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Corporate Governance of the Largest Russian Banks

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Abstract

Corporate governance can play an important complementary role in banking regulation by limiting excessive risk-taking by managers and shareholders at the expense of creditors, including small depositors. This paper provides a detailed analysis of corporate governance in Russia's 30 largest banks during the period from 2007 to 2017. We look at several governance features, including ownership structure, the size, composition and compensation of the boards of directors, as well as CEO characteristics. Based on our findings, we recommend policymakers focus on strengthening the role of independent directors in non-listed banks, address signs of managerial entrenchment in state-owned banks (long tenure and compensation above the level of private and foreign banks), and improve disclosure about board independence, board committees, and the backgrounds of board members.

Keywords: Board of directors, corporate governance, ownership structure, Russian banks

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1. Introduction

Corporate governance of banks differs from that of non-financial companies in important ways. Banks often work with high leverage ratios and their assets (e.g. loans to households and firms) are generally less transparent than assets of traditional non-financial companies (e.g. buildings, equipment, and patents). This creates incentives and opportunities for the shifting risk from shareholders to debtholders (Laeven, 2013).[2] As a bank gets close to failure, shareholders have an interest in taking on risky projects with only modest chances of success. Nearly all downside risk is borne by the bank's debtholders. Debtholders, however, do little to monitor bank risk. Small depositors, in particular, have little incentive to monitor as they assume they are protected by the deposit insurance scheme and likely find monitoring of bank managers burdensome. In addition, the interconnectedness of banks creates large externalities from the failure of one bank to the whole banking system, especially if the distressed bank is large enough to invoke "too-big-to-fail" protections.

Many Russian banks struggled after the global financial crisis. Russia was initially spared, but the impacts were fierce when they finally arrived. After a decade of strong economic growth, GDP plunged by almost eight percent in 2009. Banks kept a considerable volume of non-performing loans on their balance sheets after the crisis, only to face a series of additional negative shocks in the coming years: very low growth, limited loan demand, and the 2014–2015 triple whammy of falling oil prices, international sanctions and ruble devaluation.

The Central Bank of Russia (CBR), which oversees banking supervision and regulation, reacted by withdrawing the licenses of many smaller banks due to insolvency, undercapitalization or fraudulent behavior. Some banks were acquired by others. As a result, the number of active banks decreased from 1136 at the end of 2007 to 561 at the end of 2017.[3] The CBR, however, only got around to addressing the problems of systemically important large banks with the creation of the Fund for the Consolidation of the Banking Sector in 2015.

The case of Financial Corporation Otkrytie provides a good example of some of the problems mentioned above. Otkrytie (or Nomos Bank at the time) was ranked Russia's 11th largest bank in total assets in 2012. It pursued an aggressive acquisition strategy, purchasing large stakes in the insurer Rosgosstrakh, as well as the Petrokommerts and Trust banks. The acquisition of Trust Bank was financed with a CBR loan facility for the restructuring of troubled banks. Otkrytie eventually failed and had to be rescued by the CBR. Otkrytie's demise illustrates both the risk-shifting problem (its acquisitions were a bet on improving market conditions) and the "too-big-to-fail" problem (the acquisitions were part of its owners' rapid expansion strategy).

Specific incentive problems can be addressed by bank regulation through such measures as capital requirement adjustment, but corporate governance can also play a wider role in preventing or mitigating incentive problems. For example, independent and competent directors can be installed to balance the interests of shareholders and debtholders in banks. Corporate governance enhancements can also help restore access of private banks to international capital markets.

Against this background, we provide a detailed analysis of corporate governance in the largest Russian banks from 2007 to 2017. We focus on three aspects of corporate governance: ownership structure, boards of directors and CEOs. Our sample of banks consists of Russia's 30 largest banks by total assets in 2012. To detect changes in the corporate governance environment, we compare snapshots of a variety of indicators of corporate governance from 2007, 2012, and 2017. We find that

[2] Laeven, Luc (2013), "Corporate Governance: What's Special About Banks?" *Annual Review of Financial Economics*, 5, 63-92.

[3] Банк России, "Отчет о развитии банковского сектора и банковского надзора в 2017 году," Central Bank of Russia, Banking Supervision Report 2017.

many of the board characteristics depend on whether the controlling owner is the government (state-owned), a domestic private individual or group of domestic private individuals (domestic private), or a foreign bank or group of foreign individuals (foreign).

Our findings on the ownership structure show some specific features of the Russian banking sector: a high degree of state ownership, a low penetration by foreign banking groups that contrasts starkly with the experience of most Central and Eastern European transition countries, and a strong concentration of ownership. All domestic private banks are controlled by one large shareholder or a small group of individuals. These individuals holding large stakes (blockholders) are often heavily involved in the governance of the banks. Exchange-listing is limited to a few of the largest banks. This approach is sometimes referred to as the blockholder model of governance.[4]

Board size has been approximately constant at an average of nine members. The composition of boards has become more gender-diverse over time (starting from a tiny number of female board members) and more multi-national. Board independence and the presence of non-affiliated members (through ownership, current or past employment in the bank, its parent or subsidiaries) remain low. Board members are overall highly qualified for their job in terms of educational attainment and work experience in the financial sector. After an initial increase between 2007 and 2012, compensation of board members decreased considerably between 2012 and 2017. We see some signs of managerial entrenchment in state-owned banks, i.e. CEOs hold the post longer (tenure increased from 5 to 8.5 years between 2012 and 2017) and that compensation of top managers has soared, reaching levels significantly higher than those of CEOs at foreign or domestic private banks.

A key lesson for banks from the global financial crisis is the importance of paying attention to risk management and raising its profile in bank governance, and Russian banks are no exception in this respect. However, while Russian banks have stepped up risk management since the crisis, this has yet to be reflected in institutional changes at the board level. In particular, only a few of our sample banks have established risk management committees on their boards of directors.

The Corporate Governance Code (CGC), introduced in 2014, has become an important benchmark for corporate governance in Russian companies. Publicly listed companies are required to report on their compliance with the Code under a "comply or explain" principle. The Moscow Stock Exchange has also introduced a number of requirements related to corporate governance, including an independent director requirement and rules on formation of board committees, for listings in the top two listing tiers. As only a small number of Russian banks list their shares on the Moscow Stock Exchange or elsewhere, most banks are neither required to comply with exchange listing requirements nor obliged to explain instances of noncompliance with the CGC.

The rest of the paper is structured as follows. In section 2, we provide more detail on our sample and data sources. Section 3 describes in detail the ownership structures of the 30 banks and how they have evolved over time. Section 4 analyzes the size, composition, and compensation of boards of directors in our sample of banks. Section 5 presents data on the CEOs of our sample banks. In a concluding section, we summarize our key findings and draw lessons for possible improvements of information disclosure and corporate governance of banks in Russia.

[4] See, for example, Vernikov, Andrei (2007), "Corporate governance and control in Russian banks," working paper WP1/2007/02, Higher School of Economics, Moscow.

2. Sample and data sources

Our sample consists of the 30 largest Russian banks by assets as of the end of 2012.[5] The five largest banks are Sberbank, VTB, Gazprombank, Rosselkhozbank, and VTB24. The Appendix contains a list of the 30 banks, their CBR registration numbers, and remarks on reorganizations since 2007. These 30 banks accounted for 71% of total assets in the Russian banking sector and 72% of household deposits in 2012.[6] While the proportion of total assets was still approximately at the same level in 2017, the share of household deposits increased to 81%. Russia's largest bank, Sberbank, accounted for 27% of total banking assets in both 2012 and 2017 and for 44% of deposits from individuals in 2012 and 45% in 2017. Thus, the concentration of the banking sector as measured by the share of the largest 30 banks stayed virtually constant between 2012 and 2017 in terms of total assets, but increased considerably in terms of household deposits.

Mergers and acquisitions lead to slightly different samples for 2012 and 2017. By 2017, some banks had been absorbed by others. For example, VTB24, Transkreditbank and Bank Moskvy were acquired by VTB, while Petrokommerts and Khanty-Mansisky Bank were taken over by FK Otkrytie. As a result, our sample shrinks to 26 banks in 2017.[7] In the case of mergers, we have traced directors from both predecessor banks in order to have a full description of their work experience.

Three of the sample banks (Promsvyazbank, Binbank, and FK Otkrytie) experienced financial difficulties and were placed under administration of the CBR's consolidation fund. For the purposes of ownership analysis, they effectively became state-owned.

We obtain the lists of board members from quarterly reports and annual reports downloaded from the Interfax-Spark information system or bank websites. We are able to identify almost all board members such that our database contains information on a total of 751 board members. The only exceptions are ING Bank and Citibank, which we did not report about their boards for the year 2007. Thus, our sample of analysis for board structure consists of 28 banks in 2007, 30 in 2012, and 26 in 2017.

The above-mentioned sources also provide basic information about the age, tenure, main workplace, other board positions, and participation in board committees. Biographies of board members were taken from open sources. Many of board members have significant experience in the financial industry, so the website finparty.ru was a particularly useful source of biographical information on board members. It offers insight into the professional background of board members, in particular, their education and experience in banking or other parts of the financial industry. For data on education, we check to see whether board member hold doctoral degrees (Russian candidate degree or doctor of science) using the website rsl.ru (Russian Government Library). Additional information about bank committees and their structure is taken from corporate charters available from Interfax-Spark.

