Russia's Sberbank and a Fresh Look at the Glass-Steagall Act

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I. INTRODUCTION

As is well known, Russia is currently experiencing radical, fundamental changes. Many of the issues presented for the Russian banking system as a result of these changes were also faced by American policymakers during the tumultu-

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ous financial period of the 1920s and 1930s. In response to the collapse of the United States banking system at that time, Congress enacted the Banking Act of 1933, or the Glass-Steagall Act (the "Act") which separated commercial banking from investment banking in order to help ensure safer banking practices.

This article examines whether Sberbank, one of Russia’s largest commercial banks, should be similarly prohibited from engaging in one activity that has been primarily reserved for investment banks under the American system—investing in equity securities. The author concludes that the best legal prescription is to prohibit Sberbank from making such investments. Although Russian lawmakers and policy analysts are this article’s audience, this article identifies several factors that might be applicable for other legal scholars in evaluating this issue in other countries. This question is significant because it relates to protecting depositors by managing bank risk as well as fundamental issues of system development.

In order to make a recommendation on a legal issue, it is first necessary to state the underlying purposes or normative premises. There are four basic premises that help clarify the rationale behind particular policy choices in this area of banking law: economic efficiency ("efficiency"), social equity, system development, and institution maintenance. Institution maintenance suggests that public policy choices are based, at least in part, on the desire of an organization to ensure its own survival and prominence. System development emphasizes the impact of the selection of a particular model system (for example, the universal banking model for commercial banking as discussed later in this article) and adherence to the values of that system in public policy decisions. While equity and efficiency are fairly straightforward concepts, it is important to realize that, although these two goals may sometimes be in conflict, they also often overlap.

One of the most basic objectives of banking regulation in most countries is to protect depositors. This article focuses on this policy goal under the arguably broader heading of managing bank risk. A policy that promotes effective management of bank risk advances both equity and efficiency. Such a policy is efficient because it increases public confidence and, hence, financial intermediation; it is equitable because it protects the depositors, who include the less sophisticated segments of the population. The more difficult question is how to obtain effective management of bank risk.

In addition to discussing the management of bank risk, this article also examines this legal issue in a broader, macroeconomic sense. Even though efficiency and equity are relevant to this issue, system development might be the best description of this consideration. In analyzing this question, this article examines many related factors. There are two caveats in this policy discussion.

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1. Cf. EDWARD L. RUBIN, Payment Law in Russia 3, Sept. 1, 1995 (unpublished article, on file with author) (outlining the same goals for payment law).
2. Id. at 9.
3. MAXWELL J. FRY, MONEY, INTEREST, AND BANKING IN ECONOMIC DEVELOPMENT 354 (2nd ed. 1995).
4. Yet another label for this issue is safe banking practices.
First, microeconomic efficiency is not per se part of this system development analysis, and microeconomic efficiency analysis is even generally considered to be in opposition to the policy of system development. Nonetheless, given the transformational state of Russia's economy, this analysis is appropriate because Russian policy makers will have to make fundamental systematic choices. They are, in a sense, building a completely new system, not merely adjusting an old one. In general terms, the issue of separating investment banking from commercial banking is especially important in building new systems. In a macroeconomic sense, efficiency can arguably be considered part of this system development analysis. Second, public choice effects and difficulties in predictive accuracy can further impair the efficiency of system development as a policy norm. Notwithstanding these two substantial caveats, this article discusses the issue of Sberbank's involvement in equity securities in the context of this system development policy.

Part II of this article provides background on the Russian banking system and Sberbank. Part III briefly discusses the Glass-Steagall Act and sets up some of the policy issues. Part IV analyzes the management of bank risk primarily in the context of efficiency and equity, and Part V examines broader systematic issues primarily in the context of efficiency, equity, and system development. Part VI states some of the author's recommendations; however, much of the prescriptive analysis is discussed throughout Parts IV and V since the final recommendations are based on the analysis of the factors discussed in those sections.

In light of the frequent changes in Russian laws, the purpose of this article is not to provide a description of the current status of the laws, and this article should not be relied upon for such a description. Rather, the aim of this article is to examine the underlying policy analysis of the above issues.

II. BACKGROUND OF RUSSIAN BANKING & SBERBANK

During the Communist era, the Russian banking system served as the annual central plan's accounting network. Gosbank, the central bank, had several branches, and the government transferred credits on Gosbank's books to account for physical production flows and transactions between state-owned enterprises. In 1987, the government divided Gosbank into several specialized banks for different sectors of the economy while still maintaining central control of these banks. In 1988, a few commercial banks started to operate even though their legal foundation was vague. In 1990, the government enacted

5. RUBIN, supra note 1, at 9-10.
6. Id. at 10.
8. Id.
9. Id.
10. Id.
formal banking legislation and installed a licensing and regulatory process. After the Soviet Union broke up, the government partially or fully privatized the former specialized banks by issuing shares to the public; however, the government retained some degree of control over some banks, including Sberbank. The remainder of the old Gosbank was transformed into the new Central Bank of the Russian Federation (the Central Bank).

In recent years, the number of new banks has grown rapidly. There are now more than 2,500 commercial banks in Russia. Other than Sberbank, there are three basic categories of Russian commercial banks. Large industrial firms have established their own banks, which serve as their treasury departments. The former specialized banks make up the second category of independent commercial banks. The third category of banks includes a large number of completely new commercial banks of varying size. Additionally, some foreign banks operate in Russia.

In addition to rapid changes in the nature of Russian banks, there have also been many regulatory changes affecting Russian banks in recent years. Since January 1, 1988, state banks existing on that date have had to operate under full economic accountability. As a result, for the first time, they have had to be accountable and responsible for how they use their resources. Some of the important statutes include the Banking Act and the Central Bank Act. The Central Bank of Russia, which succeeded Gosbank, is only a regulatory institution, unlike Gosbank, which formerly granted loans directly to various government ministries and industries. The Central Bank licenses and supervises the commercial banks and manages the Russian currency. The Central Bank is legally independent of the Russian government.

One of the recent, important events concerning Russian banks was the August 1995 banking crisis. Although a number of reasons may explain the crisis, one can briefly summarize by stating that there was a liquidity crisis. Inflation had been at annual rates over 1000 percent generating high currency profits for banks investing in hard currency. In early 1995, the government tightened monetary policy by, for example, increasing banks' reserve require-

11. Id.
12. Id.
13. Id.
14. Id.
15. Id.
16. Id.
17. Id.
18. Id.
19. Id.
20. Id.
22. Id.
23. Id. at 148.
24. Id.
25. Id.
26. JAFFEE & LEVONIAN, supra note 7, at 2.
27. Id.
ments so that inflation decreased, and the ruble started to appreciate.\textsuperscript{28} As a consequence, many banks started to lose on their currency investments and had to forego interest due to higher required reserves.\textsuperscript{29} Many banks also stopped transactions in the interbank market because of a lack of confidence in the other banks.\textsuperscript{30} Recently, Russia's Central Bank revoked the licenses of about 12\% (or 315) of the commercial banks because of this liquidity crisis.\textsuperscript{31}

As mentioned above, Sberbank is a former specialized bank. As a result, the state owned the bank and charged it with special tasks for the economy under the former centralized system.\textsuperscript{32} During the Soviet era, Sberbank's task was primarily to "collect personal savings for which there was no other legal outlet."\textsuperscript{33} The law dictated that Sberbank loan 30\% of its deposits at highly subsidized rates to deserving groups such as war veterans.\textsuperscript{34} The remainder of the deposits was used to finance the government deficit.\textsuperscript{35} In 1991, with the support of President Boris Yeltsin, Sberbank's former chairman of 25 years succeeded in transforming the bank into a joint-stock company.\textsuperscript{36} In May 1993, new management assumed control of the bank with the goal of transforming Sberbank "from a dowdy savings bank into a universal bank that can compete with the likes of Germany's Deutsche Bank."\textsuperscript{37} Sberbank continues to have a majority of Russian deposits and is currently the only bank with governmental deposit insurance.\textsuperscript{38}

Sberbank appears to be pursuing its intentions of becoming a large universal bank. Anatoly Novikov, director of the bank's credit department, has stated that "[t]he Savings Bank of Russia will reduce the volume of its credit portfolio and increase investment in the stock market."\textsuperscript{39} Moreover, as of early 1995, Sberbank had already invested "nearly R1t in non-government securities."\textsuperscript{40} Sberbank intends to invest primarily in short-term T-bills.\textsuperscript{41} It appears that Sberbank also intends to invest in equity securities because "[t]he bank's experts believe that the fuel complex, automotive industry and the military-industrial complex hold out much promise in the future."\textsuperscript{42}

