

**THE RESTRUCTURING OF THE FINANCIAL SYSTEM IN  
BELARUS WITH SPECIAL CONSIDERATION TO THE BANKING  
SYSTEM**

**Eugeniusz Gostomski\* , Tomasz Michałowski\*\***

**ABSTRACT**

The paper examines the restructuring of the financial system in Belarus which began after the collapse of the Soviet Union. Special consideration is paid to the country's banking sector. The authors present the Belarusian banking system at the beginning of transformation, the role and functions of the Belarusian central bank, the development of commercial banking in Belarus, the participation of foreign capital in the Belarusian banking system and the status and prospects for development of the banking system in the analyzed country. Basic information on the Belarusian insurance sector and capital market is also provided. The authors conclude that despite significant changes the Belarusian financial sector is still underdeveloped which is reflected, inter alia, in the low ratio of banking penetration in the Belarusian society, low ratio of insurance premiums to GDP, small and illiquid capital market.

**Keywords:** *Belarus, Financial sector, Banking, Transformation*

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**INTRODUCTION**

The financial system is the important component of the economy of every country. It provides a mechanism for co-creation of money by firms and households and cash flow among business entities. The financial system consists of financial institutions, financial markets on which transactions in

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financial instruments are undertaken, infrastructure, and the regulations and rules governing their operation (NBP, 2013). In the financial system the banking sector, insurance sector, factoring and leasing institutions, institutions of collective investment, brokerage offices and other institutions providing banking services can be distinguished. The most important part of the financial system of Belarus is the banking system, which accounts for over 95 percent of the assets of the financial system of the country.

### **THE BELARUSIAN BANKING SYSTEM AT THE BEGINNING OF TRANSFORMATION**

By the end of 1990, the Belarusian banking system had been a part of the Soviet banking system. In 1991, that is still before the collapse of the Soviet Union in December that year, Belarus started to build its own two-tier banking system based on universal banks. The legal basis for these actions were the two acts of December 1990:

- The Act on the National Bank of the Republic of Belarus,
- The Act on banks and banking activity in the Republic of Belarus<sup>1</sup>.

All banking institutions of the Soviet Union situated in the Belarusian territory became the property of Belarus. On the basis of the Belarusian Republican Bank of the USSR, the National Bank of the Republic of Belarus (NBRB) was established. In turn, five specialized Soviet banks were transformed into five large state-owned commercial banks. These were: Belarusbank (former Sberbank Belarus), Belagroprombank, Belwnesheconombank, Belbusinessbank and Belpromstroibank. These banks dominated the banking system of the country for many years.

Initially, as an independent country, Belarus, like the other countries of Central and Eastern Europe, opted for market reforms. As a matter of fact, the transition from centrally planned to market economy was very slow and during the first five years Belarus changed the rules of functioning of its economy the least of all former socialist countries. After Alexander Lukashenka had come to power in 1994, Belarus's political system was transformed into a presidential republic with distinct characteristics of an authoritarian state. There was a shift away from market reforms, the privatization of state enterprises was inhibited and the government control over the economy was strengthened. The hybrid economic system involving

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<sup>1</sup> Those acts were consulted with the International Monetary Fund and were based on the experience of the Dutch banking system.

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the state and private property dominated by the state bureaucracy persists to this day, which exerts an impact on the functioning of banks in Belarus.

#### **THE ROLE AND FUNCTIONS OF THE NATIONAL BANK OF THE REPUBLIC OF BELARUS**

The National Bank of the Republic of Belarus is the central bank of Belarus. Besides its headquarters in Minsk, it has five branches in the major Belarusian cities: Brest, Vitebsk, Gomel, Grodno, and Mogilev. The NBRB was established in the early 1990s as an institution independent of the government, yet after A. Lukashenka had come to power, it lost its independence. Monetary policy in Belarus was nationalized, the central bank was obliged to finance the state budget deficit, provide loans or guarantees to non-reformed sectors and state-owned enterprises preferred by the state.