As for the information on the ownership structure, we rely again on the quarterly reports. From 2009, banks are required to disclose their ultimate beneficiaries and the underlying scheme of intermediate holdings.[8] We find these reports in the Interfax-Spark information system, but only starting from 2014. Our analysis of ultimate ownership is therefore most complete in 2017.

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[5] We used the list of the largest Russian banks compiled by the Expert Rating Agency as of January 1, 2013. See https://raexpert.ru/rankingtable/bank/banks_capt_2012/main.

[6] Statistics for the Russian banking sector are taken from the Central Bank of Russia's "Overview of the Banking Sector in the Russian Federation" (*Обзор банковского сектора Российской Федерации*), December 2012 and December 2018.

[7] We keep VTB24 since it its official merger with VTB did not occur until January 1, 2018. We exclude Bank Moskvy in 2017. While it exists to this day as a legal entity, most of its assets were transferred to VTB in 2016.

[8] CBR Order No. 345-P from October 27, 2009.

3. Ownership structure

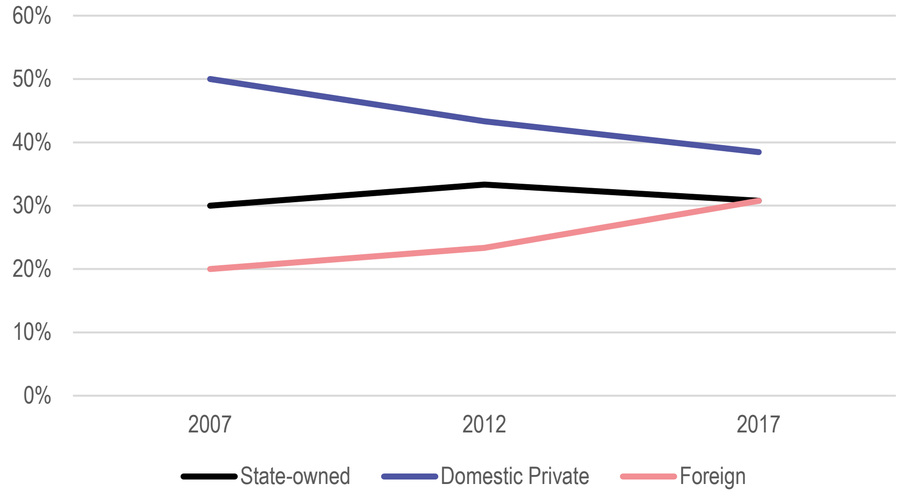
In this section, we summarize our data on the ownership structure of the 30 largest Russian banks. We have collected information on their direct shareholders and computed the voting shares of the ultimate beneficiaries. Since we are interested in the type of owners (state, domestic private, or foreign) that exercise control over banks, we focus on voting shares rather than cash flow shares. We use the weakest-link method in computing voting shares in order to trace through the sometimes long chains in pyramidal ownership structures.[9] Even if the information is insufficient to compute the exact ultimate voting shares (especially in 2007), we can still determine the type the controlling shareholder in all cases. We use the term "ownership" consistently throughout to mean exercising control. For example, "state-owned" banks have at least a 50% stake controlled by the government, possibly through other state-owned companies. They can still have minority shareholders such as international portfolio investors or private individuals. There are virtually no widely-held banks and no banks lacking clear dominance that would make it difficult to categorize them into one of our three groups of majority ownership.

As mentioned, Promsvyazbank, Binbank, and FK Otkrytie have been under the administration of the CBR's bank consolidation since the end of 2017. Effectively, the Russian government has become their sole owner and the authority of their previous boards of directors has been suspended. Except for FK Otkrytie, no new board of directors has been appointed by the end of 2017. In our analysis of the board structure, we will therefore treat them as domestic private banks and use the information about their boards that were in charge until late 2017.

To account for the transfer of control to the government, we consider how de facto nationalization of the three banks has impacted the share of government control over the largest 30 banks.

We break down in Figure 1 three types of majority ownership (state-owned, domestic private, and foreign) for the 30 largest Russian banks.

Figure 1. Proportion of banks with state-owned, domestic private and foreign majority owners



[9] This method is applied to East Asian companies in Claessens, Stijn, Simeon Djankov, and Larry H.P. Lang (2000), "The separation of ownership and control in East Asian Corporations," *Journal of Financial Economics*, 58, 81-112. This method is not universally applicable. Specifically, problems arise when control is exercised with less than 50% of the votes, when several chains lead to the same beneficiary, or in the presence of cross-ownership. Such instances are rare in our data.

We see that the fraction of state-owned banks was stable at about one third of the largest banks. The fraction of foreign banks somewhat increased on the expense of domestic private banks. We recorded five changes in the controlling ownership type between 2007 and 2017 among our sample banks: the acquisition of a controlling stake in Rosbank by Societe Generale, the privatization of Khanty-Mansiyski Bank, and the nationalization of Svyaz-Bank and Globexbank, and the takeover of Vostochny Bank by Baring Vostok Fund.

The influence of the government on the banking sector, however, is much larger than these numbers suggest as the largest banks, including Sberbank, VTB, Gazprombank, and Rosselkhozbank, are state-owned. Thus, we also present the fraction of assets of the 30 largest banks in our sample controlled by each owner type (see Figure 2).

Figure 2. Proportion of total assets of the 30 largest banks controlled by each owner type

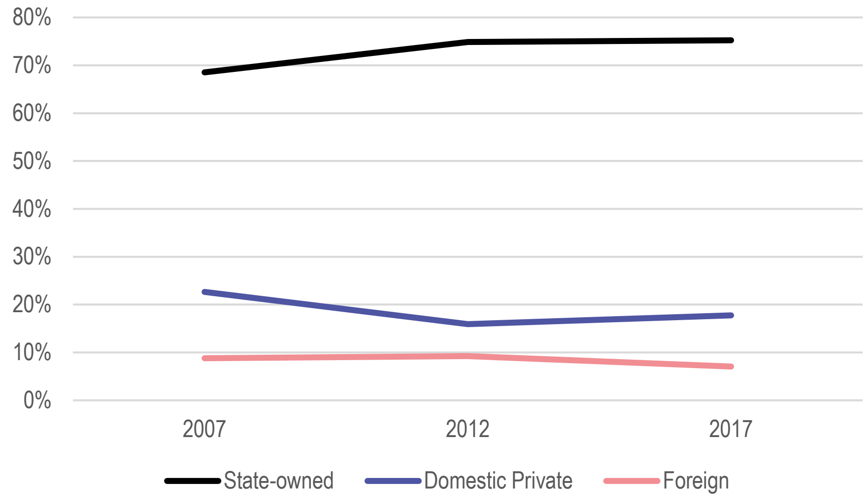


Figure 2 shows the remarkable dominance of state-owned banks in the Russian banking sector. In aggregate, the government controls about 75% of the assets of the 30 largest banks (and this dominance is not limited to the largest banks). If we assume the state-controlled banks had no other assets than that those on banks included among the 30 largest banks, the government would still control 53% of banking sector assets.[10] Vernikov (2019), however, suggests that state-owned banks actually control about 66% of total banking sector assets in Russia, implying significant state-ownership components in many smaller banks as well.[11]

Similar numbers are obtained when we compute the share of state-owned banks in total household deposits. This share reached 84% in 2007, then fell to 79% percent in 2012 and thereafter stabilized at that level.

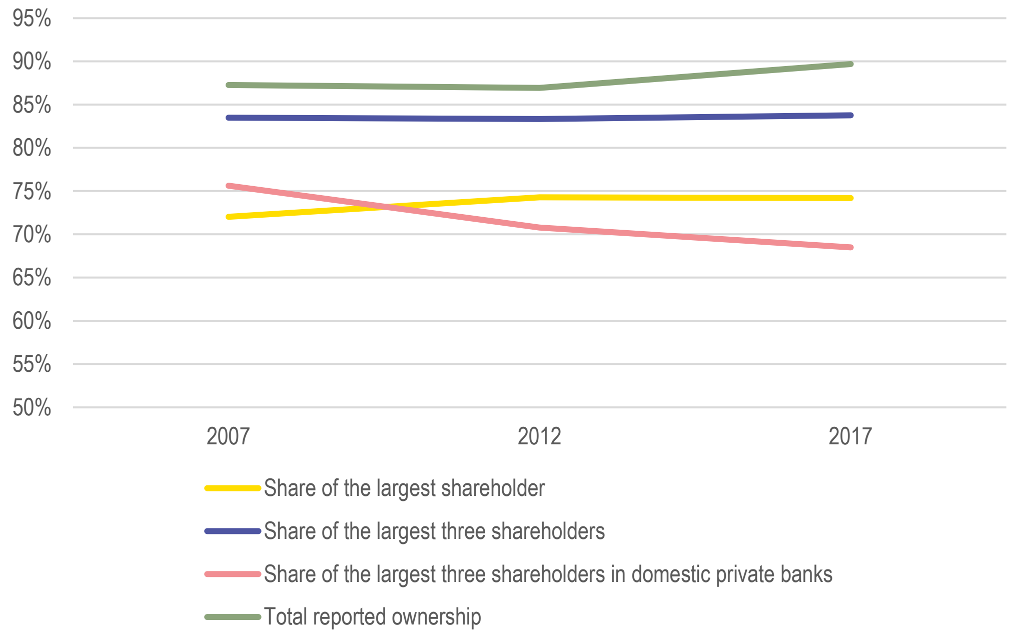
Our calculations of the control over the largest Russian banks in 2017 do not yet include the shifting of Promsvyazbank, Binbank and FK Otkrytie under CBR custodianship, which effectively amounts to a nationalization of these banks. We thus recalculate the fraction of state-owned bank after this event. The proportion of state-owned banks among the largest banks in 2017 rises from 30% to 42%, the share of assets from 75% to 81%, and the share of household deposits from 79% to 85%. By all measures, state-owned banks dominate the Russian banking system, and the largest banks in particular.

