Article 1.2.2 that banks shall have effective internal controls to ensure (i.e.,) information security, i.e., the protection of interests or objectives of a bank covering the totality of information and information infrastructure. In the

	<p>context of the bank licensing process the CBR requires information about the information security arrangements of an applicant for a banking license. Regulation 1176-U on banks' business plans requires in Article 3.3.11 information about safeguarding the activity of the bank, including the material and technical base of the organization, as well as information on IT for the protection of information. The Law on Information, Information Technology and Information Protection FZ 149-FZ lays down requirements with regard to information security. Also, the CBR has issued CBR Standard STO BR IBBS 1.0—2006 "Ensuring Information Security at Russian Banking Institutions", Executive order of the CBR 346-R, provides a "Methodology for the Evaluation of the Compliance with Information Security Measures at Russian Banking Institutions. Regulation 47-T recommends in Article 3.4 that on-site inspectors pay attention to the existence and observance of the bank's rules for protecting information against the unauthorized access and distribution of information.</p> <p><b>Criterion 6: The supervisor requires that appropriate reporting mechanisms are in place to keep the supervisor apprised of developments affecting operational risk at banks in their jurisdictions.</b> Regulation 1376-U requires banks to include operational risk information in their reports under Regulations 242-P on internal controls and 1379-U.</p> <p><b>Criterion 7: The supervisor confirms that legal risk is incorporated into the operational risk processes of the bank.</b> Regulations 76-T and 92-T contain recommendations for operational risk, legal risk and reputational risk. Based on Regulation 26-T, inspectors review the bank's management of these risk areas.</p> <p><b>Criterion 8: The supervisor determines that banks have established appropriate policies and processes to assess, manage and monitor outsourced activities.</b> The outsourcing risk management programs should cover: conducting appropriate due diligence for selecting potential service providers, structuring the outsourcing arrangement, managing and monitoring the risks associated with the outsourcing arrangement, ensuring an effective control environment, and establishing viable contingency planning. Outsourcing policies processes should require the institution to have comprehensive contracts and/or service level agreements with a clear allocation of responsibilities between the outsourcing provider and the bank: At the present time, the legislation in force does not grant the CBR the authority to establish outsourcing requirements for lending institutions. Regulation 76-T recommends that banks keep oversight over any delivery of services they use to perform their activities, as they remain liable for the results. The CBR recommends that outsourcing be carried out on the basis of agreements that provide for a delegation of rights, responsibilities and liability between the lending institution and the service provider. It is also recommended that banks specify in internal policies and procedures a procedure for the regulation of risks associated with outsourcing, including denial of service risk.</p>
Assessment	Largely compliant
Comments	The CBR is preparing draft methodological recommendations for inspection of the application of IT by banks and for the evaluation of the management of technology risks.
Principle 16.	<b>Interest rate risk in the banking book.</b> Supervisors must be satisfied that banks have effective systems in place to identify, measure, monitor and control interest rate risk in the banking book, including a well defined strategy that has been approved by the Board and implemented by senior management; these should be appropriate to the size and complexity of such risk.
Description	<b>Criterion 1: The supervisor determines that a bank's Board approves, and periodically reviews the interest rate risk (IRR) strategy and policies and processes for the identification measuring monitoring and control of interest rate risk.</b> The supervisor also determines that management ensures that the interest rate strategy policies and processes are developed and implemented.

	<p><b>Criterion 2: The supervisor determines that banks have in place comprehensive and appropriate IRR measurements systems and that any models and assumptions are validated on a regular basis.</b> It confirms that banks' limits reflect the risk strategy of the institution and are understood by and regularly communicated to the relevant staff. The supervisor also confirms that exceptions to established policies processes and limits should receive the prompt attention of senior management and the Board where necessary:</p> <p>Regulation 89-P on market risk requires banks to calculate interest rate risk for a series of instruments, using the methodology prescribed in section 2 of the regulation. It has also issued a letter to the banks, No. 15-1-3-6/3995, of October 2, 2007, on international best practice with regard to IRR management, based on Basel Committee documents. This letter does not have binding force, however. The CBR has no specific regulation requiring management and the Board to specifically approve and review IRR, but this is included in the general banking risk management requirements covered by Regulation 242-P, which also mandates the on-site inspectors to review this area. Moreover, Regulation 26-T requires inspectors to review (i) whether the bank has in place and monitors compliance with internal policies and procedures dealing with IRR which have been approved by the Board and management of the bank, (ii) whether internal policies and procedures contain a list of IRR sensitive financial instruments (also see Regulation 89-P) and the limits set on operations with these instruments, (iii) whether the bank has an independent designated unit or staff responsible for following IRR in the bank, (iv) whether IRR is measured on an ongoing basis, (v) whether the bank has reporting systems in place, including reporting to management, and whether these reports are reviewed, (vi) whether the bank has qualified staff to effectively manage IRR, (vii) whether models are used to measure IRR.</p> <p><b>Criterion 3: The supervisor requires that banks periodically perform appropriate stress tests to measure their vulnerability to loss under adverse circumstances.</b> The CBR does not explicitly require at this time that banks conduct interest rate stress tests, but is preparing improved proposals for the conduct of IRR stress tests at banks. The letter of October 2, 2007 (see above) refers to Basel Committee guidance on IRR, which includes stress testing.</p>
Assessment	Largely compliant
Comments	The letter of October 2, 2007 provides information to the banks on IRR management, along the lines of international good practice.
<b>Principle 17.</b>	<p><b>Internal control and audit.</b> Supervisors must be satisfied that banks have in place internal controls that are adequate for the size and complexity of their business. These should include clear arrangements for delegating authority and responsibility; separation of the functions that involve committing the bank, paying away its funds, and accounting for its assets and liabilities; reconciliation of these processes; safeguarding the bank's assets; and appropriate independent internal audit and compliance functions to test adherence to these controls as well as applicable laws and regulations.</p>
Description	<p><b>Criterion 1: Laws, regulations or the supervisor establish the responsibilities of the Board and senior management with respect to corporate governance to ensure that there is effective control over a bank's entire business.</b> General rules on governance and internal control are provided in the Civil Code, the Law on Joint Stock Companies, and the Law on Limited Liability Companies. Corporations are required to form a audit committee to check the activities of the company, and the Board of directors of a company is required to approve internal policies and procedures on internal control. Article 57 CBL provides the CBR with the authority to lay down rules on internal control in a bank. Moreover, the CBR has issued Regulation 242-P on internal control in banks. This regulation gives a definition of internal control, of the system of internal control and</p>

enumerates the bodies involved in internal control. Regulation 242-P, Article 1.2 states that internal control intends to achieve (paraphrased) (i) the efficiency of the conduct of the bank's business, (ii) the efficiency of the bank's management of its balance sheet, (iii) the definition and measurement of an acceptable level of risk, (iv) risk management, (v) the reliability, completeness, objectivity and timeliness of the compilation and submission to the management and the regulator of financial, accounting, statistical and other reports, information security, (vi) the observance of regulatory requirements, (vii) prevention of involvement of the bank in illegal activities including money laundering and terrorist finance. Article 2.2 of Regulation 242-P states that internal controls shall be exercised by the management bodies, the auditor and chief accountant and other staff. Regulation 242 goes on to specify that the Board should have authority over (i) the establishment of effective internal controls, (ii) the regular review of its effectiveness, (iii) the implementation of internal controls, (iv) inspections to review the appropriateness of the internal controls, and creation of mechanisms to enforce internal controls.

**Criterion 2: The supervisor determines that banks have in place internal controls that are adequate for the nature and scale of their business.** These controls are the responsibility of the Board and /or senior management and deal with organizational structure, accounting policies and processes, checks and balances, and the safeguarding of assets and investments. More specifically, these controls address: (i) organizational structure, definitions of duties and responsibilities, including clear delegation of authority, (for example clear loan approval limits), decision making policies and processes, separation of critical functions (for example business origination, payments, reconciliation, risk management, accounting audit and compliance), (ii) accounting policies and processes: reconciliation of accounts, control lists, information for management, (iii) checks and balances (or "four eyes principle") segregation of duties, cross checking, dual control of assets, double signatures, (iv) safeguarding assets and investments, including physical control. See Article 24 of Banking Law and Regulation 242-P .Guidance letter 47-T provides recommendations how the CBR should verify and assess the internal control systems of a bank. These recommendations are to be applied during on-site inspections by the CBR. The preliminary results of a verification and assessment of the organization of internal control in a bank are recommended to be discussed with the CEO of the bank. Article 1.5.1 of Guidance letter 47-T requires verification of the effectiveness and results of the activities of the bank, the effectiveness of the assets and liability management of the bank including preservation of assets. Under Article 1.5.2 of regulation 47-T, the credit organization, internal policies and practices, programs, rules and internal limits are reviewed. Also, the reliability, completeness, and objectiveness of recordkeeping and reporting systems, gathering, storing and processing of information are reviewed, as well as the effectiveness of control techniques. Article 3.1 of Regulation 47-T suggests that inspections should address the distribution of powers within the institution, the chain of command, compliance with rules and regulations, the procedure for Board monitoring of compliance with the internal control policies and practices. Also the independence of the internal control function needs to be assessed according to Article 3.3. Furthermore, Article 3.3 stipulates that information is to be provided on a regular basis to the management and supervisory Boards. Article 3.6 recommends review of the separation of functions and elimination of conflicts of interest.