In 1998, pursuant to presidential decree, the NBRB was subordinated to the government. The President was granted the right to dismiss the President of NBRB and to revoke or suspend the execution of all decisions of the central bank.

The Bank is obliged by the government to provide loans to finance projects identified by the state, for example in the area of agriculture and housing. In 1995, the NBRB created the Bank Guarantee Fund which returns savings deposits to individuals in critical situations. The main tasks of the NBRB are as follows (NBRB, 2013a):

- protecting the Belarusian ruble by maintaining its stable purchasing power and securing the exchange rate;
- safeguarding the stability of the banking system of Belarus;
- ensuring the efficient, reliable, and secure functioning of the payment system of the country.

Gaining profit is not among the main objectives of the NBRB. The core functions of the Bank are as follows (NBRB, 2013a):

- conducting monetary policy and foreign exchange policies in accordance with the objectives of the government;
- issuing the Belarusian rubles and securities of the NBRB;
- creating and managing the foreign exchange reserves of the state;
- arranging the interbank settlements and cash transactions;
- regulating the credit market and providing loans to banks;
- providing banking services to the state budget;

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- providing intermediary services as a government agent in the sale of the government securities;
- carrying out the supervision of banks;
- registering banks and non-bank financial institutions.

### THE DEVELOPMENT OF COMMERCIAL BANKING IN BELARUS

The first private commercial banks in Belarus were established in the late 1980s as a result of the transformation of the Soviet special banks into joint stock companies. Until now, most of those banks have belonged to the group of six major banks which is dominant in the Belarusian banking system. These banks, except for Priobank that is controlled by the Austrians, are characterized by a high share of the state in the authorized capital. The government and the central bank exert strong influence on their strategy. A special role in the market of banking services is played by Belarusbank, which has the largest network of bank branches situated throughout the country. Most of the Belarusians have deposited their savings in that bank.

**Table 1: Basic Data on the Banking Sector in Belarus, 2000-2012 (in each case the beginning of the year)**

Specification	2000	2005	2010	2011	2012
Number of banks	31	30	32	31	31
Banks with foreign capital	6	18	25	26	26
Assets of the banking system as a percentage of GDP	27.5	32.2	60.6	77.5	94.6
Share of state-controlled banks* in total assets of the banking sector (in %)	66.0	75.2	72.4	71.7	64.9
Share of banks controlled by foreign investors* in total assets of the banking sector (in %)	4.3	16.2	16.4	27.3	34.0
Share of problem loans in total banks' assets (in %)	15.2	1.9	4.2	3.6	4.2
Capital adequacy ratio (in %)	24.4	26.7	19.8	20.5	24.7
ROA (in %)	1.1	1.3	1.4	1.7	1.6
ROE (in %)	8.3	6.8	8.9	11.8	14.9

\* Banks in which the state has more than 50% of the authorized capital.

\*\* Banks in which foreign investors have more than 50% of the authorized capital.

**Source:** Own elaboration based on the data of the NBRB.

In the 1990s, several dozen small private banks which focused mainly on financing enterprises were established in Belarus. Their owners were large companies from the energy industry, trade unions and private individuals

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from home and abroad. The incentives to support the establishment of banks were: a low ratio of banking penetration in the Belarusian society, strong demand for banking products from companies, and the expected high rate of return on the capital invested in new banks. In 1994, 48 commercial banks operated in Belarus. However, many of them were of low human, technological and financial capacity and quickly collapsed or were taken over by stronger banks. In 1991-2003, 21 bankruptcies of private banks were registered in Belarus. At the beginning of the new century, there were 25 banks in Belarus. In the following years, their number increased to 32 (see table 1).

Several of the largest Belarusian banks have opened representative offices in Warsaw. These are: Belarusbank, Priorbank, Belinvestbank, Belwnezesekonombank, and Belpromstroibank.