\hspace{1cm} \begin{footnotes}
\textsuperscript{28} \textit{Id.}\hfill
\textsuperscript{29} \textit{Id. at 3.}\hfill
\textsuperscript{30} \textit{Id.}\hfill
\textsuperscript{31} \textit{Russia Yanks Banking Licenses,} \textit{Wall St. J.}, Jan. 11, 1996, at A10.\hfill
\textsuperscript{32} \textit{Robinson, supra} note 21, at 55.\hfill
\textsuperscript{33} \textit{Into the Fray: Sberbank,} \textit{The Economist}, May 29, 1993, at 86.\hfill
\textsuperscript{34} \textit{Id.}\hfill
\textsuperscript{35} \textit{Id.}\hfill
\textsuperscript{36} \textit{Id. at 87.}\hfill
\textsuperscript{37} \textit{Id.}\hfill
\textsuperscript{38} \textit{Robinson, supra} note 21, at 55.\hfill
\textsuperscript{39} \textit{Sberbank to Increase Investment on Stock Market,} \textit{CIS Econ. & Foreign Trade}, Sept. 12, 1995, \textit{available in WESTLAW, CISECFT Database}.\hfill
\textsuperscript{40} \textit{Id.}\hfill
\textsuperscript{41} \textit{Id.}\hfill
\textsuperscript{42} \textit{Id.}\hfill
\end{footnotes}
The state still "controls" Sberbank. The Central Bank holds a 51% stake in the shares of Sberbank and it is not clear who owns the other 49%. Even the legislature's top committee staff member for banking legislation does not know for certain who owns the other 49% of Sberbank. In 1993, non-privatized institutions apparently held most of these shares. As of 1995, it appears that there is an over-the-counter market for Sberbank shares. The status of the future ownership and control of Sberbank is also somewhat unclear. In early 1995 there was a proposal to privatize the Central Bank's shares of Sberbank; however, the legislature has apparently postponed any such privatization for the immediate future. Although the Central Bank owns 51% of Sberbank, it is questionable to assume that it "controls" Sberbank. Sberbank is technically independent. For example, even though the Central Bank's former acting chairwoman Tatyana Paramonova desired a higher monthly accrued interest rate (to about 8%), Sberbank's Board of Directors lowered the monthly accrued interest rates on term deposits to 6%.

In addition to understanding that Sberbank and Russian banks are going through enormous changes, it is important to remember that all parts of Russian society and economy are going through a fundamental transformation. Many of these other changes directly affect Sberbank and other Russian commercial banks. For example, the process of privatization and the recent development of the securities markets affect Sberbank and other banks by presenting them with more potential investment decisions. Political changes also affect these banks by either developing or hindering the progress of privatization and the securities markets.

III. The Policies of the U.S. Glass-Steagall Act

A. The History of the Act

Before examining the relevant policy issues in Russian banking, it is helpful to examine briefly the policies and background of the Glass-Steagall Act. Even though Russia has a very different economic environment than the U.S., this examination is useful because Russia may face issues similar to those encountered by the U.S. during its turbulent financial period of the 1920s and 1930s. In fact, many of the policy issues of the Glass-Steagall Act will serve as a framework for discussing Sberbank throughout this article.

43. Robinson, supra note 21, at 55.
45. Id. at 27.
46. Into the Fray: Sberbank, supra note 33, at 87.
48. Russia: Sulky sideline, supra note 44, at 27.
In 1908, U.S. banks started to establish securities affiliates to participate in, among other things, floating bond issues and underwriting stock issues. The Senate’s investigation of these stock exchange activities indicated that national banks, their securities affiliates, and bank officers and directors participated in questionable practices which had an impact on the safety of depositors’ funds and caused damage to the banks’ customers and shareholders. The view of Congress was that the banks’ securities affiliates were a significant factor in causing the Depression. As a result of these findings, Congress passed the Glass-Steagall Act of 1933, which sharply reduced commercial banks’ permitted activities and compelled them to leave important areas of the investment banking business.

In Investment Co. Institute v. Camp, the Supreme Court analyzed the legislative history of the Glass-Steagall Act and struck down a regulation of the Comptroller of the Currency which had authorized national banks to operate investment funds. The Court discussed Congress’ concern with several hazards which arose from commercial banks’ involvement in investment banking. Jonathan Macey breaks down the Court’s analysis of these hazards into two basic categories: safety concerns and conflicts of interest concerns. In addition to these two concerns, a third related general concern of the Glass-Steagall Act is maintaining public confidence and preventing bank failures. This article will discuss these three topics in the context of the Supreme Court’s analysis. In addition, because many respected academics have been critical of the underlying policies and legislative purposes of the Act, this article will also state various criticisms and disadvantages of the Act. Some of this policy analysis will then be applied to determine what policy prescriptions should be recommended for Sberbank.

B. General Safety Concerns Regarding Banking Practices

In Investment Company Institute v. Camp, the Court stated that Congress was concerned with the “obvious danger” that commercial banks might make imprudent stock or security investments. In 1981, the Court elaborated on this concern and on the general policy justification of the Act:

53. See, e.g., JONATHAN R. MACEY, Special Interest Groups Legislation and the Judicial Function: The Dilemma of Glass-Steagall, 33 EMORY L.J. 1, 4 (1984). Senator Carter Glass, a principal drafter of the Glass-Steagall Act, stated that these affiliates “made one of the greatest contributions to the unprecedented disaster which has caused this almost incurable depression.” Id.
54. JENNINGS ET AL., supra note 52, at 81.
55. 401 U.S. 617.
56. Id. at 629-34.
57. MACEY, supra note 53, at 11.
It is familiar history that the Glass-Steagall Act was enacted in 1933 to protect bank depositors from any repetition of the widespread bank closings that occurred during the Great Depression. Congress was persuaded that speculative activities, partially attributable to the connection between commercial banking and investment banking, had contributed to the rash of bank failures. The legislative history reveals that securities firms associated with banks had engaged in perilous underwriting operations, stock speculation, and maintaining a market for the banks' own stock, often with the banks' resources.\(^6\)

Macey responds that "bank ownership of high grade, blue chip stock, which is prohibited by the Act, is inherently far less risky than many bank loans such as those to third world countries or to real estate investment trusts . . . ."\(^6^1\) He refutes any argument that stock or security purchases are more risky than most personal or commercial loans because rates of return should reflect differential risks and because there is no evidence of higher average rates of return on stocks.\(^6^2\) Even though lenders often have liquidation preferences over stockholders, stock's greater liquidity provides an alternative mechanism for safety. \(^6^3\) In any event, the Glass-Steagall proscriptions are too broad because they apply to all securities, including debt and equity.\(^6^4\) Hence, if one measures safety in terms of rate of return, "by forbidding banks from diversifying their asset portfolios by holding stock, the Glass-Steagall Act makes commercial banking a riskier endeavor, not a safer one."\(^6^5\)

This last statement refers to a portfolio theory critique of the Glass-Steagall Act. This theory suggests that diversifying bank activities can reduce bank risk.\(^6^6\) As long as returns on activities are not perfectly correlated, "the combined risk of loss will be relatively smaller than the risk of the sum of the individual activities."\(^6^7\) Securities activities would, therefore, be an example of providing commercial banks with opportunities for more effective diversification of their assets and operations.\(^6^8\)

George Benston further criticizes this analysis of general unsafe commercial banking practices by stating that "the evidence from the pre-Glass-Steagall period is totally inconsistent with the belief that banks' securities activities or investments caused them to fail or caused the financial system to collapse."\(^6^9\) According to his study of these issues, views such as those of the Supreme Court

61. JONATHAN R. MACEY, supra note 53, at 11.
62. Id. at 12.
63. Id.
64. Id. Note that this article limits its focus to deciding whether to regulate or prohibit Sberbank's involvement in equity securities.
65. Id.
67. Id.
68. Id. at 16.
cited above are due to misreading the record, failing to examine the actual data, or uncritically accepting legislators’ statements. 70

Although the diversified portfolio argument is based on legitimate finance theory, Helen Garten has criticized some elements of portfolio theory. 71 She first notes that there are generally two justifications for allowing banks to increase diversification. First, U.S. banks need to diversify to remain competitive with foreign banks and domestic integrated financial services providers so that banks can also offer a similar array of financial products to customers. 72 Garten notes that the Federal Reserve Board’s decision to create firewalls, which are restrictions on the integration of lending and underwriting, undermines this rationale. 73 This aspect of Garten’s analysis does not conflict with the portfolio argument.