**Criterion 3: Laws, regulations or the supervisor place the responsibility for the control environment on the Board and senior management of the bank.** The supervisor requires that the Board and senior management understand the underlying risks in their business and are committed to a strong control environment: Article 12 of Federal Auditing Rule No. 13, requires that the management of an organization that is being audited creates

a strong control environment and maintains policies and processes that ensure an optimal outcome of the audit. Regulation 119-T on bank corporate governance stipulates in paragraph 22 that the Board and executive management of a bank understand and are responsible for the results of banking risk management and approve a policy to limit risks on all banking operations and other transactions performed by the bank, and monitor the development by executive management of rules and procedures that are necessary to ensure compliance with these policies. The Board of directors should periodically review the level of risk limits to ensure that they are in line with the bank's business strategy and activities.

**Criterion 4:** The supervisor has the power to require changes in the composition of the Board and senior management to address any prudential concerns related to the satisfaction of these criteria. Articles 60 and 74 of the CBL provide the supervisor with the power to have changes made in the composition of the Board of directors and executive management. This action can ultimately be taken when the bank refuses to comply with for instance the CBR Regulations on internal controls. If violations of the standards are not remedied within the timeframe established by the CBR, or there is a real threat to depositors and creditors.

**Criterion 5:** The supervisor determines that there is an appropriate balance in the skills and resources of the back office and control functions relative to the front office/business origination. Article 1.1 of Regulation 242-P states that the internal control system consists of the totality of management bodies and also subdivisions and employees. Article 4.5 of Regulation 242-P requires that the bank should ensure the professional competency of the manager of the internal audit function as well as its employees. Article 4.6.1 states that the bank shall establish the number of staff of the internal audit function in keeping with the scale of activity and the nature of the bank's operations. Regulation 47-T requires that inspections cover the professional competence of the manager and employees of the internal control function.

**Criterion 6:** The supervisor determines that banks have a permanent compliance function that assists senior management in managing effectively the compliance risk faced by the bank. The compliance function must be independent of the business activities of the bank. The supervisor determines that the Board exercises oversight of the management of the compliance function: Articles 2.2.2 and 2.2.3 of Regulation 242-P provide for the establishment of three different specialized compliance units that assist senior management in managing effectively the compliance risk faced by the bank. They are the "overall compliance" unit, the securities market compliance unit and the anti-money laundering unit. The functions of these units can be combined at the discretion of a credit organization. Article 4.4.8 of Regulation 242-P requires that the internal audit function should check the compliance of the bank's internal policies and procedures with the rules and regulations set by the CBR and with rules set by self regulating agencies, as applicable to the bank. Article 2.2.2 requires that a high ranking bank official is responsible for combating money laundering in the bank. Article 4.7.1. of Regulation 242-P stipulates the independence of the internal audit function. The independence of the internal audit function is supported by the "Main Methods of Internal Audit", in Appendix No. 3 of Regulation 242-P, which authorizes the internal audit unit to gain access to all business units and information in the bank. Article 3.3 of Regulation 47-T recommends verification by the inspectors of the independence and impartiality of the internal control unit. Regulation 47-T does not address explicitly the presence of a permanent compliance function with regard to compliance with applicable rules and regulations. This field is however adequately covered by the other requirements

laid down in the applicable regulations.

**Criterion 7: The supervisor determines that banks have an independent permanent and effective internal audit function** charged with (i) ensuring that policies and processes are complied with and (ii) reviewing whether the existing policies processes and controls remain sufficient and appropriate for the bank's business. The CBR's rules on internal control foresee an internal audit function separate from internal controls procedures and staff effecting current internal control responsibilities. Between the monitoring function of the Board and executive management, the independence of the internal control function, and the review functions of the CBR's on-site inspections, the quality of internal control and internal audit is adequately covered. Article 42 BL requires that a bank's external audit also audits the condition of the internal controls, and covers that aspect in its statement to the annual financial accounts of the bank.

In accordance with Chapter 4 of Regulation No. 242-P, the internal audit function performs the following functions:

- it reviews and evaluates the effectiveness of the internal control system;
- it reviews the compliance of the lending institution's internal documents with regulatory legal acts ;
- it reviews internal control processes and procedures;
- it reviews systems created for the purpose of complying with legal requirements and professional codes of behavior.

In accordance with Letter No. 47-T the organization of internal controls covering all aspects of the internal control system are evaluated in the on-site inspection of the internal control function. According to Regulation No. 242-P, a lending institution should ensure that the staff size, structure, and technical resources of the internal audit function are appropriate to the scale of its activities and the nature of the banking operations and transactions performed. According to Regulation No. 242-P, the internal audit function is required to perform reviews of all areas of a lending institution's activities. Any unit and employee of a lending institution may be the subject of a review. According to Regulation No. 242-P, a lending institution is required to ensure the uninterrupted operation, independence, and impartiality of the internal audit function, and the professional competence of its manager and employees, and to create the conditions for the unhindered and effective performance by the internal audit function of its duties.

At the same time, in accordance with Regulation No. 242-P, a lending institution ensures the independence of the internal audit function following a procedure that must establish that the internal audit function:

- operates under the direct control of the board of directors (supervisory board);
- does not perform activities that are subject to reviews;
- at its own initiative reports to the board of directors (supervisory board) on issues that arise in the course of the performance by the internal control function of its duties, and proposals to address them; and it also discloses this information to the individual executive body and collective executive body of the lending institution;
- is subject to an independent review by an auditing firm or the board of directors (supervisory board), if such a review is provided for by the lending institution's charter.
- an assessment of the internal audit function's performance of its duties in full, to ensure the unhindered and effective performance by the internal control function of its duties, including supervision of the effectiveness of measures taken on the basis of the results of reviews by individual units and management bodies of the lending

	<p>institution and measures to mitigate risks that have been identified, are carried out in accordance with Letter 47-T.</p> <p><b>Criterion 8: The supervisor determines that the internal audit function</b> (i) has sufficient resources and staff that are suitably trained and have relevant experience to understand and evaluate the business they are auditing, (ii) has appropriate independence including reporting lines to the Board and status within the bank to ensure that senior management reacts to and acts upon its recommendations, (iii) has full access to and communications with any member of staff as well as full access to records files or data of the bank and its affiliates whenever relevant to the performance of its duties, (iv) employs a methodology that identifies the material risks run by the bank, (v) prepares an audit plan based on its own risk assessment and allocates its resources accordingly, and (vi) has the authority to assess any outsourced functions: According to Regulation No. 242-P, a lending institution should ensure that the staff size, structure, and technical resources of the internal audit function are appropriate to the scale of its activities and the nature of the banking operations and transactions performed. According to Regulation No. 242-P, the internal audit function is required to perform reviews of all areas of a lending institution's activities. Any unit and employee of a lending institution may be the subject of a review. According to Regulation No. 242-P, a lending institution is required to ensure the uninterrupted operation, independence, and impartiality of the internal audit function, and the professional competence of its manager and employees, and to create the conditions for the unhindered and effective performance by the internal audit function of its duties.</p> <p>At the same time, in accordance with Regulation No. 242-P, a lending institution ensures the independence of the internal audit function following a procedure that must establish that the internal audit function:</p> <ul style="list-style-type: none"> <li>• operates under the direct control of the board of directors (supervisory board);</li> <li>• does not perform activities that are subject to reviews;</li> <li>• at its own initiative reports to the board of directors (supervisory board) on issues that arise in the course of the performance by the internal control function of its duties, and proposals to address them; and it also discloses this information to the individual executive body and collective executive body of the lending institution;</li> <li>• is subject to an independent review by an auditing firm or the board of directors (supervisory board), if such a review is provided for by the lending institution's charter.</li> <li>• Internal Audit unit prepares an audit plan which is to be approved by the Board of Directors of credit institution (Appendix 3 to regulation 242-P)</li> </ul>
Assessment	Compliant
Comments	
<b>Principle 19.</b>	<b>Supervisory approach.</b> An effective banking supervisory system requires that supervisors develop and maintain a thorough understanding of the operations of individual banks and banking groups, and also of the banking system as a whole, focusing on safety and soundness, and the stability of the banking system.
Description	<p><b>Criterion 1. The supervisor has policies and processes in place to develop and maintain a thorough understanding of the risk profile of individual banks and banking groups.</b></p> <p>To develop and maintain a thorough understanding of the risk profile of each bank and banking groups, risk management is assessed by the Bank of Russia as a process of decision making, execution, and control. Off-site supervision receives and analyzes numerous reports on each bank's financial condition and prudential requirements. This off-site monitoring and analysis is undertaken using a software system entitled the "Analysis of</p>

the Financial Condition of Banks" (AFSB), which since 2006 has been accessible at all 78 territorial offices and 7 Regional offices of the Bank of Russia.

In accordance with Article 75 of the Law on the Bank of Russia, the CBR analyzes activities of banks to determine potential situations which could jeopardize the interests of depositors and creditors and the soundness of the banking system. The assessment of the system of bank risk management is made using, inter alia, a weighted point method described in Directive No. 1379-U, as described earlier in the text.

The overarching objective of the on- and off-site supervisory analysis is to determine the degree to which a bank is subjected to various risks, identify activities which contribute to increasing risks, determine potential mitigating measures which could be adopted and how changes in indicators may effect the institution going forward.

Recently the Bank of Russia created an early warning system (EWS) which is soon to be integrated into the system of supervisory practice. The EWS software selected uses a model of forecasting up to six-months' capital adequacy levels at each bank using a modified linear regression method.