In the last two decades, the banking sector in Belarus has been developing very unevenly which has been influenced by the regulatory changes and the economic situation of the country. There have been the phases of both dynamic development and banking crises. Throughout this period, the role of the banking system in the national economy has increased and its structure has changed significantly. In 2000, the assets of the banking sector in relation to GDP were at 27.5 percent and by 2012 they had risen to 94.6 percent (table 1). The increase in assets resulted mainly from the increase in bank lending both to businesses and individuals. There has also been an increase in the ratio of bank deposits to GDP. In 2012, the Development Bank of the Republic of Belarus was established. It is the financial institution engaged in financing investment projects of a public benefit. It is subordinated to the government.

Due to their weak integration with the international financial markets, Belarusian banks were not affected by the global financial crisis. The Belarusian banking system went also relatively mildly through the debt crisis that hit Belarus in 2011. As a result of the devaluation of the Belarusian ruble (it lost 64 percent of its value against the US dollar), losses were suffered mostly by foreign owners of banks, for which the size of profits and the amount of capital invested calculated in US dollars or euros are the most important. It is estimated that they lost nearly half a billion US dollars, that is half equity involved in the country. Some banks suffered losses too, but none of them fell. In 2012, there were signs of economic stabilization, which was reflected in the decline in inflation to 21.8 percent. The situation of banks also improved.

**FOREIGN CAPITAL IN THE BELARUSIAN BANKING SYSTEM**

Due to the large role of the state in the economic life of the country and strained political relations with Western countries, Belarus is seen in the world as a country of high political and economic risk. Therefore, foreign investors are very cautious when it comes to investing and doing business in that country. This also applies to banks. In addition, there are formal restrictions on the access of foreign capital into the banking system. They arise from the fears of the government that the expansion of foreign capital could threaten the position of indigenous banks in the market of banking services. For many years, foreign investors could only take over the shares of small banks in Belarus. The impassable limit of 25 percent of foreign ownership in total equities of the banking sector was in force. It was only in September 2008, when the threshold was increased to 50 percent (Makhlis, 2009). Even in 2010, the share of banks controlled by foreign investors in the assets of the banking system was low and amounted to only 16.4 percent. However, the role of these banks increased significantly in 2011-2012, which is evidenced by the increase in their share in the market respectively to 27.3 percent and 34.0 percent (see table 1).

Among foreign banks, it is only the Austrian bank Raiffeisen International which has managed to take a significant position in the Belarusian market. In 2003, Raiffeisen International acquired a majority stake in one of the largest banks in Belarus – Priobank. Today, Priorbank, which distinguishes itself by modern technology and high efficiency, is the sixth largest bank in Belarus in terms of assets (NBRB, 2013b). At the beginning of 2013, it had 98 branches and almost 2500 employees. It is a universal bank serving nearly 700,000 private and corporate clients (Priorbank, 2013). It offers a wide range of banking products and holds the strongest position in settlements of Belarusian foreign trade transactions in which its market share is 40 percent. In the area of serving foreign transactions, it cooperates with Polish Bank Pekao SA.

Since 2007, a growing interest in banks in Belarus has been observed among Russian investors. They invest particularly in small banks. The only exception is the Russian state bank Sberbank, which in late 2009 acquired the large Belarusian BPS-Bank for USD 291 million (GET Belarus, 2011).

At the beginning of 2008, Polish Getin Bank acquired a majority stake in the small bank "Sombelbank". In February 2013, the name of the latter bank was changed into Idea Bank BelTA. 100 percent of its capital is in the hands of foreign companies. It is one of the fastest growing banks in the Belarusian market. It specializes in comprehensive banking services to households and small and medium-sized enterprises. It focuses strongly on the development of mini-branches located in shopping centers. At the end of

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2012, its sales network consisted of 109 branches, which placed it 7<sup>th</sup> in Belarus in this regard. BelTA Idea Bank is a leader in the sale of installment loans and cash loans. It distinguishes itself among the other banks by a high quality of services and profitability exceeding twice the average for the Belarusian banking system (Idea Bank Białoruś, 2013).