[10] The product of the share of total assets of the largest 30 banks (71%) and the state share among the largest 30 banks (75%).

[11] Vernikov, Andrei (2019), "A Guide to Russian Bank Data: Breaking Down the Sample of Banks," SSRN Discussion Paper 2600738.

Extremely high ownership concentration also characterizes the ownership structures of Russian banks. We present two measures of concentration, i.e. the share held by the largest owner and the combined share of the three largest owners. We also compute the sum of all reported ownership stakes larger than three percent. These calculations are plotted in Figure 3.

Figure 3. Ownership concentration and total reported ownership



On average, the holdings of the single largest shareholder far exceed 50% of shares. The three largest shareholders together hold on average about 84% of shares. For state-owned and foreign banks, having a single large shareholder (the government or a foreign bank holding) is not surprising. Thus, we compute a separate number for domestic private banks (green line). In 2017, the largest three shareholders together held on average 69% of voting shares in these banks. While this number has decreased somewhat from 2007, it was still quite high. We also compute the total ownership of board members in domestic private banks (45% in 2017). This surprisingly high figure implies that many large shareholders represent their interests in person on boards of directors.

The sum of all ownership stakes greater than three percent is about 90% on average. This leaves little room for minority shareholders. Taken together, these numbers are evidence of a blockholder model of bank governance.

An issue closely related to the ownership structure is the question whether a bank's stock is listed on an exchange. The Moscow Stock Exchange requires a minimum free float and has introduced requirements related to corporate governance (independent board members, board committees) for firms that want to list their shares in the first two listing levels. These requirements are similar to the recommendations of the CGC.

However, the vast majority of Russian banks (including banks in our sample) are not listed, so listing requirements do not apply to them. Unlisted banks do not have to report about compliance with the CGC in their annual reports. Indeed, only four banks in our sample had first-tier listings at the end of 2017 (Sberbank, VTB, Bank Sankt-Peterburg and Moskovski Kreditny Bank). Another three banks have third-tier listings with low listing requirements and overall low liquidity

(Promsvyazbank, Rosbank, Uralsib).[12] Hence, only 27% of banks in the sample were listed in 2017. A similar fraction of large banks was listed in 2007 (25%), and a slightly higher fraction in 2012 (34%).

Two banks, Sberbank and VTB, have also depositary receipts listed at the London Stock Exchange. They are required to publish corporate governance statements in their annual reports, including the degree to which they comply with the UK Corporate Governance Code. Most of the parent banks of the foreign banks in our sample are listed, but the corporate governance rules for the parents do not apply to Russian subsidiaries.[13]

4. Boards of directors

In this section, we consider on the main characteristics of the boards of directors of the largest Russian banks in 2007, 2012, and 2017. Where applicable, we compare these findings to the 25 largest European listed banks for a similar period (2007–2016) reported by Nestor and Andersson (2018).[14] Our indicators range from personal characteristics (age, gender, nationality, education, and work experience) to measures of affiliation or independence, tenure on the board, other board membership, compensation, and formation and composition of board committees. We start our analysis with the size of bank board (number of seats on the board).

Board size

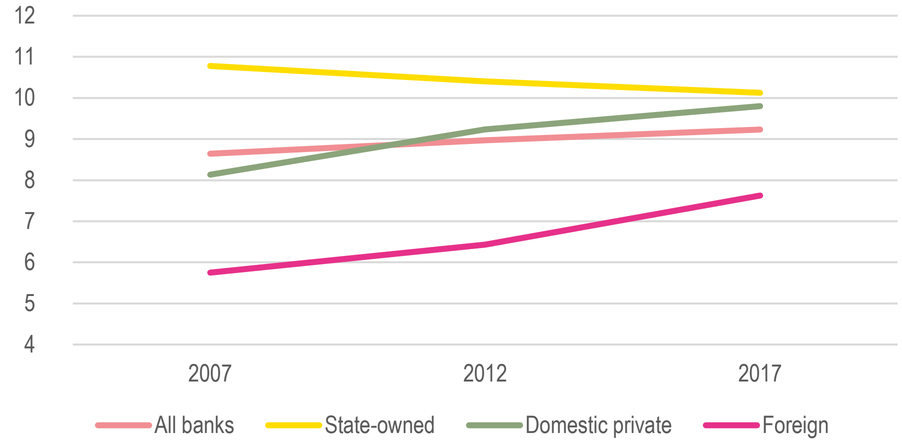
Figure 4 displays the average board size of Russia's 30 largest banks of our sample and in three subgroups by majority shareholder (state-owned, domestic private, or foreign). On average, large Russian banks have nine seats on their boards at the end of 2017. Overall, the number of board members has roughly stayed constant at nine members over the ten years under consideration. However, it increased from six to eight members in foreign banks and slightly decreased in state-owned banks from almost eleven to ten. For comparison, the average board size of European banks decreased from about 16 members to 14 members between 2007 and 2016.

[12] In the previous year, FK Otkrytie and Promsvyazbank had first-tier listings.

[13] Specifically, Unicredit SpA, Societe Generale (owner of Rosbank), Raiffeisen Bank International, Citigroup, Nordea Bank, and ING Bank.

[14] Стилпон Нестор, Лиза Андерссон, Корпоративное управление в 25 крупнейших европейских банках через десять лет после кризиса, Национальный доклад по корпоративному управлению, Москва. Nestor, Stilpor and Liza Andersson (2018), National Report on Corporate Governance, 2018. Unless indicated otherwise, all comparisons with European banks in this section refer to this paper.

Figure 4. Board size



The largest bank (Sberbank) had also the largest board (17 members in 2007 and 2012, and 14 members in 2017). The smallest board had four members (Home Credit Bank in 2012 and 2017). When we split the sample in two halves according to bank size (total assets), we see that boards in the larger banks are larger (by one member in 2007 and by about two members in 2012 and 2017). A formal t-test shows that these differences are significant at the 5% level in 2017 and when we take all years together. They are significant at the 10% level in 2012. Several studies suggest this may be efficient. For example for US bank holding companies, Adams and Mehran (2012) find that larger boards are associated with better performance, especially those with complex holding arrangements (banks with more subsidiaries).[15]

Next, we turn to the composition of boards of directors. All averages reported below are taken first across board members, and then averaged across banks. We do this to give equal weight to each bank and not to each board member (which would overweight banks with large boards).

Age

The average age of board members increased from 47 years in 2007 to 50 years in 2017. For comparison, this indicator is lower than the average age of boards of directors in large listed (mostly non-financial) Russian companies (55 years) and in large listed European companies (58 years).[16] There are almost no differences between banks in our three ownership categories. The average age of board chairpersons has increased from 50 years in 2007 to 55 in 2017. In 2017, the average age of the oldest board member was 64, while the average age of the youngest member was 38.

Gender

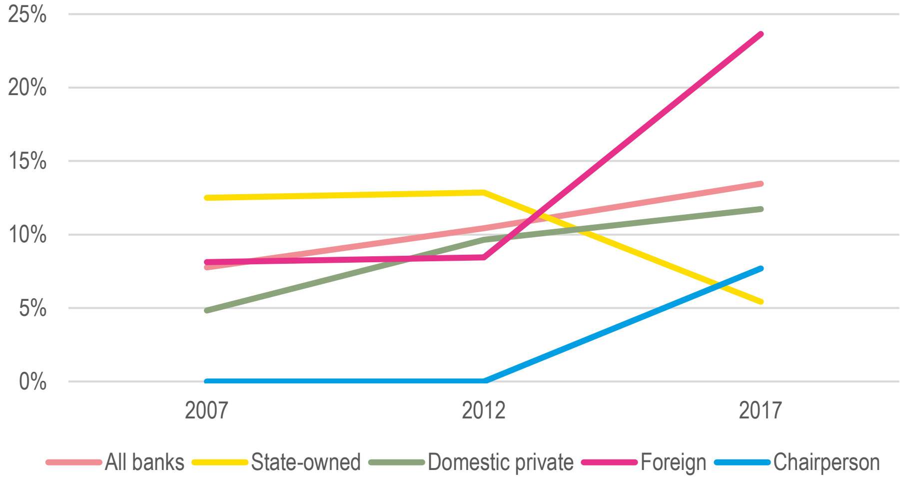
The share of female board members rose over our ten-year sample period, but we should note a very low starting level. Figure 5 shows the proportion of female directors. In 2007, women accounted for 8% of board members on average. In 2017, this number climbed to 13%. In 2017, two of the 26 banks took the unprecedented step of appointing female chairpersons to their boards. Female board representation has also increased in European banks, but at a higher level (from 15% in 2007 to 34%

[15] Adams, Renée B. and Hamid Mehran (2012), "Bank board structure and performance: Evidence for large bank holding companies," *Journal of Financial Intermediation*, 21, 243-267.