**Criterion 2. The supervisor monitors and assesses trends, developments, and risks for the banking system as a whole.** The supervisor also takes into account developments in non-bank financial institutions through close contact with their regulators.

The Bank of Russia systematically monitors the overall banking system utilizing a variety of financial and prudential reports provided by banks. Thus, off-site supervision can identify sensitive risks as reported, determines if the prescribed threshold values are exceeded, in which case analyze what such deviations may indicate for the institution, or if more broadly seen, possible sectoral implications. The CBR publishes an Annual Report with a chapter on banking supervision, and a separate report on developments in the banking system.

The assessment and monitoring of the financial soundness of the banking sector, including off-site monitoring of banking risks, is carried out by the Bank of Russia's lead office in Moscow. Territorial offices of the Bank of Russia are promptly informed the results of this monitoring and conduct more detailed analysis of a situation in banks whose contribution to negative tendencies in the banking sector as a whole was decisive; in instances where potential violations occur, an on-site inspection is arranged, which forms the basis for determining the nature and scope of possible violations. On-site supervision reports its findings through the (comprehensive or targeted) inspection report and accompanying note, which then is used to finalize judgments as to possible supervisory actions, including sanctions, to be taken against banks.

In a bid to systematically assess potential vulnerabilities in the banking system, since 2003 stress-testing of the banking sector has been conducted annually by the Bank of Russia for the 200 largest banks. This exercise has since been expanded to include all 1,100+ institutions in country and is undertaken on a bi-annual basis. Selected results from these stress tests are published in the annual "Banking Supervision Report".

Since 2005 the Bank of Russia recommended that banks organize stress-testing. The bi-annual stress-testing is supplemented by on-site inspections at each. Apparently an increasing number of banks apply stress-testing for risk assessment: in a recent survey, 81 percent of 196 respondents used the stress test approach as recommended by the Bank of Russia.

**Criteria 3. The supervisor used a methodology for determining and assessing on an**

<p><b>ongoing basis the nature, importance, and scope of the risks to which individual banks or banking groups are exposed.</b> The methodology should cover, inter alia, the business focus, the risk profile, and the internal control environment, and should permit relevant comparisons between banks. Supervisory work is prioritized based on the results of these assessments.<sup>10</sup></p> <p>In addition to the systematic monitoring of banks' condition, the Bank of Russia's Territorial offices undertake an abbreviated assessment of the financial condition of banks in accordance with Directive 766-U, entitled "On Criteria for Determining the Financial Condition of Credit Organizations". This assessment is based on two essential criteria -- the bank's condition of capital and liquidity, from which banks are classified into one of two categories, and thereafter in one of two groups within the categories:</p> <p>Category I. Financially stable credit institutions:</p> <ul style="list-style-type: none"> <li>Group 1. Banks with no shortcomings in their activities</li> <li>Group 2. Banks with specific institutional shortcomings</li> </ul> <p>Category II. Problem credit institutions:</p> <ul style="list-style-type: none"> <li>Group 3. Banks experiencing serious financial difficulties</li> <li>Group 4. Banks in critical financial condition</li> </ul> <p>Thus, considering the above groupings and utilizing its existing off-site supervisory reports and on-site inspection findings, Bank of Russia may adopt a different approach to organizing its supervisory processes towards higher risk banks. For example, when organizing supervision of problem banks, the Bank of Russia actively requests additional information from banks about their activities to better accomplish fulfill its mandate. Specifically, utilizing Letter 419, the Bank of Russia has the right to require a more intensive frequency (even daily) of balance sheet submission, the status of a credit organization's capital and numerous other asset quality related standards as laid out in Directive 1376-U.</p> <p>Secondly, the Bank of Russia has just issued Regulation 310-P (to which earlier comments were provided by the mission) entitled "On Curators of Credit Organizations." The imminent introduction of the Curator into Russian bank supervisory practice is slated to contribute to the further development of risk-oriented supervision. The regulation stipulates that the curator will be the primary contact person of the supervisory authority (both on- and off-site) in the Bank of Russia's relations with bank management. The curator will be responsible to accumulate information on the activities of a bank on a more on-going basis, making it possible to better plan risk-oriented supervision.</p> <p>To support this important shift in supervisory responsibilities and to facilitate the Curator's adoption of more qualitative approach to his/her duties, a draft Methodological Guide for the Curator of a Credit Organization (or 'Curator's Ready Reference) book has been prepared. This book is designed to support implementation of the new Regulation for the Curators and Territorial office staff through: (i) better integrating on- and off-site supervision; (ii) cataloguing needed information; (iii) describing the analysis and assessment of the activities of credit organizations required; and (iv) laying out indicators on current and future financial soundness and the quality of management and internal control.</p> <p><b>Criterion 4. The supervisor confirms banks' and banking groups' compliance with prudential regulations and other legal requirements.</b></p> <p>In accord with the Central Bank Law and the Law on Banks, the Bank of Russia establishes</p>
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<sup>10</sup> Please refer to the footnote to Core Principle 1(1), Criterion 1.

	<p>numerous mandatory reporting standards for banks. Compliance with the legal and prudential requirements is assessed by the Bank of Russia off-site supervision, based on reports submitted in combination with the results of on-site inspections of banks. Remedial measures established by Article 74 of the Central Bank Law are applied to banks for violations of prudential norms.</p> <p><b>Criterion 5. The supervisor requires banks to notify it of any substantive changes in their activities, structure, and overall condition, or as soon as they become aware of any material adverse developments, including breach of legal or prudential requirements.</b></p> <p>Banks, if issuers of securities, in accord with Federal Law dated 22/04/1996 № 39-FZ "On the Securities Market," and otherwise through Bank of Russia Instruction 128-I, are obligated to notify the Bank of Russia about changes in their activities entailing increases or decreases in the value of assets, financial results, or about one-time transactions whose size is 10 percent or more of the value of the bank's assets as of the date of the transaction. Similarly, in accord with Directive 1376-U, banks are obligated to notify the Bank of Russia about their failure to meet mandatory standards or to form requisite loan loss provisions.</p> <p><b>Criterion 6. The supervisor has an adequate information system which facilitates the processing, monitoring, and analysis of prudential information.</b> The system aids the identification of areas requiring follow-up action.</p> <p>The Bank of Russia receives numerous reports at different time intervals (daily, every 10 days, monthly, quarterly, biannually, annually), though generally most reports are submitted on a monthly basis. As well, a number of reports are submitted to the Bank of Russia on an ad hoc basis, as material information changes.</p> <p>The monitoring of prudential and financial data are undertaken within the AFCB (Analysis of the Financial Condition of the Bank) system by off-site monitoring. Off-site bank supervision staff throughout the country have access (on a need to know basis) to the AFCB system, wherein banks' reporting data is compiled and analyzed. The main objective of which is to determine the degree of an institution's vulnerabilities to risks and to determine what factors may influence the change in the nature of risks assumed. The AFCB system is likewise expected to aid in monitoring and following up with banks.</p>
Assessment	Largely compliant
Comments	<p>The Bank of Russia has invested significant human and financial resources into on-going (both quantitative and qualitative) supervision (off-site supervision and on-site inspections). Within its existing operating environment the CBR determines the structure of the banking group in the scope provided by current legislation. The CBR has access to a wide range of information about the banking group participants (from reports and another data base available to the CBR) which can be used for the purposes of understanding the risk profile of banks, including risk on related parties) and utilizing its available resources, the Bank of Russia has reasonably strong policies and procedures in place to develop and maintain a thorough understanding of the risk profile of banks. Going forward, this capacity should continue to be improved.</p> <p>To that end, the Bank of Russia has begun to prepare (the estimated adoption time is the second half of 2008) a draft regulatory act "On Modes of Supervision of Credit Organizations" as a basis for more risk based supervision of banks depending on the risk profile and financial soundness of the institution. The draft calls for five modes of supervision (standard, increased attention, overcoming current difficulties, overcoming serious problems, and supervision during a solvency crisis). It is envisaged that the mode of supervision selected by the Territorial offices will be based on the classification of the bank</p>