Garten’s discussion of the second justification of diversification does, however, offer some astute analysis. She describes the second justification as a means to “reduce unsystematic, or unique, risk associated with investment in a single business,” which is just another way of describing the above financial theory based on correlation values. 74 Garten criticizes this approach on several grounds. First, economists disagree on whether an equity holder’s diversification investment strategy also reduces risk for corporations. 75 Because investors can easily diversify their own equity portfolios, they will probably not pay a premium to invest in a corporation merely on the basis of its own diversified investments. 76 Therefore, “if conglomerate stocks cannot command a premium, corporate managers will not want to pay extra to buy new businesses solely to create a diversified portfolio.” 77

Furthermore, Garten notes that diversification by a firm may be more difficult or less efficient than a securities investor’s diversification because, for example, buying divisions may be expensive. 78 Moreover, “[p]roblems in one operation may spill over into other operations if the businesses share funds, technology or customers. Bad central management and planning will affect all operations.” 79 In this context, the regulatory framework of firewalls does make sense. 80 Garten, however, notes that firewalls may not be sufficient:

70. Id. at 20-42.
72. Id. at 71. Note that Garten also earlier alludes to the diminished profitability of banks as a justification. This allusion arguably refers to an institutional maintenance rationale for bank diversification. In any event, the commercial banking industry and the securities industry have engaged in public choice political and lobbying battles over these diversification issues. See, e.g., JENNINGS ET AL., supra note 52, at 84.
74. Id. at 72.
75. Id. at 73.
76. Id.
77. Id.
78. Id.
79. Id. (emphasis added).
80. Id.
But it is clear that the regulators cannot rely entirely on firewalls to achieve proper management of diversified banks. Even if the firewalls worked perfectly, the benefits of bank diversification might still be lost due to unskillful management of the diversified banking operation . . . If parent company management is poor, all of the diversified operations will suffer.  

In practice, U.S. regulators have essentially handled this issue through rules (e.g., firewalls) and by trying to "ensure that senior bank holding company managers have the skills and experience needed to run a diversified enterprise and the internal monitoring and control devices needed to supervise junior officers." Moreover, the regulators evaluate this managerial aptitude and experience and skill of individual banks before giving banks permission to start undertaking risky new ventures.

C. Conflicts of Interest

In addition to general safety concerns, another justification of the Glass-Steagall Act in the U.S. is the specific concern of conflicts of interest. In Investment Company Institute v. Camp, the Supreme Court wrote, "[a]lthough the committee was very concerned about the plain conflict between the promotional interest of the investment banker and the obligation of the commercial banker to render disinterested investment advice." In 1933 and 1934, Ferdinand Pecora conducted the Stock Exchange Practices (SEP) Hearings of the Senate Committee on Banking and Currency which detailed many of the pre-Glass-Steagall conflicts of interest and general abuses. According to Robert E. Litan,

Hearings orchestrated by the chief counsel of the Glass subcommittee, Ferdinand Pecora, uncovered various abuses involving large banks and their securities affiliates. These hearings revealed that certain banks had made loans to securities purchasers to help support artificially [high] securities prices, dumped 'bad' securities with correspondents in trust accounts, and used securities affiliates to relieve the banks of their bad loans and to purchase stock in companies to which the banks had loaned money. George Benston, however, challenges the evidence in these hearings. He notes that these unsavory specified acts refer only to two banks and that the evidentiary record does not support most of the allegations.

Another form of this concern over conflicts of interest is that "a bank has an incentive to lend money to a financially distressed affiliate that it would not have if the affiliate were, in fact, independent of the bank." The theory is that a bank may try to throw good money after a bad investment because inaction

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81. Id. at 78-79.
82. Id. at 79.
83. Id. at 79-80.
84. 401 U.S. at 633.
85. BENSTON, supra note 69, at 16.
86. Id. at 46-47.
87. Id. at 47-89.
88. Id.
could result in a loss of the entire equity investment. This conflict of interest is exacerbated if the bank is dependent on the equity investment to such a high degree that the affiliate’s bankruptcy causes the bank to become bankrupt. In such a situation, a bank’s behavior may appear rational because the bank has nothing to lose. Macey sharply criticizes this theory because market incentives should influence banks’ lending in such a manner as to maximize the banks’ net revenues. Macey’s analysis is consistent with market finance theory, which holds that one generally makes investments on the basis of future expectations, not on the basis of past losses unless the analysis of those losses is a factor in future expectations. In short, this view is that finance theory holds that a rational decision maker will not generally throw good money after bad.

There is still a debate in the U.S. about whether or to what extent there are conflicts of interest when commercial banks engage in investment banking. George Benston is skeptical that sufficient evidence exists to support the charges of conflicts of interest against U.S. banks that participated in securities operations before the enactment of the Glass-Steagall Act in 1933. On the other hand, Garber and Weisbrod suggest that when bank holding companies try to achieve economies of scope through broader securities powers, these banks will have problems with conflicts of interest. This article makes no conclusion as to this issue in the United States, but this article does examine this issue in the context of Russia.

D. Maintaining Public Confidence and Preventing Bank Failures

In addition to concerns over general banking safety standards and conflicts of interest, another justification for the Glass-Steagall Act is the maintenance of public confidence and prevention of bank failures. Public confidence is important for at least two reasons: it increases efficient use of banks and efficient intermediation and it prevents bank runs and panics. Banks are particularly concerned about public confidence because the principle of fractional reserves maintains that banks generally do not hold a sufficient amount of cash to satisfy all customers’ withdrawal requests.

In Investment Company Institute v. Camp, the Supreme Court mentioned concerns about maintaining public confidence by noting that the failures of an affiliate might impair public confidence in the associated bank. Macey criticizes this analysis by arguing that public confidence would suffer to the same degree on bank losses on securities operations as on lending operations and that deposits “will simply flow to those banks that give sound investment advice.”

90. Id.
91. Id. at 559.
92. MACEY, supra note 53, at 13.
93. BENSTON, supra note 69, at 213.
94. GARBER & WEISBROD, supra note 89, at 563.
96. 401 U.S. at 631.
97. MACEY, supra note 53, at 14.
Macey also states, "[a]ny residual problems will be solved by deposit insurance."98 The perverse incentives and moral hazards of deposit insurance, however, undermine this latter argument as a justification for abolishing Glass-Steagall although this moral hazard problem may not necessarily cause a public confidence problem. These moral hazard problems are discussed further below. Di Lorenzo's position directly conflicts with Macey's view. He believes that the banking industry has a special status. He writes that in deciding whether to eliminate the separation of commercial and investment banking,

[the policy framework for that decision should focus principally on the need to maintain public confidence in banking. Analysis in that framework, in turn, leads to the conclusion that unwaivering (sic) separation of commercial and investment banking is the wisest course of action for Congress and the courts.99

E. A Model of System Development and Macroeconomic Efficiency

Finally, some commentators have noted that another basic justification for the Glass-Steagall Act is to develop a more efficient and equitable overall macroeconomic model and system. This justification is conceptually broad and includes several topics. For example, the Act may promote fair competition.100 That is, the U.S. government provides commercial banks unique federal advantages such as favorable tax treatment, credit privileges, and deposit insurance, and the Glass-Steagall Act helps promote a "level-playing field."101 Another justification for the Act is that the separation of investment and commercial banking promotes a more efficient model based on securities markets, rather than universal banks.102 Benston criticizes both of these justifications.103 As to the first justification, he argues that, if the commercial banks get any federal subsidy, this subsidy would have an insignificant impact on securities operations.104 As to the second justification, he argues that it is not clear that universal banking is the cause of a less active corporate securities market and, in any event, it is not clear whether this result is undesirable.105

IV. SBERBANK: MANAGING BANK RISK

A. Introduction

"The leading issue in banking law today is— or ought to be— bank risk."106 By applying some of the policy analysis from the above discussion, this section will prescribe a policy recommendation based on the normative

98. Id.
100. See, e.g., Jennings et al., supra note 52, at 85.
101. Id.
102. See, e.g., Fry, supra note 3, at 336-37.
103. Benston, supra note 69, at 212.
104. Id. at 166-67.
105. Id. at 212.
premises of banking safety, efficiency, and equity. The policy decision will present three choices: (1) prohibit Sberbank from investment banking activities such as dealing in securities; (2) regulate Sberbank's participation in such activities; or (3) choose not to act with regard to Sberbank's participation in such activities. This section concludes that, in terms of managing bank risk, the legislature should prohibit Sberbank from engaging in investment banking activities such as dealing in equity securities.

A preliminary question is whether equity securities are more risky for Sberbank than other types of investments. Answering this question requires a brief examination of the Russian securities market as well as Sberbank's position and banking practices.