[16] SpencerStuart (2018), 2018 Russia Spencer Stuart Board Index, https://www.spencerstuart.com/-/media/2019/march/russia_board_index_2018.pdf

in 2016). Only state-owned banks in our sample appointed less women to the board in 2017 than in 2012 (a decline from 13% to 5%).

Figure 5. Proportion of female board members



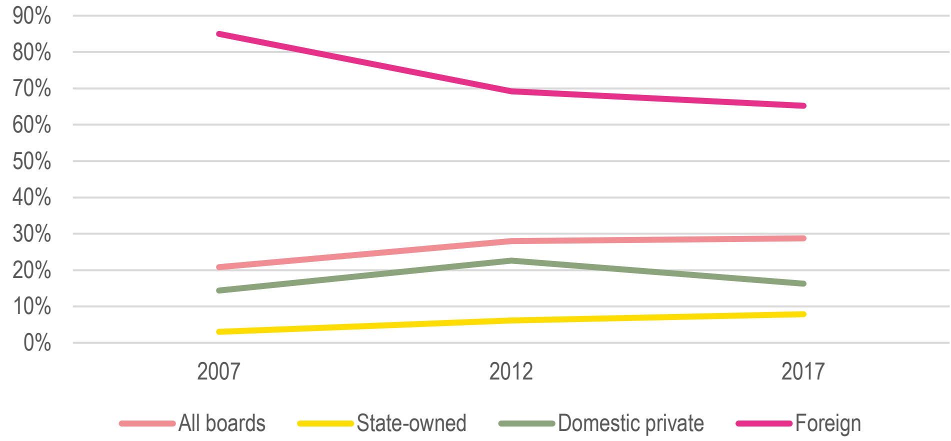
The literature on gender diversity of corporate boards, including its impacts on board activity and firm performance, suggests that higher gender diversity has an overall positive influence. For example, Adams and Ferreira (2009) find that boards with more female members are better at monitoring and more likely to fire underperforming CEOs.[17] While increased female board representation does not add value to firms generally, it does add value for the subset of firms with inferior governance scores. Garanina and Muravyev (2019) observe that gender diversity of the board positively affects stock market and operational performance in Russian firms, especially when several women are appointed to the board.[18] However, both Adams and Ferreira and Ahern and Dittmar (2012) conclude that gender quotas (i.e. mandated female board representation) have a negative effect on firm value, possibly due to short adaptation periods.[19]

Nationality

Figure 6 shows the share of foreign board members. During the decade under consideration, the percentage of foreign directors has increased by eight percentage points (from 21% to 29%). In comparison, this indicator for European banks is roughly similar (from 20% in 2007 to 25% in 2016).

[17] Adams, Renée B. and Daniel Ferreira (2009), "Women in the board room and their impact on governance and performance," *Journal of Financial Economics*, 94, 291-309.
[18] Garanina, Tatiana and Alexander Muravyev (2019), "The Gender Composition of Corporate Boards and Firm Performance: Evidence from Russia," IZA Discussion Paper No. 12357.
[19] Ahern, Kenneth R. and Amy K. Dittmar (2012), "The changing of the boards: the impact on firm valuation of mandated female board representation," *Quarterly Journal of Economics*, 127, 137-197.

Figure 6. Proportion of foreign board members



We observe some marked differences between banks with different controlling owners. State-owned banks have the lowest share of foreigners, about 8% in 2017, while foreign banks have 65% foreigners on average. The trends go in opposite directions, however. State-owned banks raised the share of foreigners over the sample period, while foreign banks relied increasingly on local talent when staffing their boards. Interestingly, there was not a single foreign chairperson in a state-owned bank during all years, while 20% of domestic private banks and 75% of foreign banks have foreign chairpersons in 2017.

For domestic banks, foreign directors should increase diversity of backgrounds and culture and could overall help to improve corporate culture in Russia. Muravyev (2017) finds that the proportion of foreign directors has a positive effect on the market-to-book ratio of equity and Tobin's Q.[20]

Board independence

The CGC emphasizes the importance of board independence.[21] Before the introduction of the CGC, banks paid little attention to this issue – only three out of 28 banks (11%) report having one or more independent board members in 2007. The share of banks with at least one independent board member rose to 33% in 2012 (10 out of 30 banks) and to 62% in 2017 (16 out of 26 banks).[22] In 2017, two banks indicated explicitly that none of their board members were independent. The remaining eight banks provided no details about independent board members in their quarterly and annual reports or on their websites.

To determine if a board member is independent, we mostly rely on the declarations of the banks themselves. However, we also check to see whether board members declared to be independent were current or former employees of the bank or of the group of companies with which the bank is affiliated. For example, the largest shareholder of VTB 24 is VTB. We would not consider a top

[20] Muravyev, Alexander (2017), "Boards of directors in Russian publicly traded companies in 1998–2014: Structure, dynamics and performance effects," *Economic Systems*, 41, 5-25.

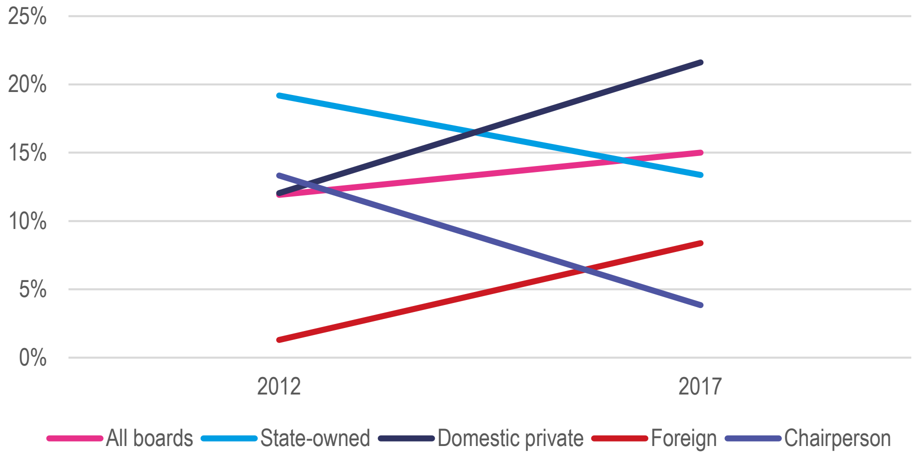
[21] Part B, section 2.4 of the CGC provides a detailed definition of the term *independent board member*: "An independent director shall be a person who has sufficient professional skills, expertise and independence to hold his own position, capable of making objective and bona fide judgments free from the influence of the company's executive, individual groups of shareholders or other interested parties. It should be noted that, under normal circumstances, a candidate (elected director) cannot be regarded as independent if he is connected with the company, a substantial shareholder, a material trading partner or competitor, or connected with the government."

[22] Due to the small number of banks reporting on independent directors in 2007, we only report figures for 2012 and 2017 in the next paragraphs.

manager of VTB an independent member of the board of VTB 24. This check led us to correct the independence indicator for board members of a few banks.[23] We will use our corrected independence throughout the analysis. This correction reduces the number of banks with at least one independent director from 16 to 15 (out of 26, or from 62% to 58%) in 2017 but leaves this count unaffected for 2012 and 2007.

If we just focus on those banks with at least one independent director the proportion of independent directors for these banks declines from 36% in 2012 to 26% in 2017. Also, the share of independent chairpersons in these banks went down from 40% to 7%. What is the net effect of more banks having independent directors and a lower fraction of them? If we assume that those banks that do not report on independent directors have none, we can compare the overall proportions in 2012 and 2017. We think this is a reasonable assumption, at least for 2017, after the introduction of the CGC. The results are depicted in Figure 7.

Figure 7. Proportion of independent board members



We see that the overall proportion of independent directors remains low. Under the assumption that non-reporting banks have no independent directors, their average share among all board members was 15% in 2017, which contrasts sharply with a share of 63% for European banks. This number has, however, increased from 12% to 22% in domestic private banks.

All of the four first-tier listed banks in our sample follow the recommendation of the CGC that one-third of the board members be independent. Foreign board members in domestic banks (both state-owned and private) are often independent (64%). In other words, increasing foreign directors may be a strategy for CGC compliance.

Insiders and outsiders

As noted, many banks fail to report information about the presence of independent members on their boards. We therefore adopt an alternative concept of inside and outside directors that is not based on bank declarations, but rather on the public information about the affiliations and ownership of board members. We use the following definitions of insiders and outsiders:

- *Narrow definition.* We consider only the CEO and members of the management board as insiders. All other board members are defined as outsiders. This definition is useful in assessing the affiliation of outsiders with the private or public sector.