	<p>in one of the five classification groups as defined by a supporting Draft Directive to be entitled "On Assessment of the Economic Condition of Banks."</p> <p>Based on the mode of supervision, the Territorial offices will develop individual supervision programs for each bank depending on the specific features of its activities and systemic significance. The supervision program developed would stipulate the objectives of the on-site inspection, basic tools and approaches to accomplish the supervision, and also a plan of specific actions for the Territorial offices towards the bank for up to three months.</p> <p>As well, the Bank of Russia is endeavoring to improve the capabilities of its off-site assessment of banks' financial soundness. Thus, a new draft Directive has been prepared, tentatively entitled "On Assessment of the Economic Condition of Banks." This Directive is designed to further integrate the Bank of Russia's off- and on-site supervisory approaches to assessing the activities, performance and potential vulnerabilities of banks. Upon its adoption in January 2008 a more qualitative approach can be used than was put in place in 2004 through 1379-U to assess banks for inclusion in the deposit insurance system.</p> <p>Finally, the Bank of Russia's existing (if limited) use of professional judgment to date is based largely on the provisions established by Article 75 of the Central Bank Law, by which measures can be applied according to the results of its on- and off-site inspections of banks in the event the bank's situation threatens the interests of its depositors or the stability of the banking system. The opportunity to exercise professional judgment is currently limited to circumstances surrounding prudential violations.</p> <p>To improve the Bank of Russia's means to act on a more timely basis, it is necessary to expand its staffs' authority to exercise professional judgment in a variety of non-violation circumstances. Proposals have been advanced to amend the Federal law (specifically, the Central Bank Law) to outline the scope of circumstances and powers of the Bank of Russia to use professional opinion. The mission supports this position: correctly used, risks in the banking sector can be more successfully mitigated.</p>
<b>Principle 20.</b>	<b>Supervisory techniques.</b> An effective banking supervisory system should consist of on-site and off-site supervision and regular contacts with bank management.
Description	<p><b>Criterion 1. The supervisor employs an appropriate mix of on-site and documentary supervision to evaluate the condition of banks and their inherent risks, and takes the corrective measures necessary.</b> The specific mix may be determined by the particular conditions and circumstances of the country. The supervisor has policies and processes in place to assess the quality, effectiveness, and integration of on-site and documentary inspections, and to address any weaknesses that are identified.</p> <p>On- and off-site supervision of banks by the Bank of Russia is a unified process, combining the regular receipt of financial and prudential reports with periodic on-site inspections, of which both comprehensive and focused types are undertaken through 78 Territorial offices and 7 Regional offices. These offices maintain regular contact with banks in their respective regions. Of the 1837 on-site inspections conducted by the Territorial office in 2006, about 937 on-site inspections were of bank headquarters or main offices and 633 were at branch offices. The Moscow Territorial office undertook 528 on-site inspections in 2006.</p> <p>The frequency of regular contact with banks is largely a function of the degree of financial soundness (as determined by off-site supervision), the risk profile of the institution, past regulatory violations and the scope of the problems discovered through current on-site inspections. The imminent introduction of Curators into the supervisory regime is likely to foster increased cooperation with banks, and in time facilitate a more risk-based approach to on-site inspections.</p> <p>In preparation for an on-site inspection, the CBR issued recommendation Letter 169-T,</p>

entitled "On Methodological Recommendations for Preparing for Conducting an Inspection of a Credit Organization." To enhance the effectiveness of on-site inspection and focus upon activities of greatest concern off-site supervision recommends to the on-site inspection division its proposals for including banks to be inspected. These recommendations in the form of a comprehensive 'Audit Requirement' or inspection terms of reference, which is to be followed by the on-site inspectors in the course of their work.

In accord with current bank supervision department practices, the inspection report findings are reviewed for quality and consistency with the terms of reference. Thereafter, supervisory decisions are developed and the (final) on-site bank inspection report is forwarded to the bank for action / comment. Depending upon both the findings and supervisory decisions authorized at the Territorial offices, follow up monitoring is undertaken by both on- and off-site supervision.

The quality and effectiveness of supervision in the Territorial offices and the CBR in general are evaluated by Banking Regulation and Supervision Department and Internal Audit Department of the Bank of Russia.

**Criterion 2. The supervisor has in place a coherent process for planning and executing on-site and off-site activities.** There are policies and processes in place to ensure that such activities are conducted on a thorough and consistent basis with clear responsibilities, objectives, and outputs, and that there is effective coordination and information sharing between the on-site and off-site functions.

According to the results of the regular off-site supervisory analysis of reports received and periodic on-site inspections undertaken, the on-site supervision division prepares the "Consolidated Annual Plan for Inspections of Credit Organizations" for scheduling comprehensive (full scope) inspections. As referenced earlier, the off-site inspection develops the on-site inspection terms of reference.

Inspections in credit organizations are conducted by respective Territorial offices of the Bank of Russia at least once every 18 months in accord with the above 'Consolidated Annual Plan', which is developed based on proposals of the Territorial offices, main office of the Bank of Russia and the Deposit Insurance Agency.

However, the frequency of inspections is dependent upon, inter alia, the bank's financial soundness, susceptibility to risks, the condition of its risk management and internal control systems, frequency of unreliable data identified by the off-site supervision department of the CBR and the results of previous on-site inspections.

**Criterion 3. On-site work, conducted either by the supervisor's own staff or through the work of external experts, is used as a tool to:**

- provide independent verification that adequate corporate governance (including risk management and internal control systems) exists at individual banks;
- determine that information provided by banks is reliable;
- obtain additional information on the bank and its related companies needed for the assessment of the condition of the bank, the evaluation of material risks, and the identification of the necessary remedial actions and supervisory sanctions, including enhanced off-site monitoring;
- monitor the bank's follow-up on supervisory concerns.

On-site inspections are conducted by the Main Inspectorate of the Bank of Russia and the relevant Territorial office. For banks with significant branches in different regions of the

country, the Main Inspectorate coordinates inter-regional inspection teams with the respective Territorial offices, finalizes inspection staffing plans, changes the Consolidated Plan if necessary, and takes decisions on conducting unscheduled inspections.

The on-site bank inspections are conducted in accordance with approved terms of reference, following Bank of Russia Instruction 108-I and Directive 1542-U, entitled "On Special Features of Conducting Inspections of Banks with Participation of Employees of the State Corporation 'Deposit Insurance Agency.'" To support the on-site inspection process, the Bank of Russia has issued numerous internal procedures, such as: (i) preparations for on-site inspections; (ii) requirements for specific aspects of on-site inspections; (iii) determining the legitimacy of sources of equity capital; (iv) evaluations of internal control and banking risk management systems; (v) formalizing the results of inspections.

As described in Article 73 of the Law on the Central Bank, the decision to undertake an unscheduled inspection is taken by the Board of Directors of the Bank of Russia, the Chairman of the Bank of Russia, the Banking Supervision Committee of the Bank of Russia, by the manager of a Territorial office of the Bank of Russia, or by the Inspector General of the Main Inspection.

**Criterion 4. Off-site work is used as a tool to:**

- regularly review and analyze the financial condition of individual banks using prudential reports, statistical data, and other necessary information, including publicly available information;
- follow up on matters requiring special attention, evaluate developing risks, and help identify the priorities and scope of further work;
- help determine the priorities and scope of on-site inspections.

The principal objective of off-site supervision is to obtain sufficient information to understand the current status at a bank, to adequately assess its financial soundness, verify the reliability of the information submitted and the bank's compliance with current laws and regulations. This is done so as to identify at the earliest possible stage issues which may undermine the solvency of the institution, threaten the interests of its depositors and other creditors and to ensure the timely application of corrective measures to address any regulatory breaches.

To fulfill this task, off-site supervision at the respective Territorial office receives and analyzes a large number of reports (see CP21.1 for a partial listing). During the course of its on-going analysis, off-site supervision identifies, inter alia, areas of concern regarding financial performance, increased risks and/or regulatory violations. The analysis may then be discussed with the bank and/or Territorial office inspection staff. Depending upon the outcome from these discussions, the bank may receive either recommendations or instructions to eliminate noted violations within a prescribed time.

In combination with the data derived from periodic on-site inspections and available market information, the Bank of Russia can generally maintain an informed view of the risk profile of most banks.

**Criterion 5. Based on the risk profile of individual banks, the supervisor maintains sufficiently frequent contacts as appropriate with bank boards, non-executive directors, audit committees, and senior and middle management (including heads of individual business units and control functions) to develop a better understanding of and assess such matters as strategy, group structure, corporate governance, performance, capital adequacy, liquidity, asset quality, and risk management**