B. The Russian Equity Securities Market Compared to Other Investments

The archetypal form of traditional commercial banking is a bank loan, while the essence of investment banking is generally to buy and sell common stock of a publicly held company. Macey implies that there is "no real economic difference between a loan and an investment," and so "there is no real distinction between a traditional commercial banking function (lending) and a traditional investment banking function (buying stock)." Macey further argues that stocks are not necessarily more risky than loans. This argument may or may not be true in the United States where there is a well-developed securities market that is highly regulated. In Russia, however, as further discussed below, the securities market is neither developed nor well regulated. Both priority of claims and collateral loans are two features of debt that could make loans less risky than securities.

Securities investments are very risky in Russia, much more so than those in the United States. Equity markets in Russia are underdeveloped and disorganized. J. Robert Brown describes this recent period by writing, "broker behavior was almost entirely unregulated, with no requirements for reporting stock transactions, no restrictions on the disclosure of mark-ups, and no general principles of investor protection." Predictably, there have been serious abuses and consequent losses of investment money in Russian equity markets. One notorious example is the 1994 MMM scheme, during which millions of Russians lost money investing in an investment company which turned out to be a pyramid scheme.

The Russian government has taken steps to improve the regulatory structure of the equities market. For example, in order to address MMM-type problems, there is a new presidential decree that requires investment companies

108. Id. at 8.
110. Id.
to re-register as mutual funds, thereby requiring them to show their books to the Russian Securities and Exchange Commission, or face liquidation.\textsuperscript{112} Furthermore, the Russian government has promulgated many laws and regulations on the trading and issuance of securities, including disclosure requirements. Many of these laws have features similar to those found in developed markets.\textsuperscript{113} Despite these improvements, the reality is that the operation and regulation of the Russian securities market remains undeveloped and highly risky. Government measures may be successful in stabilizing the equities markets in the long run, but they have yet to take root. Dmitry Vasiliev, a leading member of the Federal Commission on Securities and Capital Markets recently stated that he was optimistic that Russia will someday have an efficient "civilized capital market."\textsuperscript{114} Vasiliev acknowledged, however, that at the present time, "[o]ur capital market suffers not only from an underdeveloped regulatory system and infrastructure but also from an inadequate judicial system, weak law enforcement and widespread public distrust of both business and the government."\textsuperscript{115}

One unique risk to the Russian equity securities market is political instability. As is well known, on December 17, 1995, the Russian people elected a leftist (that is, closer to the communist end of the political spectrum) Duma (parliament).\textsuperscript{116} While the results of the recent presidential elections in Russia suggest that the rise of a communist government is unlikely, such an outcome is conceivable. The risks of such a change for the equities markets would be significant as deprivatization, nationalization and other possible measures could strain the equity markets to the point of collapse. Moreover, recurring questions regarding President Yeltsin's health highlight the tenuous future of his government.

Having shown that the Russian equity securities market is especially risky, the next issue is to evaluate whether loans (debt) are less risky because the efficiency of restricting equity securities activity depends on the efficiency and risk of the alternative major bank investment opportunity — loans. An especially risky equities market does not necessarily suggest a particularly safe debt market. In fact, many loans in Russia are also quite risky. The risk of non-return on private sector loans is 25-30\% according to Rating, the Moscow financial research agency.\textsuperscript{117} Unreliable financial information increases lenders' risks, and contract enforcement is problematic.\textsuperscript{118} Laws are either unclear or non-existent

\begin{itemize}
  \item \textsuperscript{112} Id.
  \item \textsuperscript{114} DMITRY VASILIEV, We Russians Can Mind Our Markets, WALL ST. J., July 7, 1995, at A10 (stating that the Russian government has taken important steps to develop equity markets, but recognizing that Russia has much work to do in developing equity markets).
  \item \textsuperscript{115} Id.
  \item \textsuperscript{116} NIKITA KIRICHENKO ET AL., The Economy and the Communists, MOSCOW NEWS, Jan. 18, 1996, available in LEXIS, News Library, MOSCWS File.
  \item \textsuperscript{117} RUSSIA: Moscow Menace, THE BANKER, Apr. 1, 1995, at 36.
  \item \textsuperscript{118} JAFFEE & LEVONIAN, supra note 7, at 3.
\end{itemize}
in such areas as property rights, collateral loans, and order of claims in bankruptcies.\textsuperscript{119}

Despite these difficulties, in Russia, loans have several advantages over securities in terms of managing and reducing risk. First, debt-holders have higher preference over equity security-holders when there is liquidation. Second, unlike equity securities, the parties can at least contract for collateralized, secured transactions, and there is a possibility that this contract will be enforced even if the collateral laws are not yet clear. Indeed, because of Sberbank's relationship to the Central Bank, it should have a comparative advantage in loan enforcement for interbank loans. Third, in Russia, loans are arguably easier to value, because interest rates are probably a more objective criterion than the stock market or prospectuses for new issues. Fourth, some Russian banks, including Sberbank, have a history of making loans, not equity investments. These banks might, therefore, be more familiar with evaluating credit risk than with evaluating equity values. Fifth, Macey's argument regarding the offsetting liquidity advantage of stocks does not exist in Russia because stocks in Russia generally are not nearly as liquid\textsuperscript{120} as they are in the U.S., in part because the Russian secondary markets are not yet sufficiently developed.

C. Evaluating Sberbank's Banking Practices, Positioning, and Abilities

In addition to being a function of the state of equity and debt in Russia, the analysis of risk management of equity securities and debt is a function of the ability of various institutions such as Sberbank to engage in such risk management.

1. Sberbank's Positioning and Ownership Structure

As discussed above, Sberbank is a former specialized bank which Russia still owns.\textsuperscript{121} The Central Bank holds a 51% stake in the shares of Sberbank and it is not clear who owns the other 49% of the shares.\textsuperscript{122} The status of the future ownership and control of Sberbank is somewhat uncertain.\textsuperscript{123} As stated above, despite the Central Bank's ownership, it is questionable to say it actually "controls" Sberbank because Sberbank is technically independent.\textsuperscript{124}

Discussing Sberbank's ownership structure and position in the context of its ability and standard of care in investment banking activities is important for at least six reasons: (a) its ownership structure causes accountability problems; (b) its position as a former government bank creates problems in terms of following the Soviet legacy of easy leniency and credit to industries; (c) it has

\textsuperscript{119} Id.

\textsuperscript{120} See, e.g., ANDREI VOLGIN & YURI MILLER, VOUCHER INVESTMENT FUNDS IN RUSSIA, IN RUSSIA: CREATING PRIVATE ENTERPRISES AND EFFICIENT MARKETS, 55 (Ira W. Lieberman et al. eds., 1995).

\textsuperscript{121} Id. at 55.

\textsuperscript{122} Russia: Sulky sideline, supra note 44, at 23.

\textsuperscript{123} Id.

\textsuperscript{124} Yevgeny Yasin, supra note 49.
several characteristics that create potential or actual monopolistic problems; (d) having come from, and still being a part of, a state-run industry, its staff probably does not have the necessary ability for good banking practice in investment banking activities; (e) Sberbank itself has probably not yet developed sufficiently good banking practices for investment banking activities; and (f) there is a moral hazard due to deposit insurance. This section will discuss each of these factors.

a. Accountability

Sberbank's ownership structure and position present serious issues of accountability. Because the Central Bank is the majority shareholder and Sberbank is a former specialized state bank, Sberbank does not have the same checks and balances that private ownership can provide. Furthermore, Sberbank's independence and its uncertain remaining ownership create potentially large accountability problems because its status as a government-affiliated entity can be exploited by an uncertain minority non-governmental entity that is supported by the government's ownership. That is, the ownership structure itself presents a risk of a moral hazard because an ownership contingency can make highly risky investments without being fully accountable as a private American corporation generally is. This argument is similar to the moral hazards of deposit insurance discussed below. This potential accountability problem can exacerbate poor banking practices and is one factor that argues for either prohibition or careful regulation of Sberbank's investment activities. Macey's portfolio theory assumes that commercial banks are private entities that are accountable for their decisions. As such, U.S. commercial banks will make efficient investment banking decisions. Sberbank's structure does not resemble U.S. commercial banking structure where there is clear private ownership with no veneer of apparent government ownership.

Recent steps have been taken that would appear to help address this accountability problem. The Central Bank has started to assert more power over Sberbank. For example, the Central Bank's nomination of Andrei Kazmin as Sberbank's new president was approved by Sberbank's shareholders.125 Efforts by the Central Bank to assert power over Sberbank should improve accountability because the Central Bank should be able to exercise more control and take responsibility for Sberbank's actions.