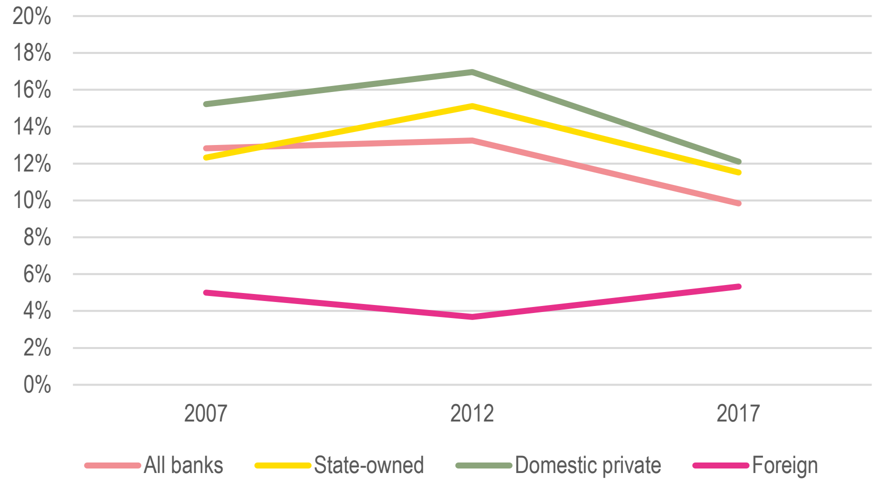
[23] We requalified five board members of VTB24 in 2017 as not independent, as well as one board member of Rosbank in 2012, two board members of Rosbank in 2017 and one board member of Bank Vostochny in 2017.

- *Broad definition.* In addition to the CEO and members of management board, we also consider the following individuals as insiders: current employees of the bank at any level, former CEOs, top managers or other employees who have worked for the bank during the past five years, group insiders (employees in holding and subsidiary companies), large shareholders (with stakes larger than 5%) and persons with kinship relations to other insiders in this definition. All other board members are considered outsiders. This definition of outsiders comes close to the definition of independent directors, and therefore can be seen as an alternative when banks fail to report independent status or follow common definitions of independence.

Outsiders in both definitions are then divided into three groups by their main affiliation: state-affiliated (working in government agencies or state-controlled companies), private-affiliated (working in the private sector) and others (e.g. academia, non-profit organizations, or international financial organizations).

We first report summary statistics on insiders using the narrow definition in Figure 8.

Figure 8. Proportion of insiders on boards (narrow definition)

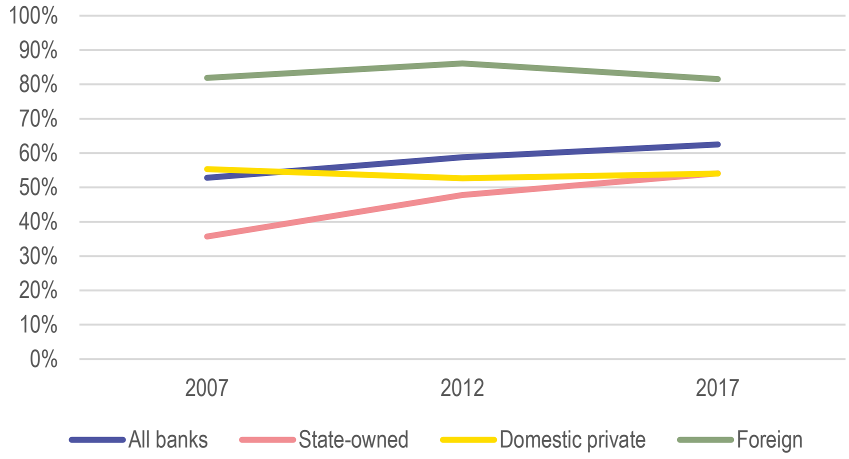


As shown in the graph, there is an overall a tendency to reducing the share of inside directors. CEOs and member of the management board account for only 9% of board members in 2017. In foreign banks, the proportion remains approximately constant, amounting to 5% in 2017. In five out of eight foreign banks in 2017, the CEO is not a member of the board of directors.

As for outside board members, the proportions of state-affiliated and private-affiliated directors barely changes during these ten years. In 2017, 28% of board members were state-affiliated, 58% private-sector affiliated, and 5% had other affiliations.

When we classify insiders according to our broad definition, the picture changes strikingly. This is shown in Figure 9.

Figure 9. Proportion of insiders on boards (broad definition)



Overall, the number of inside directors in the broad sense tends to increase, particularly the increase in insiders other than members of the management board (e.g. advisors, former top managers, employees of holding companies, and large shareholders). In 2017, insiders in the broad sense accounted for 63% of the board members on average. The insider share in state-owned banks soared to 54% in 2017.

The most substantial change in the results compared to the narrow definition of insiders can be observed among foreign banks. Many are formally separate legal entities, but effectively managed like branches of the foreign bank. Hence, the boards of these banks often do not include the local CEO and consist mostly of top managers of other banks within the holding.

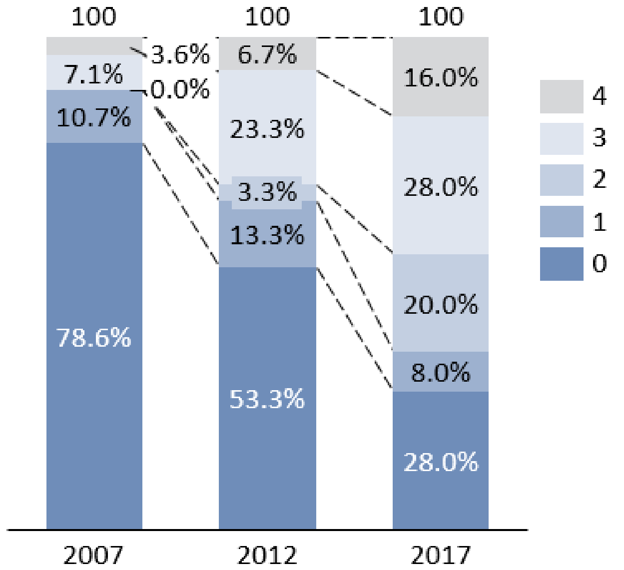
The breakdown of outsiders (all members who are not insiders according to the broad definition) is the following: in 2017, 16% of the board members are state-affiliated outsiders, 18% are private-sector affiliated outsiders and 5% have other affiliations. We also apply the same definitions to chairpersons, whose distribution between insiders and outsiders is also important for corporate governance. Under our broad insider definition, 73% of chairpersons on average were insiders in 2017.

Taken together, these numbers bolster the view that the blockholder model is compatible with the insider model of governance. In many private banks, boards are populated by insiders (large shareholders themselves or their appointed current and former top managers). The prevalence of insiders is perhaps even more troublesome for state-owned banks. Although some decisions may be based on instructions from controlling state agencies, the large proportion of insiders on their boards may lead to serious agency problems when managers are not effectively monitored.

Board committees

The CGC also stresses the presence of committees and disclosure of information about them. We start with some statistics of the number of committees that are formed. Figure 10 presents the shares of banks with zero, one, two, three, or four committees.

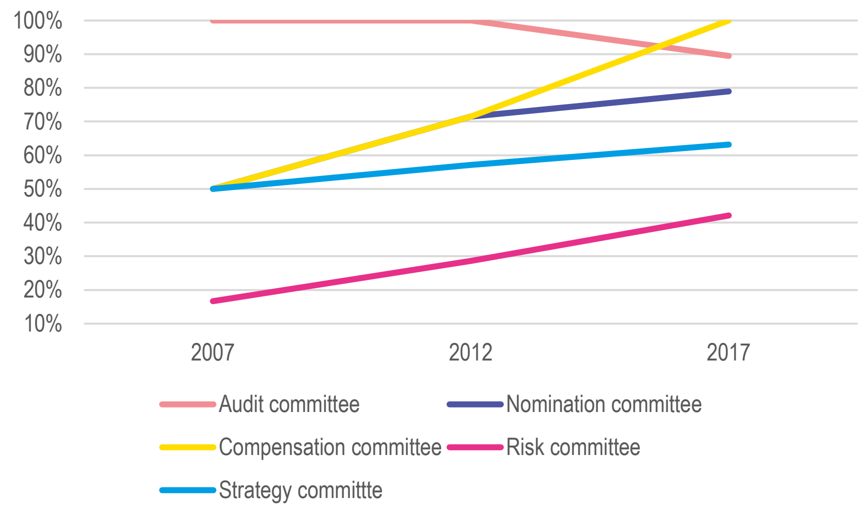
Figure 10. Fraction of banks with board committees (0 to 4)



Some 79% of banks had no committees in 2007,[24] but by 2017 the situation had improved radically with 72% of banks reporting they had at least one committee.

Next, we examine which committees are formed in those banks that report having at least one board committee. The committees recommended by the CGC are the audit, nominations, and compensation (remuneration) committees. The latter two are often combined in a single committee. We nevertheless count separately whether any of these is present in each sample bank. In addition, banks often form committees for strategy (or development) and for risks (or risk management). Rarely (and not reported here), committees for capital markets, corporate governance, finance or credit committees at the board level are formed. Figure 11 reports the incidence of the major types of committees.