<p><b>systems.</b></p> <p>The frequency of regular contact with banks is largely dependent upon the degree of financial soundness, the risk profile of the institution, past regulatory violations and the severity of the problems discovered through on-site inspections. Territorial offices maintain regular contact with banks in their respective areas, which is strengthened through more frequent, targeted on-site inspections. Further to which, the imminent introduction of Curators into the supervisory regime is likely to foster increased cooperation with banks and in time, a more risk-based approach to on-site inspections.</p> <p><b>Criterion 6. On an ongoing basis during off-site observation and on-site inspections, the supervisor considers the quality of the Board and management.</b></p> <p>Regulation 119-T on bank corporate governance stipulates in paragraph 22 that the Board and executive management of a bank understand and are responsible for the results of banking risk management and approve a policy to limit risks on all banking operations and other transactions performed by the bank, and monitor the development by executive management of rules and procedures that are necessary to ensure compliance with these policies. The Board of directors should periodically review the level of risk limits to ensure that they are in line with the bank's business strategy and activities.</p> <p>In accord with the approved inspection terms of reference and Bank of Russia recommendation 102-T, specific aspects of a bank's credit and interest rate policies towards related party loans are thoroughly reviewed during on-site inspections. Bank of Russia Letter recommendation 86-T entitled "On Methodological Recommendations for the Model Structure and Content of a Lending Institution (Branch) Inspection Report" requires that an inspection report contains, amongst other elements: (i) a separate assessment of the credit risks and group concentration for connected borrowers; (ii); off-balance sheet commitments; (iii) related parties of the institution, including subsidiary and parent borrowers groups. Bank of Russia on-site inspectors compare terms and conditions of insider loans to market terms. Finally, Board of Directors' meeting minutes are scrutinized during the on-site inspection to, inter alia; identify voting patterns, possible conflicts of interest and how such may have been addressed at the Board meeting. Please reference CP 7.1-4 for specific references as to how banks' Board of Directors and senior staff are to engaged in the risk management function, and moreover, how the Bank of Russia supervisory staff evaluate compliance.</p> <p><b>Criterion 7. The supervisor evaluates the work of the bank's internal audit function and determines whether, and to what extent, it may rely on the internal auditors' work to identify sources of potential risk.</b></p> <p>Early in the on-site inspection, each (larger) bank which has a staffed internal compliance control (or audit) function is thoroughly evaluated, as this cross-cutting role is viewed as critical to the bank's on-going, independent assessment of risk management processes. The on-site inspectors review the board of directors' meeting meetings, material changes to internal processes and the internal audit report findings and recommendations.</p> <p>To the extent the compliance control function is not well resourced, its operation constrained or its findings not acted upon by the board of directors, the scope of the Bank of Russia on-site inspection may expand accordingly.</p> <p><b>Criterion 8. The supervisor communicates to the bank the findings of its on- and off-site supervisory analyses by means of written reports or through meetings with management.</b></p> <p>In accordance with current practice, findings from the on-site inspection and off-site</p>
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	<p>supervisory decisions are integrated at the Territorial offices. Each on-site bank inspection produces a written draft report, which after appropriate review is forwarded to the bank for action. After the on-site inspection report is reviewed and bank's financial condition analyzed, the off-site supervision division communicates its recommendations or requirements to take appropriate corrective actions to the bank. Depending upon the findings and recommendations, follow up monitoring is undertaken by both on- and off-site supervision.</p>
Assessment	Largely compliant
Comments	<p>The Bank of Russia has a complex national supervisory regime utilizing 78 Territorial offices which integrate off-site supervision with frequent on-site bank inspections through 7 Inter-regional (on-site inspection) offices. Off-site supervision analyzes financial and prudential data received through receipt of its regular reporting requirements. Scheduled on-site inspections appear to be thorough, yet rather compliance (quantitative) oriented, covering most areas of a bank's operations. In the event a negative trend is detected however from off-site supervision, the request for an on-site inspection is made. The number of unplanned inspections was reduced from 839 in 2003 to 416 in 2006. From the second half of 2005 to the first half of 2007 the number of unplanned inspections as a proportion of the total number of inspections remains unchanged at a level of about 30 per cent.</p> <p>Off-site supervision findings serve to shape the preparation of the annual on-site inspection plan, and more importantly, each on-site inspection terms of reference, which is narrowly defined, but can be augmented with specific areas of particular interest with regard to the bank in question. According to existing legislation the CBR is able to inspect a specific area of operations of a certain bank only once per inspection period. If needed the Board of Directors of CBR can approve a follow-up inspection of a particular aspect.</p>
<b>Principle 21.</b>	<b>Supervisory reporting.</b> Supervisors must have a means of collecting, reviewing and analyzing prudential reports and statistical returns from banks on both a solo and a consolidated basis, and a means of independent verification of these reports, through either on-site examinations or use of external experts.
Description	<p><b>Criterion 1. The supervisor has the right<sup>11</sup> to require banks to submit information, on both a solo and a consolidated basis, on their financial condition, performance, and risks, at regular intervals.</b> These reports provide information on such matters as on- and off-balance sheet assets and liabilities, profit and loss, capital adequacy, liquidity, large exposures, asset concentrations (including by economic sector, geography, and currency), asset quality, loan loss provisioning, related party transactions, interest rate risk, and market risk.</p> <p>The Bank of Russia's rights to establish mandatory reporting procedures for banks is well laid out in Articles 4 and 57 of the Central Bank Law. Supporting implementation of this law, Bank of Russia Directive 1376-U was issued to describe most mandatory reports and procedures for compilation and transmittal to the CBR.</p> <p>The following key reports are used for supervisory purposes:</p> <ul style="list-style-type: none"> <li>• "Working Statement for Accounts of a Credit Organization" (Form 0409101);</li> <li>• "Profit and Loss Statement" (Form 0409102);</li> <li>• "Calculation of Equity (Capital)" (Form 0409134);</li> <li>• "Consolidated Market Risk Report" (Form 0409153);</li> <li>• "Information on Mandatory Standards" (Form 0409135), which contains, inter alia,</li> </ul>

<sup>11</sup> Please refer to CP 1(3).

	<p>information about capital adequacy;</p> <ul style="list-style-type: none"> <li>• "Data on Large Credits" (Form 0409118), contains information about the concentration of credit risks (groups of related borrowers);</li> <li>• "Information about Assets and Liabilities by Call and Repayment Dates" (Form 0409125), containing information about a bank's liquidity position;</li> <li>• "Information on Quality of Loans, Loan and Equivalent Indebtedness" (Form 0409115), containing information on loan loss provisions;</li> <li>• "Information on Loan Loss Reserves" (Form 0409155), containing information on the quality of other assets, contingent liabilities of a credit nature, as well as loan loss provisions;</li> <li>• "Information on Credits and Indebtedness under Credits, Issued to Borrowers of Various Regions" (Form 0409302), includes loan by economic sector, geographic region, and currency;</li> <li>• "Report on the Composition of Members of a Banking (Consolidated) Group" (Form 0409801), including information on legal entities whose activities the bank may influence;</li> <li>• "Consolidated Balance Sheet" (Form 0409802), including information broken down by banking group participants, which enables the supervisor to better understand the economic and geographic concentration of the group's assets;</li> <li>• "Consolidated Profit and Loss Statement" (Form 0409803), including information on the financial results of the group's activities for which the consolidated balance sheet is compiled;</li> <li>• "Report on Mandatory Standards of the Banking (Consolidated) Group" (Form 0409805), reports the capital of the group and on its compliance with the prudential norms established by the Bank of Russia;</li> <li>• "Report on Internal Control in the Credit Organization" (Form 0409639), including information on the internal control functions of the bank.</li> </ul> <p>The Bank of Russia intends to improve the above reporting regime through the introduction of new, additional report forms to obtain more complete risk related information. In particular, beginning in 2008, it is planned to introduce the following new reporting forms:</p> <ul style="list-style-type: none"> <li>• "Information on Securities Acquired by a Credit Organization", providing the Bank of Russia detailed information on securities acquired by a bank, broken down by issuer as well as the current fair value of these securities;</li> <li>• "Information on the Credit Risk Level for Financial Instruments Reflected in Off-Balance Sheet Accounts";</li> <li>• "Information on Interest Rate Risk".</li> </ul> <p>To further the implementation of risk-oriented supervision and usage of (consolidated) reporting principles more consistent with IFRS<sup>12</sup> it is envisaged that in 2008 the CBR will update the following forms: "Information on the Quality of Loans and Equivalent Indebtedness" (Form 0409115), "Data on Large Credits" (Form 0409118), and "Information on Assets and Liabilities According to Call and Repayment Dates" (Form 0409125).</p> <p>In sum, the Bank of Russia receives a large number of financial performance and prudential</p>
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<sup>12</sup> For example, the principles of substance over form, and IFRS requirements for information disclosure.

reports, from which it undertakes a thorough analysis. Most of the referenced reports are now said to be accessible on-line to appropriate staff.

**Criterion 2. The supervisor provides report instructions that clearly describe the accounting standards to be used in preparing supervisory reports.** Such standards are based on accounting principles and rules that are widely accepted internationally.

In accord with Directive 1375-U, section 4.4 entitled "On Rules for Compiling and Submitting Reports by Credit Organizations to the Russian Federation Central Bank" all reporting data submitted to the Bank of Russia must be based on accounting standards promulgated through Bank of Russia Regulation 205-P, entitled "On Rules for Performing Accounting at Credit Organizations Located on the Territory of the Russian Federation."

Importantly however, beginning January, 1 2008, a new Bank of Russia Regulation will come into force, 302-P, entitled "On Rules for Performing Accounting at Credit Organizations Located on the Territory of the Russian Federation." This new standard will require banks to report on a basis of accounting significantly closer to IFRS. Section 1.12 of 302-P determines the main new requirements for performing accounting such as using of accrual methods (p. 1.12.2) and fair value concept (for financial assets and liabilities – p. 1.12.11). Those methods are to be used by banks in modifying / adopting their accounting policy.

**Criterion 3. The supervisor requires banks to utilize valuation rules that are consistent, realistic, and prudent, taking account of current values where relevant.**

The basic accounting principles followed by banks are defined through Bank of Russia Regulation 205-P, paragraph 1.12. The new version of accounting disclosure requirements, effective January 1, 2008 (Regulation 302-P), will introduce accrual accounting determines inter alia which accounting principles will be introduced for accruals and mark-to-market valuation of assets or through creating new loan loss provisions.

**Criterion 4. The supervisor collects and analyzes information from banks at a frequency (e.g., monthly, quarterly, annually) commensurate with the nature of the information requested, and the size, activities, and risk profile of the individual bank.**

The Bank of Russia receives prudential reports at various frequencies (daily, every 10 days, monthly, quarterly, biannually, annually), though most are provided monthly. Additionally, a number of reporting forms are submitted on an ad hoc basis.

The frequency of submitting reports is dependent in part on the bank's financial soundness. In the event increases risks are identified, the Bank of Russia has the right to increase the frequency of submitting reports, as authorized in Letter 419, entitled "On Measures to Intensify Supervision of Credit Organization Activities".

**Criterion 5. In order to make meaningful comparisons between banks and banking groups, the supervisor collects data from all banks and all relevant entities covered by consolidated supervision on a comparable basis and related to the same dates (stock data) and periods (flow data).**

Banks which serve in the lead (or parent) role of a banking group submit to the Bank of Russia report on both an individual bank and on consolidated basis in accord with two Bank of Russia regulations. In accordance with the Bank of Russia Procedural Directive dated. 30.07.2002 № 191-P "On consolidated Reports" the head credit organization alongside with the consolidated reports submits to the Bank of Russia the specific subsidiary reporting, prepared according to the sectoral rules. The consolidated reporting rules presume its

submission for every specific subsidiary. It makes it possible for the Bank of Russia to assess their assets and liabilities separately. This allows the Bank of Russia to make adequate assessments of risks, taken by the group and every specific subsidiary.