Even though these steps will increase accountability, especially for such issues as monetary supply, they are insufficient to justify allowing Sberbank to engage in equity securities investment activities. For example, these steps do not help develop market discipline. They may also aggravate problems such as institutional legacy issues which are discussed below. Moreover, these steps provide more justification for the system development rationale discussed below because there is now an even stronger argument for promoting investment

banks’ interests in a level playing field as well as investment banks’ positioning for providing a private actor alternative for equity investment activities.

Furthermore, as a quasi-government, quasi-private entity, Sberbank is able to exploit government goodwill. Significant segments of the population are likely to trust Sberbank more than other banks because of its unique position as a bank with a history of savings deposits and government affiliation. This trust and association with the government is somewhat similar to the Bank of United States, which the public erroneously believed was an official institution because of its name and which collapsed in 1930. For example, it would seem that less sophisticated segments of the population are more likely to trust such a unique, government-affiliated bank. Indeed, the fact that Sberbank’s main clients are pensioners and workers supports this assertion because this segment of the population is likely to be less sophisticated than the business community on financial affairs. The nature of Sberbank’s clientele also suggests that an equitable policy requires a policy prescription which ensures that Sberbank’s activities are especially safe. Although the public may consider Sberbank to be relatively safe and conservative because of its government affiliation, whether this reputation is well-deserved is discussed further below.

Stephen Breyer has implied that a tentative solution to this type of accountability problem might be to try some form of incentive-based regulation. For example, instead of addressing inadequacies of accountability by prohibiting Sberbank’s equity securities investments, one prescription might be to completely privatize Sberbank. There have, in fact, been recent proposals to privatize the bank. One might argue that such a policy would promote efficiency because private actors tend to be more efficient since they have more of an incentive to be efficient. Other practical and equitable considerations suggest, however, that complete privatization may not yet be appropriate for Sberbank. Sberbank has an important social role as exemplified by the fact that it still is responsible for collecting phone bills and paying pensions. Sberbank has also been an important instrument for carrying out various reforms of the Russian government. Moreover, privatization of Sberbank does not seem to be a panacea for some of the other problems noted in this article, such as the moral hazard associated with deposit insurance. Mere regulation, other than restriction

126. For example, one article states, “Sberbank, backed by the government is considered secure by 53.8% of the population. For commercial banks this figure is 14.9%.” VARLEY CHEREDNICHENKO, The Population Trusts Sberbank Less And Puts Money Into Foreign Currency And Gold, Mar. 28, 1995, available in LEXIS, Nexis Library, RusData DialLine — BizEkon News. A recent survey by a Moscow research institute called the Center for International Sociological Studies indicates that Russians consider Sberbank as relatively the safest and most conservative savings institution even though 53 percent of those surveyed would rather not put their money in any bank at all. Russians Learn the hard Way Not to Rely on Banks, THE PLAIN DEALER (Cleveland), Oct. 1, 1995 at 5H.

127. GARBER & WEISBROD, supra note 89, at 574.


129. STEPHEN BREYER, REGULATION AND ITS REFORM 192 (1982).

130. Russia: Sulky Sideline, supra note 44, at 23.
of equity securities investments, does not seem to address Sberbank’s accountability problem. Hence, accountability suggests a policy of prohibiting Sberbank’s equity securities investments because Sberbank’s structure may lead to inefficient decision making in the investment of equity securities.131

One recurring issue that arises in the discussion of most or all of this section’s positioning and structural factors is how the application of these factors or problems in the context of equity securities differ from their application to loans. Many of the factors or problems discussed in this section also apply in analyzing Sberbank’s loan-making behavior. In short, Sberbank’s loan-making practices are also probably not as well developed as they should be. As noted above, this article argues that equity securities investments are generally even more problematic for Sberbank than loans because of such factors as their intangible nature, special difficulties in valuation, their lower liquidity preferences, and the undeveloped Russian securities market. It is important to keep this argument in mind while reading about the following factors.

b. Institutional Legacy Problem

Sberbank’s position as a government-affiliated bank presents a high risk of poor general banking practices due to its close relationship to the government, to the old Communist banking system, and to former or current state industries. This problem can be described as an “institutional legacy problem.” That is, Sberbank may have institutional habits of favoring state firms that may be inefficient. Several American authors have observed similar issues in the U.S. For example, Alfred E. Kahn writes that government intervention in the economy creates vested interests, usually places benefits on some groups of people, and imposes burdens on others.132 Kahn illustrates this principle by explaining that the airline industry before deregulation is an example of how regulation created interest groups.133 In Russia, the earlier creation of Sberbank also created interest groups. For example, Sberbank and its large number of employees is itself a large institutional interest group. Sberbank may become resistant to any reforms just because it wants to promote its own institutional interests. Furthermore, Sberbank may feel a biased affinity for other current (or former) governmental institutions because of a common background of shared interests of institutional maintenance. Past political and associational ties can exacerbate this institutional legacy problem.

As noted above, this institutional legacy problem creates an environment that could be conducive to public choice problems, where interest groups engage in rent-seeking behavior. There is already some evidence of this problem of habitual leniency to state or formerly state industries. For example, Pharmansk,

131. This analysis might also suggest that Sberbank’s accountability structure might also lead to bad loans. This suggestion is also possibly true, but this article later discusses what kinds of activities in which Sberbank can invest without incurring too much risk for its capabilities.
133. Id. at 135-36.
a pressure group designed to help out former government wholesalers of pharmaceutical products, recently worked with Sberbank to form a "financial break" with "easy ruble credit." This credit situation appears to be an example of what Jeannette Van Winkle labels as a preferential credit extension to industry.

This pattern of leniently supporting state or former state industries indicates that Sberbank may not always be making its financial decisions on efficient microeconomic factors, but rather on the basis of the Soviet legacy of favorable credit extensions. Indeed, a recent article supports this observation of a possible efficiency problem by stating, "Sberbank invests in many important but unprofitable sectors of the Russian economy." Given this legacy of leniency, preventing Sberbank from engaging in investment banking activities might be more efficient because it will prevent Sberbank from incurring costly losses from bad equity securities investments. Mere regulation does not offer a solution to this particular factor or problem. Jeannette Van Winkle writes,

[the legacy of Soviet financial management is one of bank passivity, automatic credit extensions to industry, and lingering non-settlement of accounts. As in many developing markets, ownership ties between the financial and business sectors coupled with a lingering dependence on central bank credit make the commercial banks poor agents for promoting investment and economic transition.]

Russia has had a significant problem of corruption in its government, due in part to the legacy of the Communist regime and recent structural changes. The relatively large amount of governmental power vested in Sberbank officials may lead to abuses of power for personal profit. This article draws no conclusion as to whether there is a problem of corruption or fraud in Sberbank's activities. Nonetheless, Sberbank's governmental positioning does create a structural risk of corrupt banking practices. This risk of governmental corruption is one factor that suggests that a safer, more efficient and more equitable policy would be to prohibit Sberbank's investment banking activities.

c. Monopolistic Positioning

In addition to the accountability and institutional legacy problems, Sberbank is in a position that is at least potentially monopolistic and probably is, in fact, monopolistic. A market-based efficiency rationale recognizes that a market failure such as the existence of monopoly power is a legitimate basis for administrative or policy intervention.

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136. CHEREDNICHENKO, supra note 126.
137. VAN WINKLE, supra note 135, at v.
139. See, e.g., RUBIN supra note 1, at 7.
with a government guarantee on its deposits, and Sberbank formerly had a monopoly on household savings.\textsuperscript{141} Even though it is sometimes said that the monopoly no longer technically exists, Sberbank still holds a very large portion of the bank deposits of the average Russian.\textsuperscript{142} Sberbank’s large network of about 38,000 branches helps Sberbank keep its strong position.\textsuperscript{143} This large network is arguably a form of a natural monopoly because of the economies of scale present in a country that is just developing its banking network resources. The fact that competition is starting to develop in the market for deposits means that the market might be becoming more efficient. Still, the competition has not yet eliminated potential monopolistic problems due to Sberbank’s positioning, especially concerning less sophisticated segments of the population.

Prohibiting Sberbank’s equity security investments does not per se solve the monopoly problem. The monopoly problem does, however, help justify this prescription in two ways. First, the monopoly means that any of Sberbank’s safety problems are exacerbated due to Sberbank’s unique importance in guarding much of the public’s nest egg.\textsuperscript{146} Second, Sberbank’s monopolistic positioning ensures that Sberbank is in a natural, government-provided position to make relatively easy profits, which lessens Sberbank’s need to try to increase profits more through equity securities portfolio diversification.

Stephen Breyer states that nationalization or a cost of service ratemaking are tentative solutions for this type of natural monopoly problem.\textsuperscript{147} These solutions do not seem to help in this instance. It is unlikely, for example, that a completely nationalized Sberbank will be able to handle equity security investments any better than Sberbank currently can, for many of the same reasons discussed throughout this article.