Figure 11. Presence of board committees

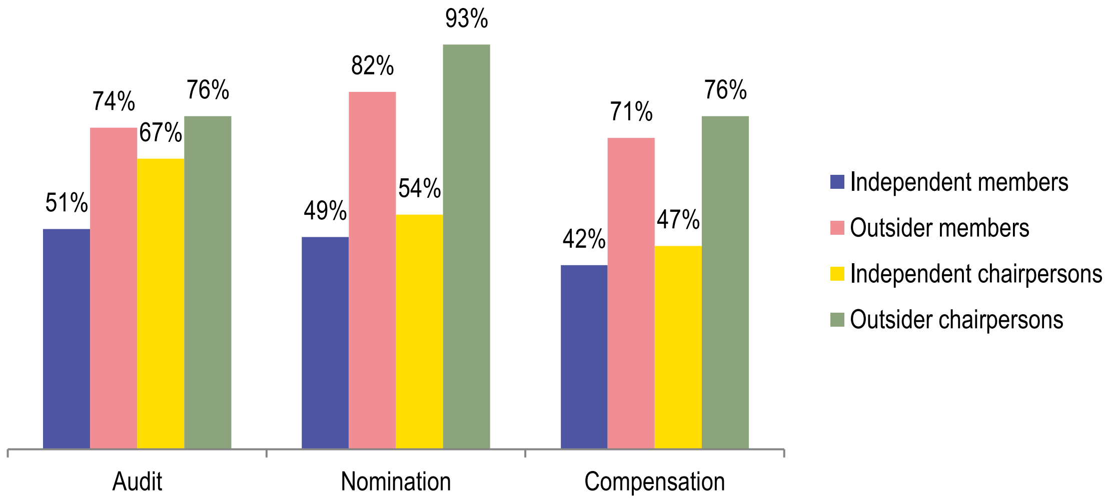


[24] If no information on board committees is provided in the annual or quarterly reports, we assume no committees have been formed.

Nearly all banks with at least one board committee had audit, compensation and nomination committees in 2017. Risk committees also gained in popularity, but were still not present in the majority of banks. A strong and independent risk management function in banks is advocated by e.g. Ellul (2015).[25] It is important that the risk committee reports to the CEO and has a direct counterpart at the board level.

Next, we analyze the composition of the three types of committees that the CGC focuses on, in particular the presence of independent and outside members. The average number of member on audit committees in 2017 was 3.6 members, while nomination and compensation committees average member numbers were 3.7 and 3.5, respectively. The data on their composition in 2017 is summarized in Figure 12. Outsiders are defined as those that are not insiders under our broad definition.

Figure 12. Composition of the three committees recommended by the CGC in 2017



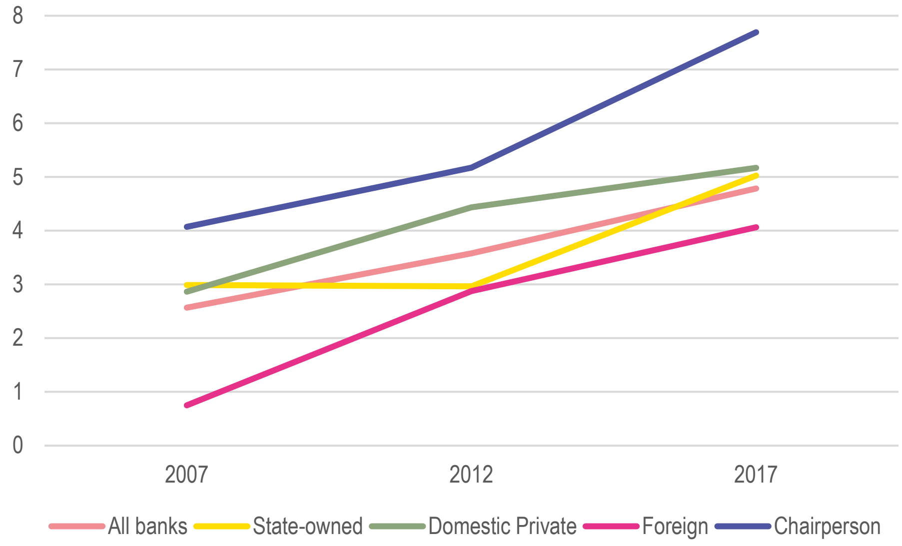
Among the three types of committees, independent members constitute about half of the members on the audit and the nomination committees. These committees also usually have an independent chairperson. Recall, however, that these numbers are computed only for those banks that report on board independence and committee composition. When we use our broad definition of insiders, which is available for almost all banks, only few members of the board committees are insiders and the vast majority are outsiders.

Tenure

Even though board members need to gather some experience with a particular bank, lengthy tenures may impair a board's monitoring function. The CGC assumes that a board member is no longer independent if she has served for more than seven years on a board. Our data, presented in Figure 13, shows that the average tenure for all banks increased by two years between 2007 and 2017, reaching 4.8 years on average. Tenure in 2017 had increased for all bank types, and particularly in state-owned banks and chairpersons (whose board service average 7.7 years).

[25] Ellul (2015), The Role of Risk Management in Corporate Governance, The Annual Review of Financial Economics, 7, 279-299.

Figure 13. Average tenure on the board (in years)



Other board memberships

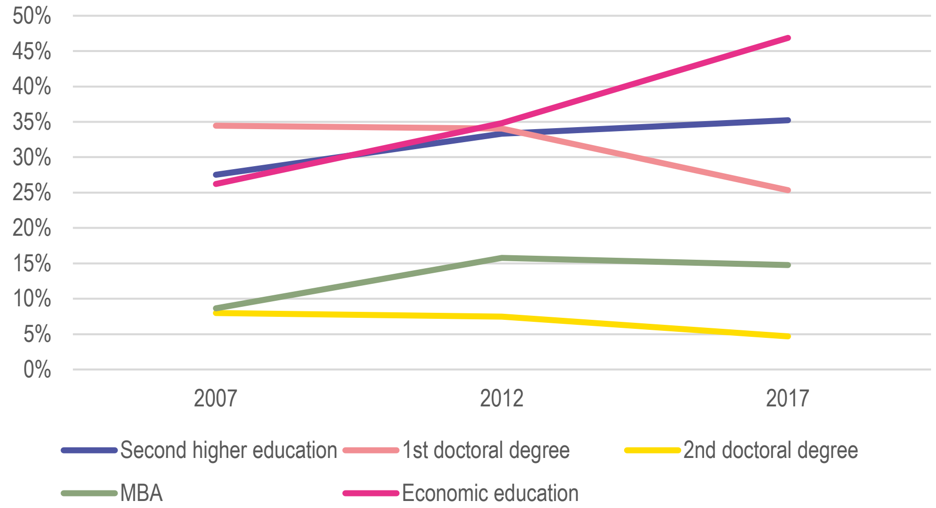
Participation on boards of other commercial organizations shows the "busyness" of a board member, but may also signal her professional network and experience. Research on non-financial companies tends to find a negative effect from "busyness" (or "overboarding") on the monitoring role of boards with many such members. It also appears to hurt firm performance.[26] Boards of directors in our sample participated in 3.5 other boards on average. Board members of state-owned banks were particularly busy, participating in 4.1 other boards on average. The busiest director participated in no less than 24 other boards in 2017.

Education

Virtually all members of boards of directors in our sample of banks held academic degrees. Graduates of Moscow State University (12%) were most commonly found on Russian boards in 2017, followed by graduates of the Financial University (8%) and the State University of Management (4%). We provide more detailed statistics on educational attainment in Figure 14.

[26] See, for example, Fich, Eliezer M. and Anil Shivdasani (2006), "Are Busy Boards Effective Monitors?" *Journal of Finance*, 61, 689-724.

Figure 14. Educational attainment of board members

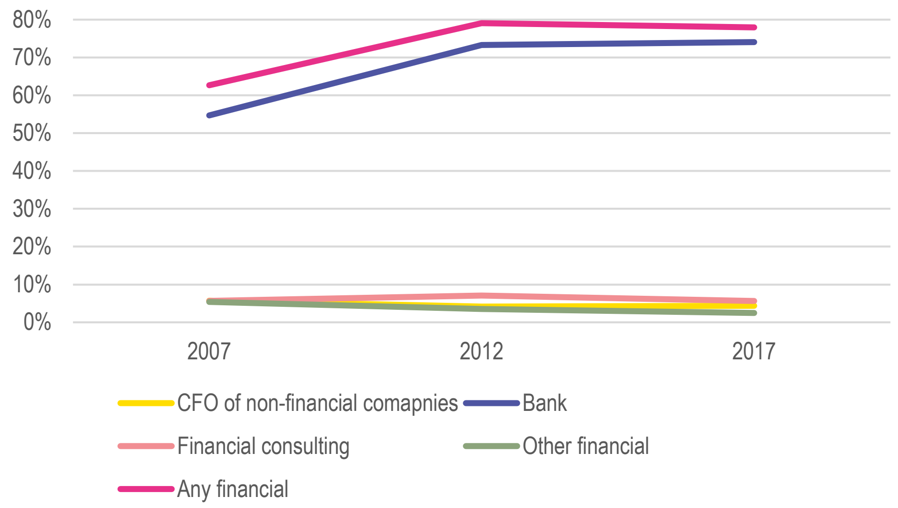


On average, 35% of board members completed a second degree in 2017. While many board members held doctoral degrees (25% held candidate of science or PhDs, while 5% had doctor of science degrees), these shares have been decreasing since 2012. Roughly 15% had MBA degrees (this number increased between 2007 and 2012, but not afterwards). For bank board members, it seems particularly important to have a modern economics or business education, which we define as a degree in either economics or business, obtained in countries with developed market economies or in transition countries (mostly in Russia and former Soviet Union) from 1993 on. We see a strong increase of the share of board members with modern economics education, from 26% in 2007 to 47% in 2017. This cannot be attributed simply to the youth of new board members, but rather an increased demand on the part of banks for directors with modern economics degrees. The share of Russian board members with a foreign education among those with more than one degree rose from 25% in 2007 to 39% in 2017.