The number of banks with foreign capital has increased gradually. However, the share of foreign investors in the Belarusian banking sector is still not large compared to the other countries of Central and Eastern Europe. In 2000, foreign investors owned shares in six banks in Belarus. By 2012, that number had increased to twenty six. In 2012, the share of foreign investors in the capital of nine banks was 100 percent. In the case of 23 banks the ratio exceeded 50 percent. Foreign capital came from Austria, Poland, Russia, Cyprus, Switzerland, Germany, the Netherlands, Luxembourg, Kazakhstan, the United Kingdom, the United States, Ukraine, Lithuania and other countries. In 2012, the share of banks controlled by foreign investors in the total regulatory capital of the Belarusian banks was at 26 percent, and in total assets at 34 percent.

In the nearest future, a further gradual increase in the importance of foreign capital in the banking system of Belarus will probably be observed. The low level of usage of banking services among the Belarusian society, weak competition in the market of banking services, and relatively high rate of economic growth in Belarus will encourage foreign investors to undertake banking activities in this country.

Belarusian market needs new banking products, services and technologies. A lot of financial products which are commonly offered to retail customers in developed countries are not available in Belarus. Investment banking and private banking are in the initial phase of development. With the help of foreign banks and foreign capital, Belarusian banking could reach the level of development similar to its western neighbor much earlier.

### **THE STATUS AND PROSPECTS FOR DEVELOPMENT OF THE BANKING SYSTEM IN BELARUS**

According to the Belarusian central bank, at the beginning of 2013, 32 banks operated in Belarus. As many as 23 of them were controlled by foreign investors, 4 were controlled by the state and 5 by private individuals from Belarus. Five banks were classified by the NBRB as large, 5 as medium and 22 as small credit institutions.

As of 1 January 2013, the share of state-owned banks in the banking sector's authorized capital was at 79 percent. The corresponding share of banks in which foreign investors had a majority stake was at 19.6 percent.

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The rest of the capital (1.4 percent) was in the hands of private individuals from Belarus.

At the beginning of 2013, the assets of all Belarusian commercial banks amounted to BYR 317,780 billion (a 23.5 percent increase compared to the previous year), i.e. USD 37 billion and 95 percent of GDP. The state-owned banks accounted for 64.8 percent of total assets, banks in which foreign investors had a majority stake for 34.2 percent and the remaining banks for 1 percent.

High concentration is a characteristic feature of the Belarusian banking system. As of 1 January 2013, five largest banks owned 79.8 percent of all banks' assets (own calculations based on NBRB, (2013b) and NBRB, (2013c)). In this group of banks, which comprises banks of which each accounts for more than 5 per cent of total assets of the banking system, there are three banks in which the state has a majority stake and two banks which are controlled by foreign investors. The largest Belarusian banks are presented in table 2.

**Table 2: Top five banks in Belarus by total assets, (as of 1 January 2013)**

Name of the bank	Owner	Assets in trillions of BYR
Belarusbank	Belarusian government	129.5
Belagroprombank	Belarusian government	58.3
BPS – Sberbank	Sberbank (Russia)	33.0
Belinwestbank	Belarusian government	18.3
Bank BelVEB	Vnesheconombank (Russia)	17.1

**Source:** NBRB (2013b).

As much as 64 percent of total assets of the banking system of Belarus are receivables from loans to non-financial entities. Liabilities are dominated by liabilities to customers (66.4 percent). According to estimates of the credit agencies, about half of all loans are preferential loans or loans granted by order of the government mainly to state-owned companies or to finance investment projects which are important from the point of view of the country's authorities. Loans in Belarus are the important instrument of the government economic policy. However, such a large share of government loans makes the banking sector highly dependent on the government and negatively affects the level of competition on the credit market.

The Belarusian banks are well-capitalized which is evidenced by the high capital adequacy ratio, which at the beginning of 2013 was at 20.8 percent (yet, one year earlier the ratio was at the higher level of 24.7 percent). Although, in 2012, the efficiency of Belarusian banks deteriorated,

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it was relatively high: ROE (gross) amounted to 14.85 percent and ROA (gross) to 2.21 percent. Banks which were controlled by foreign investors were characterized by the highest capital efficiency. Efficiency indicators for those banks were almost twice higher than for the whole banking sector: ROA was at 3.49 percent and ROE at 29.42 percent. At the beginning of 2013, the share of bad loans in the receivables from granted loans was at 5.5 percent, compared to 4.2 percent one year before.