Edward Rubin has recommended breaking up Sberbank as a solution to the monopoly problem.\textsuperscript{148} Rubin’s recommendation might cause tension with the prohibition of equity securities argument because Sberbank and its proposed spin-off corporations would have more pressure to try to make profits through, for example, diversified portfolios including, perhaps, equity securities.

\begin{footnotes}
\item[141.] ROBINSON, supra note 21, at 55.
\item[142.] There is a range of estimates of the exact figure for Sberbank’s market share of the deposits. The estimates seem to run from about 75 percent [\textit{See, e.g., Russia Finance Official, Central Bank Oppose Sberbank Privatization, WALL ST. J. EUR., June 7, 1995, at 19.}] to 90 percent [\textit{See, e.g., ROBINSON, supra note 21, at 55.}] of the market. One source states that 50 percent of Russians continue to keep their personal savings at Sberbank. See BETSY MCKAY, Russian Banking: A Sector Regroups, WALL ST. J. EUR., Oct. 9, 1995, at 25.
\item[143.] MCKAY, supra note 142, at 25.
\item[144.] \textit{See, e.g., SARGENTICH, supra note 140, at 423 (discussing how natural monopolies can exist in certain industries where there are large economies of scale).}
\item[145.] \textit{See, e.g., Russia: Moscow Menace, supra note 117, at 36.}
\item[146.] Note that this justification is related to the U.S. "too big to fail" doctrine, under which federal agencies have been reluctant to close large institutions whose closing might cause concerns regarding public confidence as well as regarding the entire banking system stability. MACKEY & MILLER, supra note 95, at 650. For example, federal regulators structured a rescue of Continental Illinois National Bank & Trust Co. on the basis of this justification. \textit{Id.}
\item[147.] Breyer, supra note 129, at 191-92.
\item[148.] Rubin, supra note 1, at 36.
\end{footnotes}
recommendation would generally promote efficiency because it directly addresses the monopoly problem. Rubin’s recommendation, however, seems to assume that Sberbank and its proposed spin-off corporations are ready to be competitive, private-market actors. A more appropriate policy for the short-term is to recognize Sberbank for what it is, a former Soviet bank with potentially large government structural problems that are obstacles toward Sberbank becoming a private market-actor, at least in the near future. Hence, perhaps the government should focus on policies of increasing competition from truly private companies starting from scratch and continue to regulate Sberbank closely. This latter argument is admittedly somewhat based on system-development principles, but, given that Sberbank itself has been a subsidized creature, it is worth considering.

On the other hand, it is possible that Rubin’s recommendation can co-exist with the prohibition on investing in equity securities because, as discussed below, Sberbank has many other areas in which to make profits. Such an approach might be able to incorporate the advantages of both policy prescriptions. In any event, merely breaking Sberbank up might lead to some improved efficiency, but, by itself, does not seem necessarily to lead to improved risk management of equity securities. Sberbank’s accountability and legacy problems would remain. Also, even three spin-off corporations from Sberbank still leaves a sufficiently large enough concentration of the nest egg to lead to especially significant concerns over exacerbated problems due to improper investments of equity securities. Hence, the most appropriate solution to this monopoly and concentration of the nest egg problem is to prohibit Sberbank’s investments in equity securities.

d. Staffing Problems

In addition to the potential monopolistic problems, Sberbank’s position as a former Communist and, in fact, current state bank means that Sberbank probably does not have a staff that has developed skilled banking practices for capital markets. The realities of the market-place force efficient financial, microeconomic decision making due to shareholder, bankruptcy, or take-over pressures. The government provided security that Sberbank has enjoyed over the years probably has impaired the ability of Sberbank and its staff to make efficient financial decisions. For example, the government settled the bank’s Rb280 billion debt in 1993, enabling Sberbank to increase lending operations. Private companies generally are not able to rely on such extraordinary and lenient

149. This statement is an admittedly broad theoretical statement. A socialist government could conceivably produce agencies more efficient at financial management than the private marketplace. However, the current, general trend appears to be that private actors are more efficiently managing finances than governments. This view is not to say that governments or government agencies and their staffs are bad workers; rather, this view postulates that the marketplace is a different environment, where government workers may not yet have the best market skills compared to privatized companies that have already been working in a market. These same workers may have better skills in doing government work than their marketplace counterparts.

150. ROBINSON, supra note 21, at 55.
government intervention. Lacking such a safety net, private companies sharpen their abilities to make financial decisions.

The World Bank's finding adds strong evidence to the assertion that Sberbank and its staff are incapable of expanding into equity investment decisions. That is,

the World Bank and local bankers believe that the Central Bank does not have the workforce to supervise Sberbank's undertrained staff in such matters as credit risk and that household deposits could be at risk from inadequate lending practices. This is of particular importance in view of the fact that the government guarantees Sberbank's deposits. 151

Although Sberbank has taken steps to "aggressively recruit young blood," it is not clear that such steps have been sufficient to overcome the problem identified in the World Bank's finding. Sberbank's government affiliation probably creates a structural problem against having a staff skilled at working in the financial marketplace. For example, when discussing Russian banking, Celeste E. Green writes, "[t]his paper rests on the premise that the development of banking competence in the private sector will exceed that in government. For example, higher salaries attract college graduates to private banks instead of government agencies." 153 Training Sberbank's staff and hiring a staff better adapted to free-market banking might be a solution; however, the above analysis suggests that there are structural obstacles to this solution. Hence, this staffing issue is another factor that suggests that an efficient policy would be to prohibit Sberbank from investing in equity securities so that an ill-prepared staff does not make inefficient, wasteful equity security investments.

e. Undeveloped Banking Practices

Given that Sberbank is a state bank in a transforming economy and is run by a staff which is unskilled in free-market banking, it is likely to have undeveloped banking practices. One piece of evidence showing Sberbank's poor banking ability is its recent unstable equity/asset ratio. Banks having an equity/asset ratio of less than 3 percent are generally considered to be in danger of insolvency. 154 As of November 1992, amongst the 30 largest Russian commercial banks, Sberbank had at least the 29th lowest equity/asset ratio at .3 percent (the numbers for one bank were not available). 155

There is some evidence that Sberbank's banking practices may not be that bad and may be improving. For example, Sberbank's profits were among the highest of all Russian banks in 1994 at approximately 304 million dollars. 156 Furthermore, in that same year, Sberbank's capital to asset ratio was 5.4%,
which is a significant improvement over its ratio in 1992.  It is misleading, however, to rely too much on Sberbank’s profits as an indicator of its banking practices. As discussed above, Sberbank has been in a unique, near monopolistic position to attract deposits from average Russians. These deposits have been the source of “superprofits” for Sberbank because, according to former Finance Minister Boris Fyodorov, credit interest rates have been “absurdly high and deposit rates absurdly low.” Furthermore, Sberbank has undoubtedly profited from taking in deposits and using the money while high inflation has dramatically lowered its liabilities on such deposits. Such large profits have probably also helped Sberbank increase its capital to assets ratio. As inflation decreases and as Sberbank’s unique position for attracting deposits becomes undermined by competition, it is not clear that Sberbank’s profits will remain so high.

Another factor that indicates that Sberbank’s banking practices may not be so bad is that BREE Consulting Services recently gave Sberbank a very high short term credit rating, A1, signifying an unquestioned capacity for timely repayment. However, BREE’s long-term credit rating of Sberbank was a mediocre BB+, indicating that one or two significant weaknesses may leave the bank vulnerable to extraordinary adversities that could occur over the medium term. Even though this rating is relatively high compared to other rated Russian banks, it is troublesome given Sberbank’s recent excellent positioning and windfall profits due to inflation and low deposit interest rates. Moreover, it is difficult to gauge BREE’s rating of Sberbank because the Russian government’s close affiliation with Sberbank probably gives an added veneer of safety. Furthermore, this credit rating probably does not reflect Sberbank’s planned future activities which are to decrease its credit portfolio and to increase investment in the stock market.