The Bank of Russia has the right to require a banking group to submit financial information on their subsidiaries' activities. Thus, banks which serve in the lead (or parent) role of a banking group submit to the Bank of Russia reports on both an individual bank and on consolidated basis in accord with CBR regulations.

- Regulation 191-P, entitled "On Consolidated Reporting,"
- Regulation 246-P, entitled "On the Procedure for Compiling of Consolidated Reports by the Head Credit Organization of a Banking (Consolidated) Group,"
- Directive 1270-U, entitled "On Published Reports of Credit Organizations and Banking (Consolidated) Groups").

Nonetheless, the consolidated reports have been developed based on the individual bank reporting forms. The following key quarterly reports feature information on a group or consolidated basis:

- "Report on the Composition of Members of a Banking (Consolidated) Group" (Form 0409801), including information on legal entities whose activities the bank may influence;
- "Consolidated Balance Sheet" (Form 0409802), including information broken down by banking group participants, which enables the supervisor to better understand the economic and geographic concentration of the group's assets;
- "Consolidated Profit and Loss Statement" (Form 0409803), including information on the financial results of the group's activities for which the consolidated balance sheet is compiled;
- "Report on Mandatory Standards of the Banking (Consolidated) Group" (Form 0409805), reports the capital of the group and on its compliance with the prudential norms established by the Bank of Russia;

The Bank of Russia undertakes regular off-site analysis of these and other reports, and evaluates the bank's performance on an individual and to the extent practical, a consolidated basis to assess the effect of the bank's investments in subsidiaries to its financial soundness.

**Criterion 6. The supervisor has the power to request and receive any relevant information from banks, as well as any of their related companies, irrespective of their activities, where the supervisor believes that it is material to the financial situation of the bank or banking group, or to the assessment of the risks of the bank or banking group.** This includes internal management information.

In accord with Article 57 of the Central Bank Law, the Bank of Russia has the right to request and receive any necessary information about a bank's activities or that of a related (subsidiary) group directly from the management of the bank as the 'parent' group. However, as noted earlier, the Bank of Russia has no right to access related group financial information at a "vertical" (with regard to holding companies or parents) or "horizontal" ("sister" companies) level.

	<p><b>Criterion 7. The supervisor has the power of full access<sup>13</sup> to all bank records for the furtherance of supervisory work.</b> The supervisor also has similar access to the bank's Board, management and staff, when required.</p> <p>As established by Directive 1376-U, banks are obliged to submit to the Bank of Russia any explanations as to reports submitted and other information as may be requested. This power to request any information necessary to support either an on-site inspection or off-site supervision is defined in Instruction 105-I. In practice, the Bank of Russia has no impediment to the receipt of requested bank or subsidiary information.</p> <p><b>Criterion 8. The supervisor has a means of enforcing compliance with the requirement that the information be submitted on a timely and accurate basis.</b> The supervisor determines that the appropriate level of senior management is responsible for the accuracy of supervisory returns, can impose penalties for misreporting and persistent errors, and can require that inaccurate information be amended.</p> <p>In accord with Article 74 of the Central Bank Law and Article 20 of the Law on Banks, the Bank of Russia has the right to apply sanctions on a bank for failure to submit reports, or if incomplete, unreliable or delayed. Reports submitted to the Bank of Russia, in accordance with Directive 1375-U, must be signed by one of several senior officers of the institution who are responsible for the timely, complete, and reliable submission of information.</p> <p><b>Criterion 9. The supervisor utilizes policies and processes to confirm the validity and integrity of supervisory information.</b> This includes a program for the periodic verification of supervisory returns by means either of the supervisor's own staff or of external experts.<sup>14</sup></p> <p>The Bank of Russia conducts both comprehensive and focused or limited scope on-site inspections of banks, inter alia, to verify the reliability of banks' reporting. To this end, the Bank of Russia issued recommendation 77-T, entitled "On Methodological Recommendations for Organizing and Conducting Verification of the reliability of accounting (reporting) of a credit organization (its branch)".</p> <p>In practice the Bank of Russia does not engage external experts to assist in the verification of its supervisory reports. However, it does regularly utilize bank's annual external audits as another means of validating their understanding of the banks' financial condition.</p> <p><b>Criterion 10. The supervisor clearly defines and documents the roles and responsibilities of external experts<sup>15</sup> including the scope of the work, when they are appointed to conduct supervisory tasks and monitors the quality of the work.</b> External experts may be utilized for routine validation or to examine specific aspects of banks' operations.</p> <p>In general, the Bank of Russia does not engage external experts to assist in its supervisory responsibilities. It does require that an external auditor be appointed. Special on-site inspections are undertaken by employees of the CBR, though an external auditor may be appointed by the Bank of Russia Board of Directors in the event such is deemed necessary to review the bank's condition.</p>
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<sup>13</sup> Please refer to CP 1(4).

<sup>14</sup> May be external auditors or other qualified external parties, commissioned with an appropriate mandate, and subject to appropriate confidentiality restrictions.

<sup>15</sup> May be external auditors or other qualified external parties, commissioned with an appropriate mandate, and subject to appropriate confidentiality restrictions. External experts may conduct reviews used by the supervisor, yet it is ultimately the supervisor that must be comfortable with the results of the reviews conducted by such external experts.

	<p><b>Criterion 11. The supervisor requires that external experts bring to its attention promptly any material shortcomings identified during the course of any work undertaken by them for supervisory purposes.</b></p> <p>The Bank of Russia does not have the legal authority to require external audit firms to bring to its prompt attention any material shortcomings identified in the course of an external audit.</p>
Assessment	Largely compliant
Comments	<p>Both on-site bank supervision and off-site bank inspections are undertaken by Bank of Russia staff. However, the filing of consolidated statements by banking groups, wherein all the subsidiary holdings are placed together, does not permit the Bank of Russia to readily understand or quantify risks emanating from placement under a joint holding company or from non-subsidiary (horizontal or 'sister') group holdings. In accord with best practice, this financial reporting standard should be modified to require separate filings for each related group holding. Nevertheless, the CBR has issued recommendations to banks to publish IFRS compliant accounts, which includes consolidated accounts.</p> <p>Equally, the Bank of Russia does not have the right to receive from external auditors prompt notice about information discovered on potential serious violations with the activities of the bank. Such early notice can be an extremely valuable supervisory tool to mitigate risks. Amendments (to the Law "On Audit Activities") should be sought to effect this change as quickly as possible.</p> <p>Nevertheless CBR staff in accordance with Instruction 105-I can ask and receive from the inspected lending institution or its branch any documents necessary for the examination including external auditor's reports. Apart from that following the CBR guidance on the examination of business lines of a lending institution (its brunch) CBR representatives analyze the external auditor's reports over pre-inspection period.</p> <p>With the objective to strengthen reporting requirements by both the external auditors and banks, the Bank of Russia is developing draft regulations and directive as follows, for adoption in 2008:</p> <ul style="list-style-type: none"> <li>• Bank of Russia Regulation "On the Procedure for Conducting Competitive Selection of Audit Organizations for Conducting Inspections of Credit Organizations (Their Branches) at the Direction of the Board of Directors of the Bank of Russia;"</li> <li>• Bank of Russia Directive "On Specific Features of Conducting Inspections of Credit Organizations (Their Branches) by Audit Organizations at the Direction of the Board of Directors of the Bank of Russia".</li> </ul>
<b>Principle 22.</b>	<b>Accounting and disclosure.</b> Supervisors must be satisfied that each bank maintains adequate records drawn up in accordance with accounting policies and practices that are widely accepted internationally, and publishes, on a regular basis, information that fairly reflects its financial condition and profitability.
Description	<p><b>Criterion 1: The supervisor has the power to hold bank management and the bank's Board responsible for ensuring that financial record keeping and the data they produce are reliable:</b></p> <p>The Federal Law on Accounting imposes a general obligation on CEOs of corporations to establish record keeping systems and ensure compliance with legislation. The Chief Accountant is subordinated to the CEO and is responsible for elaboration of accounting policy, record-keeping and timely filing accounting statements. Regulation 1375-U requires that the CEO and chief accountant of a bank sign the reports submitted by the bank to the CBR. Article 74 CBL stipulates that the CBR may take corrective action against banks that</p>

do not submit the required information in a timely, accurate, and complete fashion. These actions can consist of requiring that the bank remedy the situation, impose a fine, or restrict activities. If remedial action is not taken by the bank, more intrusive measures can be taken, also under Article 74 CBL. Article 19 BL reinforces that the CBR can take action under the CBL against banks that fail to present information or present incorrect or incomplete information. Many banks, especially the larger ones, have sophisticated data systems that support IFRS as well as RAS.