Balance sheets of the Belarusian banks are characterized by high dollarization, both on loan and deposit side. As far as loans in foreign currency are concerned, business loans prevail. The high share of balance sheet items in foreign currencies, mainly in US dollars makes banks heavily exposed to foreign exchange risk. The reduction of the degree of dollarization of both Belarusian households and businesses requires restoring confidence in the national currency, which is related to the reduction of inflation in the country, the appropriate relation between dollar deposit and loan interest rates to interest rates of financial instruments in the Belarusian rubles, exchange rate policy, and fiscal policy.

A major challenge for the banking sector in Belarus is the reduction of the share of the state in this sector. It can be achieved by further privatization of banks and reducing the government impact on bank loans, which weakens the competition in the banking sector and makes it difficult for banks to perform the function of intermediary in the financial market in an optimal way.

The prospects for the development of the Belarusian banking are promising. Belarus has a relatively good telecommunications infrastructure which makes a very important base for the development of electronic banking. Although, the ratio of banking penetration in the Belarusian society is still low, it has been rising gradually. Households and businesses are open to new banking products and ready to take loans. Rising interest of foreign banks, particularly from Russia, in the expansion on the Belarusian market because of the possibility of obtaining high returns on invested capital, should be expected in the future.

### **THE INSURANCE SECTOR IN BELARUS**

The insurance sector in Belarus began to develop after the abolition of the state monopoly in insurance in 1990. At the beginning of 2012, there were 25 insurance companies in Belarus, including four life insurance companies and the reinsurance state institution Belarusian National Reinsurance Organization. Eight insurance companies were controlled by the

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government, eight by foreign entities and nine companies belonged to the domestic private entities (NBRB, 2012).

The characteristic feature of the insurance sector in Belarus is a high level of concentration. The largest insurance institution is a public enterprise Belgosstrakh. In the first three quarters of 2012, that company accounted for about 50 percent of total contributions collected under direct insurance and coinsurance. At the same time, the ten largest insurance companies (mostly state ones) had a market share of 95 percent and the top five ones of 77 percent (table 3). Approximately 52 percent of the proceeds of insurance companies are insurance premiums from compulsory insurance (NBRB, 2012).

**Table 3: Top Five Insurance Companies in Belarus by Contributions Collected Under Direct Insurance and Coinsurance, January-September 2012**

Name of the company	Contributions collected (billions of BYR)	Market share (%)
Belgosstrakh	1,557	49.7
TASK	267	8.5
B&B insurance company	228	7.3
Promtransinvest	177	5.7
Belneftstrakh	173	5.6

**Source:** Belgosstrakh (2012).

The competition among insurance companies in Belarus is highly constrained by the limited scope of authorized activities of private insurance companies. Compulsory insurance in Belarus can only be made by state-owned companies. Other companies can provide compulsory insurance provided that more than half of shares in the authorized fund is owned by the Belarusian state (IMF, 2009; Ministry of Economy of the Republic of Belarus & Revera Consulting Group, 2012).

The supervisory authority for the insurance sector is the Insurance Business Supervisory Committee of the Ministry of Finance. Most insurance companies operate in Minsk.

Insurance in Belarus is underdeveloped which is evidenced by the low ratio of insurance premiums to GDP. In 2011, it amounted to only 0.86 percent, compared to 0.81 percent in 2010. This ratio is lower than in the neighboring countries of Belarus (NBRB, 2012).