Sberbank’s undeveloped banking practices create a situation potentially analogous to the savings and loan crisis in the U.S. One view of the savings and loan crisis is that deregulation of the industry was a significant factor which allowed unqualified bankers in the savings and loan industry to make very risky investments. These risky investments cost U.S. taxpayers billions of dollars. Indeed, many commentators and experts believe that outright fraud was a primary cause of the savings and loan crisis. The savings and loan associations

157. Id.
159. See, e.g., JAFFEE & LEVONIAN, supra note 7, at 2.
160. Id. (stating that recent significant monetary tightening has led to annualized inflation decreasing from 700 percent in January 1995 to 70 percent in August 1995).
162. Id.
163. Sberbank to Increase Investment on Stock Market, supra note 39.
165. Id. at 50-51.
had been required to focus on home mortgages. In the early 1980's, the government deregulated the savings and loan industry so that these banks could invest in a much broader range of products. Many savings and loan institutions then used government-insured deposits to make highly risky investments, including junk bonds and commercial real estate. As these risky investments failed, many savings and loan associations became insolvent, causing enormous government expenditures in order to guarantee consumers' deposits.

Despite the fact that this theory is quite plausible, some noted scholars criticize this theory for being incomplete. Kane, for example, believes that a deposit-insurance incentive-breakdown more fully explains the cause of the crisis. This analysis is discussed more fully below. It is quite possible that these views are not mutually exclusive explanations of the causes of the savings and loan crisis. In any event, the dangers of undeveloped banking practices combined with unregulated freedom to invest in a broad range of products and deposit insurance are applicable in Russia because of Sberbank's qualifications and positioning to make more risky equity investments.

In the future, it is possible that Sberbank's staff will become better trained, and Sberbank will become better positioned to engage in the private investment banking market. Sberbank's current undeveloped banking practices and abilities are factors that indicate that it would be safer and more efficient to prohibit Sberbank from engaging in riskier investment banking.

f. Moral Hazard due to Deposit Insurance

Edward Kane believes that a major cause of the savings and loan crisis in the U.S. is an incentive problem. This same incentive problem provides an additional justification for a prohibition on Sberbank's investment in equity securities.

As mentioned above, Sberbank is currently the only bank to have government guarantees on its deposits. Many commentators criticize a governmental deposit insurance system as creating perverse incentives or a "moral hazard." Insurance creates a moral hazard because it decreases incentives to take precautions to avoid certain harms. The private insurance markets have various methods of reducing moral hazards, including coinsurance, risk-adjusted premiums, and exclusions for egregious conduct. In a governmental deposit

166. Id. at 7.
167. Id.
168. Id.
169. Id. at 8. Note that one estimate of the taxpayer debt due to the insolvency of the thrift industry is $100 billion. See EDWARD J. KANE, THE S & L INSURANCE MESS: HOW DID IT HAPPEN? xvii (1989). Another estimate is that the savings and loan crisis will cost between $300 and $500 billion over the next decade alone. WALDMAN, supra note 164, at 4.
170. KANE, supra note 169, at 146.
171. Id. at 22.
172. ROBINSON, supra note 21, at 55.
173. MACEY & MILLER, supra note 95, at 265.
174. Id.
175. Id. at 265-66.
insurance program, however, there are generally no analogous risk-reducing methods.\textsuperscript{176}

On the other hand, governmental deposit insurance insures the depositor, not the bank.\textsuperscript{177} This factor might mitigate the moral hazard caused by governmental deposit insurance because the bank and its shareholders are still at risk.\textsuperscript{178} The fact that the Central Bank owns 51\% of Sberbank undermines this mitigating factor because the normal private shareholder accountability is either missing or impaired. Furthermore, unlike the typical private firm (or private actor) scenario, bank managers in a governmental depositors’ insurance program, in theory, are not subject to the monitoring influence of depositors.\textsuperscript{179} In the absence of a monitoring influence, bank managers may be inclined to gamble with their bank’s assets, theorizing that if the gamble pays off, the bank and its shareholders will win big, and if the gamble does not pay off, most of the costs will be borne by the governmental deposit insurance funds.\textsuperscript{180}

Hence, Sberbank may have a moral hazard to gamble and make overly risky, unwise investments in the equities securities market. The legal prescription for this problem might be to regulate or restrict banking activities or to reform the governmental deposit insurance system through various methods, such as reasonable limits on amounts insured, market discipline, risk-adjusted premiums, early regulatory intervention, and narrow banks.\textsuperscript{181} Such careful deposit insurance legislation might minimize the moral hazard of deposit insurance, but it would not address other problems, including the lack of accountability. As a result, the moral hazard problem suggests that the most efficient policy is to prohibit Sberbank from investing in equity securities in order to prevent Sberbank from having the opportunity to “gamble” its assets at the expense of the governmental deposit insurance funds.

Restricting Sberbank’s activities does not suggest that Russia should not have a well-designed deposit insurance program. Indeed, a carefully designed deposit insurance program is essential for Russia. For example, a reasonably low coverage limit on deposit insurance might be more efficient because it would reduce the moral hazard problem by increasing market discipline.\textsuperscript{182}

2. Conflicts of Interest

In addition to analyzing Sberbank’s positioning and ownership structure, it is important to analyze Sberbank’s potential for conflicts of interest. As discussed above, one of the justifications of the Glass-Steagall Act was the concern that commercial banks might encounter various conflicts of interest as a result of their investments in equity securities. This section examines some of the struc-

\begin{itemize}
\item \textsuperscript{176} Id. at 266.
\item \textsuperscript{177} Id. at 265-266.
\item \textsuperscript{178} Id. at 266.
\item \textsuperscript{179} Id.
\item \textsuperscript{180} Id.
\item \textsuperscript{181} Id. at 267-83. \textit{See also} Kane, supra note 169, at 158-79 (discussing various approaches for improving the incentive system in the deposit insurance context).
\item \textsuperscript{182} Kane, supra note 191, at 160.
\end{itemize}
tural issues that create potential conflict of interest problems in Russia and contrasts these issues with those presented in America. These contrasts indicate that the arguments that equity securities may be as safe or safer than traditional commercial banking activities, though perhaps perfectly valid in the U.S., may not apply in Russia.

One of the structural problems relates to the fact that Sberbank is a former Communist bank that is still 51% owned by the government. This positioning means that Sberbank might favor state enterprises. This conflicts of interest problem is very similar to the institutional legacy problem discussed above, and some of the same facts can be analyzed in both issues. The institutional legacy problem refers to the general habits and practices a state organization might have in making the transition to a market economy. The problem of conflicts of interest, on the other hand, refers to a more specific problem of perverse or distorted incentives. The institutional legacy problem can exacerbate the problem of conflicts of interest. Sberbank's officials' recent implication of an intent to invest in equity in the military-industrial complex is one possible example of this potential exacerbated problem. That is, historical and state connections to this industry may interfere with rational financial decision-making.

Another factor that could aggravate the problem of conflicts of interest at Sberbank is that Russia, as a transitional developing economy, has probably not yet developed adequate banking practices. Macey criticizes this concern over conflicts of interest because finance theory indicates that rational decision makers will not make decisions based on conflicts of interest. Macey assumes, however, that banks are rational decision makers familiar with market finance theory and willing to apply it. In Russia, banks such as Sberbank may either not be familiar with this theory or unwilling to apply it because of an institutional legacy of close contacts and leniency toward state firms. Maxwell J. Fry notes that in developing countries, there are special factors that might induce banks to throw good money after bad. Some of the factors include government intervention to induce credit disbursement or loans for declining industries, public sector enterprises, or targeted industries. Fry further notes that cultural factors also contribute to this problem of loans inconsistent with market finance theory. For example, Fry quotes Clive Bell by writing, “there is a widespread view in rural India that institutional loans are really grants, because politicians regularly vie with one another in promising, if elected, to have such debts forgiven.” This observation is strikingly similar to the Soviet institutional legacy problem discussed above by Jeannette Van Winkle.

Another subtle difference between the institutional legacy problem and this conflicts of interest issue regards the prescription. It is difficult to see how regulation would help solve the institutional legacy problem because it obfuscates the equity investment decision at the outset. Consequently, prohibition of Sberbank's equity securities investments seems to be the best prescription.