**Criterion 2: The supervisor has the power to hold bank management and the bank's Board responsible for ensuring that the financial statements issued annually to the public receive proper external verification and bear an external auditor's opinion:**

Article 42 BL states that banks', banking groups' and bank holdings' consolidated financial statements and reports shall be audited by a licensed external auditor once a year. The accounting rules to be applied shall be set by the CBR. The auditing standards are not set by the CBR. According to the Article 42 BL the audit report shall express an auditor's opinion whether the financial statements of the bank are accurate and reliable, fulfillment of the regulations of the CBR, quality of the management of the bank, and condition of the internal control systems as well as other questions stipulated by federal laws and bank's charter. The bank shall publish its report no later than ten working days after the adoption by the shareholders meeting. The bank shall then submit the auditors' report to the CBR three days after the adoption by the shareholders meeting. The notes to the annual statements are not published.

The financial statements published in the mass media are in abridged form, as set by the CBR, and do not include the notes to the accounts. Lending institutions' publicly published balance sheets and P&L statements are prepared quarterly in aggregated form in accordance with report forms 101 and 102, and on the January 1 in accordance with the annual report data. Additionally, in accordance with 192-U banks have to provide their customers with the following information: the copy of license authorized by the Bank of Russia, bank's balance sheet on a monthly basis (form 101), statement of loss and profit on an annual basis (form 102), the published financial statements for the last year with the external audit conclusion by putting it in a publicly visible place in their offices. Simultaneously the CBR recommends to banks to present the forms 101 and 102 in aggregated forms prepared under the rules for compiling the published financial statements. Article 43 BL states that the annual financial statements, comprising balance sheet and P&L account are published in the open press, after it has been audited. Article 8 BL states that banks shall publish its balance sheet and P&L statement on a quarterly basis, as well as information on capital adequacy and provisioning.

**Criterion 3: The supervisor requires banks to utilize valuation rules that are consistent, realistic and prudent, taking account of current values where relevant and to show profits net of appropriate provisions:**

Banks' mandatory published and audited financial statements are prepared using Russian Accounting Standards (RAS). The rules envisage regular revaluation at market value of financial assets traded in the open market, as well as foreign exchange assets and liabilities, valued at the CBR rate. Before January 1, 2008, assets not traded in the markets were held at historic cost with creation of provisions. The CBR points out that RAS are based on the same principles underlying IFRS (nb. this does not mean that RAS are identical to IFRS to the full extent): going concern basis, consistency of accounting rules, prudence, timeliness of recording operations, separate recording of assets and liabilities, substance over form, and transparency. Before January 1, 2008, RAS were based on cash

accounting as opposed to accrual accounting required by IFRS. Importantly however, beginning January 1, 2008, a new Bank of Russia Regulation has come into force, 302-P, entitled "On Rules for Performing Accounting at Credit Organizations Located on the Territory of the Russian Federation." This new standard will require banks to report on a basis of accounting significantly closer to IFRS. Regulation 302-P envisages posting income and expenditures on the accrual basis, placing securities into categories prescribed by IFRS, periodic evaluation of securities according to their fair value with posting the financial results of this evaluation to P&L account or capital. The CBR's rulemaking authority in this area is limited, as the rules for banks need to stay within the standards set by the Ministry of Finance for corporations in general, in accordance with the law on accounting. In accordance with the Article 57 of the BL the CBR sets the accounting rules for operations which the BL is considering to be the banking ones. The CBR may impose additional rules on banks which intend to provide more detail for existing standards, or which narrow the options for bank statements. The CBR requires banks to prepare IFRS statements and recommends banks to publish it in addition to the obligation to publish RAS statements. The CBR has prepared an analysis of the remaining differences between RAS and IFRS, and has compared the capital adequacy outcomes for banks, using RAS and IFRS.

**Criterion 4: Laws or regulations set, or the supervisor has the power, in appropriate circumstances, to establish the scope of external audits of individual banks and the standards to be followed in performing such audits.**

The CBR does not have direct powers to determine the scope of individual banks' external audits. The CBR can file complaints with the Ministry of Finance in case of an inadequate audit which is the regulator for the audit activities. The CBR does not determine the auditing standards to be applied. The auditing standards are set by the Ministry of Finance. Those standards are developed with the participation of the CBR, so the CBR is the member or the Audit Council, which is responsible for that matter. The content of the auditors' statements is stipulated by BL. The Article 42 demands that the audit report shall express an opinion whether accounts reflect the true and fair value of the institution, and in particular contain information on the accuracy of the financial statements of the bank, fulfillment of the regulations of the CBR, quality of the management of the bank and condition of the internal control systems.

The uniform format of the auditor's statement is established by Regulation (Standard) № 6 "Auditor statement on financial (accounting) reporting", approved by Decree № 696 of the Government of the Russian Federation, dated September 23, 2002. However, it does not envisage including information as to whether the credit organization is in compliance with the mandatory regulations set forth by the Bank of Russia, quality of its corporate governance, state of risk management systems, internal controls and a number of other important parameters of the activities of the credit organization, which, in accordance with the Article 42 of the Law on Banks, should be contained in the Auditor statement on reporting of the credit organization. Therefore, there is a conflict between the standard in question and the Law on Banks. In order to resolve this situation, in 2005, the Bank of Russia prepared and submitted to The Ministry of Finance of Russia proposals on developing methodological guidelines "Special features of the audit of credit organizations and banking (consolidated) groups." According to the information available, the Ministry of Finance of Russia is working on this issue.

**Criterion 5: Supervisory guidelines or local auditing standards shall determine that audits cover such areas as the loan portfolio, loan loss reserves, non-performing assets, asset valuations, trading and other securities activities, derivatives, asset securitizations, and the adequacy of internal controls over financial reporting.**

Article 42 BL and Regulations 1270-U and 1376-U determine that the audit needs to cover the accuracy of the financial statements, fulfillment of the CBR standards, management quality, condition of internal control, and other legal and regulatory provisions. Regulation 1270-U states that information on capital adequacy and provisions, as well as information on other assets is to be published quarterly. Also see under Criterion 2.

**Criterion 6: The supervisor has the power to reject and rescind the appointment of an external auditor that is deemed to have inadequate expertise or independence or not to be subject to, or not follow established professional standards.**

The supervisor does not have the power to reject the external auditor of a bank or rescind the contract between an external auditor and a bank. Article 42 BL does require that the external auditor be licensed under Russian law to perform such audits. Two years experience as an auditor is one of the requirements to perform a bank audit. Current legislation doesn't give to the CBR power to require performance of additional audits). If the CBR considers an audit inadequate, the CBR can also file a complaint with the Ministry of Finance, which issues and withdraws auditing licenses and request to have the license of an auditor withdrawn. The CBR has in fact several times filed complaints with the Ministry of Finance. Besides the licensing of the audit activities and the approval of the auditing standards the Ministry of Finance is responsible for organization of the training for professional auditors and for ensuring that accountants also have adequate sector specific knowledge, verify compliance with licensing requirements for auditors and compliance with auditing standards. The Ministry of Finance can also take disciplinary actions against auditors, such as license withdrawal. The large international firms dominate the bank audit market. In banks in which the State has participation, the CBR can participate in reviewing the external auditor's tenders.

The CBR regional offices regularly hold meetings with the external auditors of banks in their region, but the CBR does not have the possibility to influence the choice of auditors or require their replacement.

**Criterion 7: The supervisor requires banks to produce annual audited financial statements based on accounting principles and rules that are widely accepted internationally and have been audited in accordance with internationally accepted auditing practices and standards.**

Currently, the mandatory annual financial statements of banks are not based on International Financial Reporting Standards (IFRS), but on Russian Accounting Standards (RAS). Many prominent banks however also issue IFRS compliant statements, and the CBR recommends that banks base the financial statements published on the web, or in mass media, on IFRS. The CBR points out that RAS are based on the same principles underlying IFRS (nb. this does not mean that RAS are identical to IFRS to the full extent): going concern basis, consistency of accounting rules, prudence, timeliness of recording operations, separate recording of assets and liabilities, substance over form, and transparency. The CBR has prepared an internal analysis on the remaining differences between RAS and IFRS; moreover, a comparative table has been prepared by the CBR over 2004 and 2005 of banks' balance sheets and income statements according to RAS and IFRS. Importantly however, as mentioned under criterion 3, beginning January 1, 2008, a new Bank of Russia Regulation has come into force, 302-P, entitled "On Rules for Performing Accounting at Credit Organizations Located on the Territory of the Russian Federation", which envisages, in particular, posting income and expenditures on the accrual basis, qualifying securities into categories prescribed by IFRS, periodic evaluation of securities according to their fair value with posting the financial results of this evaluation to