Work experience

One of the main requirements for members of bank boards is financial expertise. We searched the biographies of all directors for the following types of financial expertise and experience: work as a CFO in a non-financial firm, work experience in banking, in fund management, insurance, accounting, or financial consulting. In Figure 15, we summarize the data on the average share of board members with each type of experience. We merge the least frequent types into the group "other financial." The red line shows the share of board members with any of the types of work experience we associate with financial expertise.

Figure 15. Average share of board members with particular types of work experience

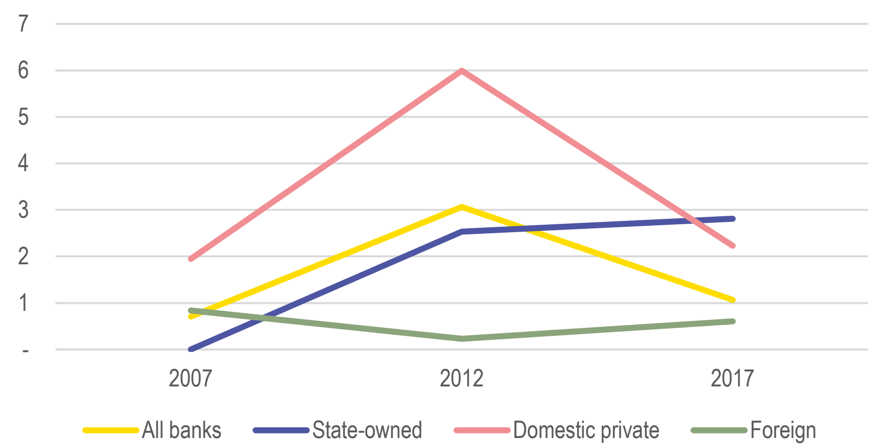


We see board members tend overall to have a very high level of financial literacy. The indicator for "any financial expertise" increased from 63% in 2007 to 78% in 2017. This trend also reflects the complexity of financial markets, i.e. members of boards are increasingly expected to have significant experience in the financial field. We judged the indicator for bank experience based on two types of experience: either the board member has been employed by a bank or has had at least five years of experience on other bank boards. Bank experience is the most frequent of all – 74% of board members have such experience. All other types of experience are far less frequent.

Compensation

Finally, we consider the monetary compensation of board members in our sample of Russian banks. Banks report compensation figures for the entire board of directors but not for individual directors. Figure 16 presents the data on compensation per person, adjusted for inflation (i.e. expressed in millions of constant 2012 rubles). Banks in some cases provide lavish compensation packages, so we report median values.

Figure 16. Board compensation, in millions of rubles (inflation-adjusted, 2012 = base year)



The graph shows that board compensation in real terms increased between 2007 and 2012, and decreased between 2012 and 2017. The median board remuneration per board member amounted to 3.1 million rubles per year in 2012, falling by 66% by the end of 2017. This decrease is entirely driven by the decrease in board compensation in domestic private banks. In our view, this decrease probably reflects a reduced role of the board of directors, especially in banks where the dominating shareholder communicates directly with the top management. When funding from international capital markets had dried up in 2017, many of the large shareholders of private banks saw little benefit in maintaining high-profile boards.

In contrast, state-owned banks increased the board compensation between 2012 and 2017, when they paid the highest per capita remuneration. We do not know the distribution of remuneration among board members of different types. It is possible that insiders are paid salaries and large blockholders are paid dividends such that the compensation of the board members is only relevant for the relatively few outside members. In European banks, the average compensation for boards of directors increased by 60% between 2007 and 2016.

5. CEOs

In this section, we briefly summarize several characteristics of the CEOs of our sample of banks. Bank CEOs make the day-to-day decisions, so their characteristics may affect bank risk-taking, strategies, and performance.

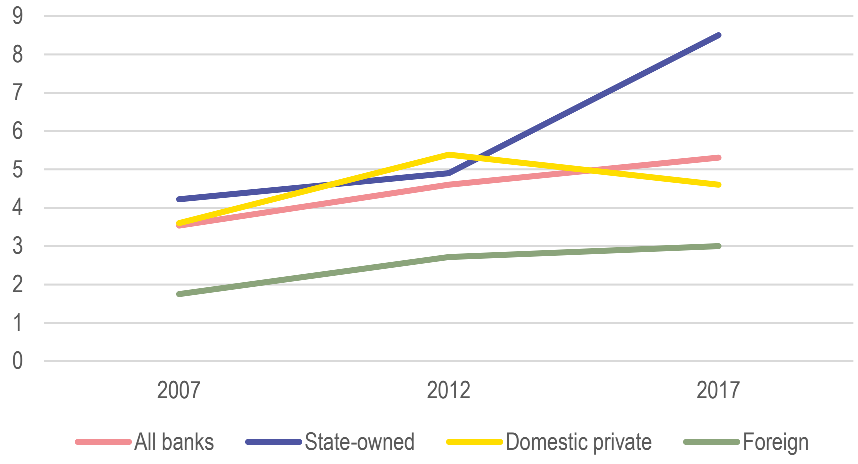
Like board members, the average CEO in 2017 was 49 years old, six years older than the average CEO in 2007. CEOs in state-owned banks tended to be older than those of private banks (52 years vs. 48 for domestic private and 47 for foreign banks). Female CEOs were virtually non-existent in Russia's largest banks. One foreign bank had a female CEO in 2017. None of the state-owned banks has employed a foreign CEO, and domestic private banks have done so only rarely. Foreign banks relied increasingly on local managerial talent. About half of the foreign banks had a foreign CEO in 2007 and 2012, but none had in 2017.

Over half of CEOs in our sample reported that they did not hold shares in their employer bank. We also found none of the CEOs in this group to be large shareholders.[27] However, in a few domestic private banks, CEOs were large shareholders. In three out of nine domestic private banks in 2017 with this data available, the CEO's stake exceeded 25%, and one bank 50%.

We now consider the CEO tenure shown in Figure 17.

[27] This still leaves the possibility that they hold small, indirect stakes.

Figure 17. Average CEO tenure

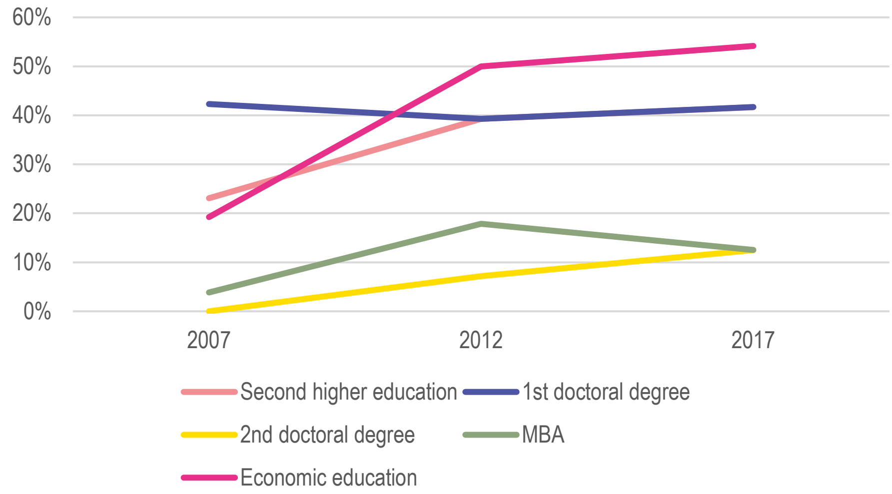


Similar to the tenure of board members, CEO tenure has lengthened from 3.5 years in 2007 to 5.3 years in 2017. Between 2012 and 2017, we observe, however, an opposite trend in state-owned and domestic private banks. In private banks, CEO tenure went down by almost one year, while in state-owned banks it increased by more than three years, from 4.9 to 8.5 years. Together with the insider-dominated board in state-owned banks, the long duration of CEO terms likely signals managerial entrenchment.

Bank CEOs also frequently sit on boards of directors of other firms. On average, the CEOs in our sample participated in 3.6 boards (other than the bank where they worked) in 2017, up from 2.3 board seats in 2007. This number decreased between 2012 and 2017 in state-owned banks from 4.6 to 3.5, but increased in domestic private banks from 2.1 to 4.9.

Next, we briefly summarize our data on educational attainment and work experience of CEOs (see Figure 18). Similar to board members, all CEOs in our sample banks hold a higher education degree.

Figure 18. Educational Attainment of CEOs

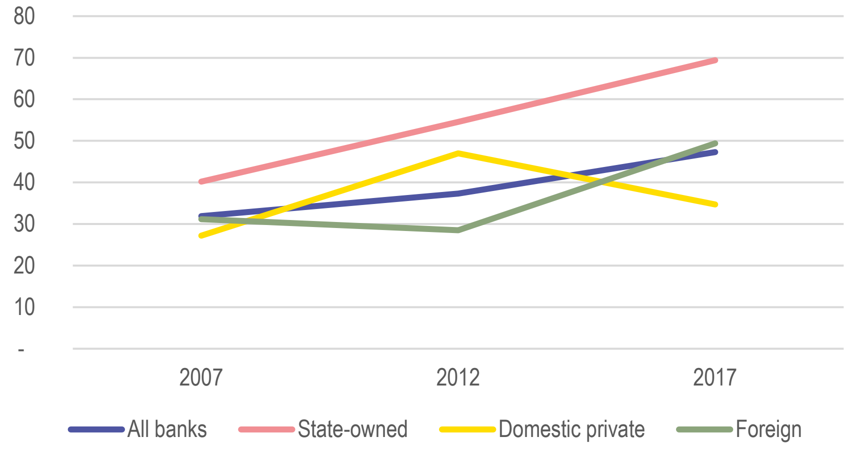


It is notable that 38% of bank CEOs in 2017 held doctoral degrees, typically in economics. Also, 42% held a second degree (doctoral degrees not included). This proportion is twice as high as in 2007. Moreover, 54% of CEOs in 2017 had received educations in modern economics or business.