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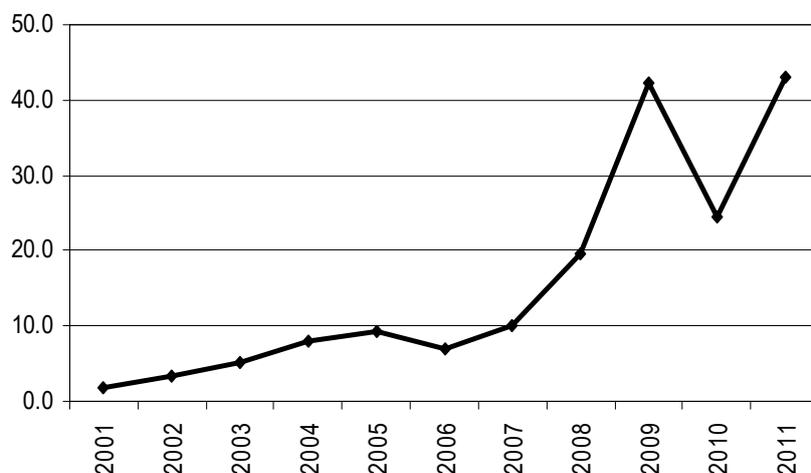
### **THE CAPITAL MARKET IN BELARUS**

Despite growing significance of the capital market in Belarus, it is still young, small and illiquid. Equity securities have the largest share in the total volume of issue of securities in the country. As of 1 January 2013, the volume of equity papers in circulation amounted to BYR 137.6 trillion (26.1 percent of GDP). At the same time, the value of corporate bonds in circulation totaled BYR 58.9 trillion (11.2 percent of GDP). The above mentioned bonds represented more than 600 issues of 227 institutions (22 banks and 205 non-bank institutions) (NBRB, 2013c). It should be noted that the expansion of the corporate bonds market as an alternative way of borrowing funds by legal persons is a new trend in Belarus. At the beginning of 2012, corporate bonds accounted for one third of the total amount of securities in circulation. To compare, five years earlier, they were almost at zero level (NBRB, 2012).

At the beginning of 2013, the government long-term bonds denominated in Belarusian rubles which were in circulation amounted to BYR 13.9 trillion at face value. At the same time, the volume of government bonds denominated in foreign exchange which were in circulation in the domestic market totaled USD 1.4 billion (NBRB, 2013c).

The only institutional stock exchange of the country is the Belarusian Currency and Stock Exchange (BCSE). It was established in 1998 in Minsk. Its main shareholder is the Belarusian Central Bank. The BCSE organizes trade in foreign currencies, futures, and securities. Tradable securities are government securities, corporate securities, municipal loan bonds, bills of exchange.

In 2011, the total volume of securities trade on the floor of BCSE amounted to BYR 43.1 trillion, compared to BYR 10.0 trillion in 2007 and BYR 3.4 trillion in 2002 (figure 1). The trade in BCSE is highly dominated by the trade in government securities. In 2011, government bonds accounted for 80.2 percent of the total volume of securities trade. The corresponding shares for non-government bonds and equity securities were respectively at 19.2 percent and 0.6 percent (Belarusian Currency and Stock Exchange, 2012). The capitalization of tradable equity securities in circulation in the market totaled only 0.7 percent of GDP at the beginning of 2013, compared to 3.2 percent GDP one year before (NBRB, 2013c).



**Figure 1: Volume of Securities Trade on the BCSE in 2001–2011, in trillions of BYR**

**Source:** BCSE, 2006, 2008, 2012.

## CONCLUSIONS

The financial sector of Belarus has undergone serious changes since the collapse of the Soviet Union. The two-tier banking system based on universal banks has been created. The number of banks and insurance institutions and the range of financial products offered to customers have substantially increased. The growing participation of foreign capital in the Belarusian financial sector has been observed. However, the sector is still underdeveloped which is reflected, inter alia, in the low ratio of banking penetration in the Belarusian society, low ratio of insurance premiums to GDP, small and illiquid capital market. The Belarusian financial sector remains relatively closed to the rest of the world. Some regulations governing the functioning of that sector do not meet international standards. Sustainable development of the Belarusian financial sector is highly constrained by the strong influence of the government.

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