	<p>P&amp;L account or capital.</p> <p><b>Criterion 8: Laws, regulations or the supervisory rules require periodic public disclosure of information by banks that adequately reflect the bank’s true financial condition.</b> The requirements imposed should promote the comparability, relevance, reliability and timeliness of the information disclosed:</p> <p>Article 42 BL requires publication of the audited annual statements of a bank. Regulation 1270-U requires quarterly publication of a balance sheet and P&amp;L statement, information on capital adequacy and provisions. All institutions and consolidated groups shall publish annual reports with this information. Regulation 302-P envisages accrual accounting. Annual financial statements are audited by an external auditor based on RAS, which, although different—inter alia, because they are based on cash accounting—is based on the same accounting principles as those underlying IFRS. These principles support consistency, comparability, and relevance. The CBR does not have access to the working papers of the auditor. At this time, this matter is being discussed within auditor’s community only.</p> <p><b>Criterion 9: The required disclosures include both qualitative and quantitative information on a bank’s financial performance, financial position, risk management strategies and practices, risk exposures, transactions with related parties, accounting policies, and basic business, management and governance.</b> The scope and content of information provided and the level of disaggregation and detail should be commensurate with the size and complexity of a bank’s operations:</p> <p>Article 42 BL requires audited annual statements and an auditors’ statement. The audit report shall express an auditor’s opinion on the reliability of financial statements of the bank, fulfillment of the regulations of the CBR, quality of the management of the bank, and condition of the internal control systems as well as other questions stipulated by federal laws and bank’s charter. All banks and banking groups disclose such audited information on a solo/consolidated basis once a year. The CBR has provided formats for publication of the balance sheet, profit and loss statement, capital adequacy and for impaired assets reserves.</p> <p><b>Criterion 10: Laws, regulations or the supervisor provide effective review and enforcement mechanisms designed to confirm compliance with disclosure standards.</b></p> <p>Regulation 1270-U requires information about the source of the data provided in the public reporting. Article 74 CBL provides enforcement tools against breaches of the CBR’s reporting and disclosure requirements.</p> <p><b>Criterion 11: The supervisor or other relevant bodies publish aggregate information on the banking system and the exercise of market discipline.</b> Such information includes aggregate data on balance sheet indicators and statistical parameters that reflect the principal aspects of banks operations (balance sheet structure, capital ratios, income earning capacity and risk profiles). See Principle 19.</p>
Assessment	Largely compliant
Comments	<p>On January 1, 2008, Regulation 302-P entered into force, which introduces accrual accounting, IFRS compliant accounting for financial instruments. A new draft accounting law stipulating international standards as a basis for developing of national accounting standards is being developed, and currently being considered by the Government. The Duma is also considering legislation to strengthen the audit profession including mandatory membership of professional organizations, advance of the convergence between RAS and IFRS and put quality control mechanisms in place. It is recommended to amend the Law</p>

	<p>“On Audit Activities” with the right for the CBR to require auditors to submit working papers of the auditor’s inspection to the CBR and to demand the auditor’s replacement. The mission supports the CBR’s efforts in developing methodological guidelines "Special features of the audit of credit organizations and banking (consolidated) groups".</p>
<b>Principle 25.</b>	<p><b>Home-host relationships.</b> Cross-border consolidated supervision requires cooperation and information exchange between home supervisors and the various other supervisors involved, primarily host banking supervisors. Banking supervisors must require the local operations of foreign banks to be conducted to the same standards as those required of domestic institutions.</p>
Description	<p><b>Criterion 1: Information to be exchanged by home and host supervisors should be adequate for their respective roles and responsibilities.</b> Russian banks have a limited number of establishments abroad and arrangements have been concluded with a significant number of countries (see below) to obtain the necessary information. These arrangements work broadly satisfactorily. Host countries of Russian banks are handicapped by the prohibition in Article 51 CBL which forbids the CBR to provide client information to other country authorities. In the context of bank licensing information is exchanged about shareholders and related parties, and after licensing on the day to day banking activities and issues.</p> <p><b>Criterion 2: For material cross-border operations of its banks, the supervisor of its home country identifies all other relevant supervisors and establishes informal or formal arrangements (such as memoranda of understanding) for appropriate information sharing, on a confidential basis, on the financial condition and performance of such operations in the home or host country.</b> Where formal cooperation arrangements are agreed, their existence should be communicated to the affected banks and banking groups: The CBR has concluded 22 MoUs with home and host supervisors abroad. Russia has taken part in a number of supervisory colleges and cooperates closely with a number of home regulators, such as the United Kingdom, Netherlands, United States. Around ten more are pending, among others with the OCC. These arrangements work satisfactorily at a working level. The CBR publishes information on the MoUs on its website.</p> <p>When a bank is of particular importance for the national banking sector, a memorandum of understanding can be concluded with regard to that particular bank. Alternatively, it may be entered into an Annex to a generic memorandum of understanding. In this context, it is important to note the memorandum of understanding pertaining to regulation of activities of the commercial bank DnB NOR Bank ASA and its Russian subsidiary, and the open joint stock company “DnB NOR Monchebank”. This MoU was drawn up between the CBR and the Financial Supervision Department of Norway. Also the Annex to the memorandum of understanding between the Bank of Russia and Financial Supervision Department of Finland regarding cooperation on supervision over the Sampo Bank Group and its subsidiary credit organization closed joint stock company “ Danske Bank” can be mentioned.</p> <p><b>Criterion 3: The home supervisor provides information to host supervisors on a timely basis,</b> concerning:</p> <ul style="list-style-type: none"> <li>• the overall framework of supervision in which the banking group operates;</li> <li>• the bank or banking group, to allow a proper perspective of the activities conducted within the host country’s borders; the specific operations in the host country;</li> <li>• and where possible and appropriate, significant problems arising in the head office or other parts of the banking group if these are likely to have a material effect on the safety and soundness of subsidiaries or branches in host countries. A minimum</li> </ul>

level of information on the bank or banking group will be needed in most circumstances, but the overall frequency and scope of this information will vary depending on the materiality of a bank's or banking group's activities to the financial sector of the host country. In this context, the host supervisor will inform the home supervisor when a local operation is material to the financial sector of the host country.

**Criterion 4: The host supervisor provides information to home supervisors on a timely basis, concerning:**

- material or persistent non-compliance with relevant supervisory requirements, such as capital ratios or operational limits, specifically applied to a bank's operations in the host country;
- adverse or potentially adverse developments in the local operations of a bank or banking group regulated by the home supervisor;
- adverse assessments of such qualitative aspects of a bank's operations as risk management and controls at the offices in the host country;
- and any material remedial action it takes regarding the operations of a bank regulated by the home supervisor.

A minimum level of information on the bank or banking group, including the overall supervisory framework in which they operate, will be needed in most circumstances, but the overall frequency and scope of this information will vary depending on the materiality of the cross-border operations to the bank or banking group and financial sector of the home country. In this context, the home supervisor will inform the host supervisor when the cross-border operation is material to the bank or banking group and financial sector of the home country.

In practical terms, the Russian supervisory authorities have good working contacts with their foreign counterparts on issues at hand and at various times exchange information according to the needs of home or host authorities. Examples of this are recent working level interchanges with the Netherlands, Finland, Austria, Hungary, including AML issues, and other matters. Foreign supervisors have been to Moscow to visit subsidiaries of banks of that country. In the context of the licensing of foreign banks in Moscow over the past year, a number of exchanges with foreign supervisors took place. In June 2007, there have been contacts with the supervisory authorities of Estonia and Sweden regarding the actions taken by the CBR towards a subsidiary of an Estonian bank.

**Criterion 5: A host supervisor's national laws or regulations require that the cross-border operations of foreign banks are subject to prudential, inspection and prudential reporting requirements similar to those for domestic banks.** All foreign banks in Russia are subsidiaries of foreign parents, so all are treated as domestic banks in all aspects. The same prudential regulations apply. There are no longer any differences with regard to licensing.

Within the Russian Federation foreign banks have the right to establish subsidiaries or participate in the capital of domestic institutions. They are also allowed to open representative offices. At the same time, the CBR has the authority to establish, in accordance with the procedure set forth in the Central Bank Law, additional requirements for credit organizations with foreign investments to complement the statutory requirements, procedures of reporting, approval of the managerial staff, lists of banking transactions performed, requirements with respect to the minimum level of the charter capital for newly registered credit organizations with foreign investments (Article 18 BL).

	<p><b>Criterion 6: Before issuing a license, the host supervisor establishes that no objection (or a statement of no objection) from the home supervisor has been received.</b> For purposes of the licensing process, as well as ongoing supervision of cross-border banking operations in its country, the host supervisor assesses whether the home supervisor practices global consolidated supervision: See Core Principle 3, criterion 11.</p> <p><b>Criterion 7: Home country supervisors are given on-site access to local offices and subsidiaries of a banking group in order to facilitate their assessment of the group's safety and soundness and compliance with KYC requirements.</b> Home supervisors should inform host supervisors of intended visits to local offices and subsidiaries of banking groups.</p> <p>The CBR is keen to engage in cross border supervisory cooperation in the supervision of cross border institutions. A request from foreign banking supervision authorities based on Regulation 108-I is considered grounds for performing an unscheduled inspection by the CBR. Relations between the CBR and foreign supervisory agencies are based on MoUs. Regulation 105-I sets forth specifics for the inspection of subsidiaries abroad.</p> <p>Inspections of foreign subsidiaries cannot take place with foreign participation, but parallel or separate inspections by foreign supervisors can take place. The main results of the inspections are shared, although there is no exchange of the full report of the Russian inspectors. Such cooperation has recently taken place, when inspection teams from for instance Turkey, the Netherlands and Germany conducted on-site inspections of subsidiaries in Russia. A letter is sent in advance of the foreign inspection, and a de-briefing takes place with the Russian colleagues at the end of the visit. At that occasion, a general exchange of views on the condition of the subsidiary can take place between the home and the host supervisors.</p> <p><b>Criterion 8: The host supervisor supervises shell banks, where they still exist, and booking offices in a manner consistent with internationally agreed standards.</b> Russian law does not permit the licensing of shell banks.</p> <p><b>Criterion 9: A supervisor that takes consequential action on the basis of information received from another supervisor consults with that supervisor, to the extent possible, before taking such action.</b> The CBR will notify any home supervisor of minor actions taken against the foreign subsidiary, and will consult in advance in case of any serious remedial actions. In June remedial action has been taken against a subsidiary of an Estonian bank.</p>
Assessment	Largely compliant
Comments	The inability of the CBR to share client information is a significant barrier to cooperation.