The MBA degree had yet to establish itself as part of the typical career path for bank CEOs in Russia. After an initial growth between 2007 and 2012, the proportion of CEOs with an MBA decreased from 17% to 12% between 2012 and 2017. Virtually all CEOs had previous banking experience, and almost none had experience in other parts of the financial industry such as fund management, insurance, financial consulting, or as CFO of a non-financial company.

Finally, we consider management compensation. Russian banks report only the total compensation of the management board, no individual compensation and no decomposition into various components such as salary, bonus, stock, or option grants. We divided the total compensation figure by the number of members of the management board and adjust for inflation by expressing all values in constant 2012 rubles. As in the case of board compensation, a few banks offer extremely generous compensation packages, so we report medians. The data for compensation in banks of various ownership types is summarized in Figure 19.

Figure 19. Executive compensation in millions of rubles (inflation-adjusted, 2012 = base year)



Unlike board compensation, executive compensation increased in real terms between 2012 and 2017. The median compensation per member of the management board went up by 27% in these five years, and *average* compensation increased by 74%. Median compensation increased at both state-owned and foreign banks, but fell at domestic private banks. At some private banks, compensation increased strongly such that the average increased for this type of bank. The level of executive compensation was the highest at state-owned banks in all three years, which may be due to the fact that the largest banks are also state-owned banks. This situation presents an interesting jumping-off point for further research into how ownership and board composition affect managerial compensation.

6. Conclusion

In this paper, we have provided a detailed description of corporate governance arrangements, in particular ownership structure, the size and composition of the board of directors, characteristics of CEOs, and compensation at Russia's 30 largest banks. Overall, we find that most private banks followed a blockholder model, i.e. ownership is highly concentrated, large shareholders often personally represent their interests as board members, and a large fraction of board seats is occupied by insiders under our broad definition of insiders (which includes current and former executives, executives from affiliated companies, and large shareholders).

Female representation on bank boards increased, but was still fairly low. The fraction of foreign board members has been stable since 2012 at about 30%. Banks often failed to report on the independence of their board members; those that did were still in the minority in 2017. On the positive side, independent members often represented the majority on key board committees such as the audit and nomination committees. Board members as a rule were highly qualified, often holding more than one degree and possessing work experience in the financial industry. Somewhat puzzling is the finding that board compensation decreased in real terms after 2012, even as executive compensation rose.

The high ownership concentration in private banks likely exacerbates the risk-shifting problem described in the introduction. Bank managers with small stakes are likely to act more conservatively due to their career concerns. In their cross-country study, Laeven and Levine (2009) found that banks with large shareholders took greater risks on average, particularly in countries with weak legal investor protections.[28] In addition to strict prudential regulation, fiduciary duties of bank managers to act in the interests of both shareholders and debtholders and strengthening the role of independent directors with a similar mandate could help reduce the excessive risk-taking observed in Russian banks in the past (e.g. risky loans, often to related parties, attracting funds at high deposit rates). Since the vast majority of banks are not listed on any stock exchange and lack significant minority shareholders, there is little regulatory pressure to install independent directors.

In summary, improvements in corporate governance can certainly play a complementary role to bank regulation in limiting bank risk-taking and making the banking system more stable. Forming a specialized risk management committee might also be useful in linking the internal risk management function to the board of directors.

Improving governance of state-owned banks is its own subject. In particular, strengthening the monitoring function of the board may require limiting the presence of bank and group insiders who currently dominate the boards of directors of state-owned banks. This is because inside directors are in a position to insulate bank managers from oversight of the main shareholder, i.e. the government. Some symptoms of this affliction are long tenure and high compensation of CEOs in state-owned banks.

An important policy recommendation concerns the disclosure of governance structures of banks. While banks are just as obliged as listed firms to publish IFRS-compliant accounting statements and must adhere to even higher requirements on disclosure of beneficial ownership than non-financial companies, the information on board committees, the background of board members and top managers and, importantly, their independence, is often fragmentary. In this study, we used a variety of data sources to obtain a more complete picture of director affiliations, education and work experience at the banks in our sample. Similarly, the CGC obligation to report ("comply or explain") applies only to listed firms and certain state-owned companies. This requirement could well be extended to all banks.[29] In order to understand the incentives for bank managers, it would be also important to know more about the structure of their compensation.

We hope this exploration generates further research on the relationship between ownership structure, the characteristics of board members and CEOs on one hand, and risk-taking, bank performance and director compensation on the other. Of particular interest is the issue of whether boards of Russian banks – despite widespread state ownership and ownership concentration – have gained real influence in determining bank strategies, managerial compensation, risk-taking, and performance.

[28] Laeven, Luc and Ross Levine (2009), "Bank governance, regulation, and risk-taking," *Journal of Financial Economics*, 93, 259-275.

[29] In exchange, a number of other reporting requirements such as most documentation linked to currency controls could be dropped. Thus, we refrain from suggesting an increase in the regulatory burden for banks.

Appendix

Russia's 30 largest banks ranked according to the 2012 Expert RA list
(includes name, CBR registration number, and remarks on mergers and liquidations)

Rank	Bank name	CBR registration no.	Comment
1	Sberbank	1481	
2	Bank VTB	1000	
3	Bank GPB (Gazprombank)	354	
4	Rosselkhozbank	3349	
5	VTB 24	1623	Merged with VTB on Jan. 1, 2018.
6	Bank of Moscow	2748	Spark indicates that Bank of Moscow was merged with VTB in 2016 (a small part was allowed to continue separately as AO BM-Bank)
7	Alfa-Bank	1326	
8	Unicredit Bank	1	
9	Promsvyazbank	3251	According to the order of the Bank of Russia dated Dec. 15, 2017, No. OD-3525, the functions of the temporary administration for the management of Promsvyazbank were assigned to the Management Company of the Banking Sector Consolidation Fund of the CBR for a period of six months, with the suspension of powers of the management board of Promsvyazbank.
10	Rosbank	2272	
11	Nomos-Bank, now FK Otkrytie	2209	Nomos became FK Otkrytie in 2014, after it was acquired by Otkrytie Group in 2012 (Otkrytie brokerage and Bank Otkrytie). In 2013, the two banks Nomos Regiobank and Nomos Bank Siberia were also merged into Nomos Bank. According to the CBR order of Nov. 29, 2017 (No. OD-3341), the functions of the temporary administration for the management of Bank FK Otkrytie were assigned to the Management Company of the Banking Sector Consolidation Fund (LLC) of the CBR for a period of six months, with the suspension of powers of the management board of Bank FK Otkrytie.
12	Raiffeisenbank	3292	
13	Transkreditbank	2142	Merged with VTB24 on Nov. 1, 2013.
14	Bank Uralsib	2275	
15	Bank Sankt-Petersburg	436	
16	MDM Bank, now Binbank	323	Merged with FK Okrytie on Jan. 1, 2019. MDM Bank has a complicated history. On Aug. 6, 2009, the former MDM-Bank (liquidated) and Ursa Bank were merged to form MDM Bank. The earlier MDM-Bank was liquidated and Ursa Bank renamed MDM Bank. However, since MDM Bank was the larger of the two and sent more board members to the new board of the merged bank, we use the former MDM Bank in our sample for 2007 (and not the former Ursa Bank). According to the CBR order of Sept. 20, 2017 (No. OD-2723), temporary administration was appointed for the management of PJSC Binbank for a period of six months with the suspension of the powers of the management board of PJSC Binbank.

			According to the CBR order of Dec. 15, 2017 (No. OD-356), the functions of the temporary administration for the management of the bank were assigned to the Management Company of the Banking Sector Consolidation Fund (LLC). Roman V. Romanenko was appointed as the head of the temporary administration for the management of PJSC Binbank from Dec. 15, 2017. On December 15, 2017, when temporary administration was imposed, the powers of the bank's management board were suspended.
17	Ak Bars Bank	2590	
18	KhKF (Home Credit Finance) Bank	316	
19	Citibank	2557	
20	Ab Rossiya, Ao	328	
21	Moskovski Kreditny Bank	1978	
22	Bank Russki Standart	2289	
23	Khanty-Mansiski Bank	1971	Acquired by Nomos Bank in 2010, later merged with FK Otkrytie on Aug. 22, 2016.
24	Svyaz-Bank	1470	
25	Nordea Bank	3016	Previously ORGRESBANK
26	Bank Petrokommerts	1776	Merged with FK Otkrytie on Jun. 15, 2015.
27	Globeksbank	1942	Merged with Svyazbank on Nov. 26, 2018
28	Bank Zenit	3255	
29	Bank Vostochny	1460	
30	ING Bank (Evraziya)	2495	

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