183. Fry, supra note 3, at 334.
184. Id. at 329-34.
185. Id. at 330.
Sberbank might not face the same institutional legacy and conflict of interest problems in making some equity investments, however, including those in brand new companies or companies previously unknown to Sberbank. Nonetheless, after the initial investment there are possibilities of conflicts of interest because Sberbank might have perverse incentives to make bad loans to the company in which it has equity investments.\(^\text{186}\) Hence, unlike the Soviet legacy problem, mere regulation might be able to help solve this conflict of interest problem. Such regulation, often called "firewalls," was "traditionally erected to separate banking from securities activities to protect banks from potential losses."\(^\text{187}\)

Kathleen O'Connor concisely summarizes several necessary provisions for firewalls, which agencies can implement in order to provide safety and soundness for the banking industry.\(^\text{188}\) The provisions are as follows: (1) requiring banks to get prior approval from the relevant regulatory agency before making loans to corporations in which the banks have equity investments; (2) bank disclosure and customer consent forms showing that governmental deposit insurance does not cover consumers' investments in equity securities; (3) regulations requiring bank disclosure when they are soliciting or selling in order to negate any customer expectations of a disinterested banker; (4) regulations requiring higher capital requirements for bank equity security departments; (5) relevant regulatory approval of management to make sure that only qualified experts would be allowed to direct equity security investments; (6) and regulatory authority to give sanctions and fines as well as revoke licenses and privileges for banks' noncompliance or negligence.\(^\text{189}\)

Garber and Weisbrod believe that, in some cases, even firewalls are not a sufficient method of preventing holding companies from encouraging banks into unsound practices and higher risks in some cases.\(^\text{190}\) Conflicts of interest are risks in many types of business activities, however, and regulation can significantly mitigate these types of issues. Hence, analysis of the conflicts of interest factor suggests that prohibition of Sberbank's equity securities investments is not necessary. Regulation in the form of firewalls could be a sufficient prescription of efficiency and safety to help banks like Sberbank avoid inefficient conflict of interest transactions. Russia could implement such policies through its Central Bank.

\(^{186}\) For a view contrary to Macey's criticism of the plausibility of such conflicts of interest, see Garber & Weisbrod, supra note 89, at 558-59 (discussing how once an affiliate and consequently a bank have gone bankrupt, a rational approach might be to throw "good money after bad" because if they fail, only the depositors lose).


\(^{188}\) Id. at 600. Note that Ms. O'Connor's discussion is specifically in reference to mutual funds; however, for the purposes of this article, her discussion is relevant in the broader sense as well.

\(^{189}\) Id. at 600-01.

\(^{190}\) Garber & Weisbrod, supra note 89, at 562-63.
3. Maintaining Public Confidence and Preventing Bank Failures

Another justification for the Glass-Steagall Act was the desire to maintain public confidence and prevent bank failures. If Sberbank were to fail, it is theoretically possible that its failure could cause a crisis among other banks (e.g. bank runs). On the other hand, one could reasonably argue that such an outcome is unlikely in Russia because the majority of the deposits are already with Sberbank. Nonetheless, there is an efficiency argument in maintaining public confidence in Sberbank because the failure of Sberbank itself would be a tremendous loss to taxpayers and potentially to depositors if the government failed to live up to its commitment to guarantee deposits in Sberbank.

Significant concern exists over the health of banks in Russia generally. Russia recently experienced one banking crisis when the banks had severe liquidity problems in August 1995, and several commentators have recently stated that there is a significant risk that Russia will have a large-scale financial and banking crisis similar to the recent collapse in Mexico. As a result of the possibility of a large-scale banking crisis, much of the population does not trust banks. This distrust prevents them from saving in any bank, including Sberbank. There is evidence that Russian citizens are already losing money to some Russian banks other than Sberbank. A survey by the Center for International Sociological Studies, a Moscow research institute, indicated that 53 percent of those surveyed would prefer not to put their money in any bank at all. This survey suggests a lack of confidence in Sberbank and in Russian banks in general. Russian banks are therefore not serving the traditional banking role of providing efficient financial intermediation. An efficient policy prescription would need to increase public confidence in the banks in order to increase financial intermediation.

In addition to this problem of public confidence in Russians banks generally, there is also a specific problem of a lack of public confidence in Sberbank itself. Many people do not trust Sberbank because in recent years they have effectively lost their savings there because of high inflation and low interest rates on deposits. Even though the Russian parliament has recently taken steps to help those who lost their savings at Sberbank, the reality is that the government will probably do little to remedy this problem. These facts sug-

195. See, e.g., McKay supra note 142, at 24.
gest that there is a definite problem with public confidence in Sberbank as well as other Russian banks.

The question still remains whether preventing Sberbank from investing in equity securities will improve public confidence or at least prevent public confidence from getting worse. Macey holds the view that deposit insurance will solve any residual problems regarding public confidence. This might be true in the U.S. where depositors probably have more confidence in their relatively stable government. In Russia, on the other hand, the unstable government and the unstable economy might cause Russian citizens to doubt the security of their deposit insurance more than in the U.S. Moreover, the previous Soviet and recent Russian governments have a history of disappointing Russian citizens in areas of finance. For example, Russians still have bad memories of being coerced in 1937 into subscribing to government loans that later turned out to be worthless. This process was repeated again in 1961. In recent years, the government's various currency reforms and exchange programs have further undermined the public's confidence in areas of governmental financial security.

Macey notes that losses in securities operations should have the same effect on public confidence as losses in loan operations. This article concludes, however, that the securities operations are more risky and more likely to incur losses at least until the securities market is more developed. In any event, it is likely that the public will perceive the new equity securities markets as more risky than the loans market which has been operating for many years. Events such as the notorious MMM catastrophe are likely to enhance such public perceptions. Such perceptions of a particularly risky equity securities market are especially likely among workers and pensioners, who make up the majority of Sberbank's deposit customers. Lastly, there is a structural difference in the way securities losses affect public confidence compared to loans losses. It is generally easier to isolate one loan loss to a specific enterprise, whereas, one piece of significant news can dramatically cause an entire volatile stock market to decrease in value. Even combinations of loan losses among enterprises are less often publicized than volatile decreases in the stock market.

On the other hand, governmental deposit insurance probably does generate some public confidence, and this insurance is surely one reason why Sberbank is the top bank in terms of deposits. Furthermore, it is possible that some of Sberbank's depositors truly believe that their money is insured and do not know, or even care, what Sberbank does with their money. This possibility suggests that the public confidence factor may be irrelevant in determining whether or not Sberbank should invest in equity securities or whether it should be regulated. A survey asking Sberbank depositors whether Sberbank's investment activities in

197. MACEY, supra note 53, at 14.
199. MACEY, supra note 53, at 14.
200. Both Poor And Rich Prefer To Keep Their Money In Their Stockings—Research Center of the Round Table of Russian Business, supra note 128, at 9.
equity securities would or does affect depositors' confidence in Sberbank would be helpful on this issue. Absent more evidence, this article cannot conclude whether Sberbank's equity investment activities would affect public confidence. The above analysis, however, suggests that this type of activity could have an adverse effect on public confidence. If this analysis is correct, then an efficient policy would be to prevent Sberbank from investing in equity securities in order to maintain public confidence.

V. AN EFFICIENT MACROECONOMIC MODEL

The next major policy issue to discuss is the impact of prohibitions or regulations regarding Sberbank's equity securities operations on Russia's macroeconomic model. This issue is related to Russia's choice as to how it will develop its entire capitalistic system. The question is whether Russia should choose either a system based on universal banks as in Germany or a system with a relatively stronger role for the securities market as in the U.S. To date, Russia has essentially chosen a model based on universal banks. This article will now examine whether Sberbank should follow the universal bank model which allows commercial banks to invest in equity securities.

A. A Level Playing Field

The government has structured several very significant advantages for Sberbank, including a monopoly on governmental deposit insurance, a near monopoly on deposits and a large number of branches originally established by the government. Monopolistic positioning is not only an important safety issue, but also an important systematic issue because it means that the playing field is currently uneven for other banks. An efficient policy needs to promote a diversity of banks as a means of providing portfolio management of risk as well as providing a portfolio management of active investment.

Although there are other measures that could be taken by the government to level the playing field, a prohibition on Sberbank's investment in equity securities is the most viable and appropriate. One government intervention alternative is to give other institutions similar advantages. This alternative is unrealistic. Even though there are apparent plans to provide deposit insurance for other banks, these plans have not yet been executed, and moral hazard concerns suggest that deposit insurance should not be provided for all banks. Moreover, a government subsidy helping other banks to establish large numbers of branches is inefficient and unrealistic. Another alternative could be to regulate Sberbank's equity investments, but it is not clear how this alternative would

203. ROBINSON, supra note 21, at 55.
204. On the other hand, extending deposit insurance to more qualified banks (and not to unqualified banks) will become important and appropriate. As indicated above, deposit insurance is useful in maintaining public confidence. Also, deposit insurance for more banks will provide healthy competition for Sberbank.
solve the problem of unfair competition. Removing Sberbank's advantages is also an unattractive alternative because deposit insurance does help public confidence which itself promotes efficient financial intermediation. Hence, it appears that prohibiting Sberbank's equity securities investments is the best prescription for promoting efficient competition.

It is arguably inequitable to Sberbank to prohibit its equity investments. This prescription is, however, more equitable to all of the other institutions that do not have Sberbank's advantages. This unfair competition policy factor is especially important in Russia where, in contrast to the U.S., investment banks and securities dealers have not yet established strong positions from which they could effectively compete with commercial banks.

B. An Efficient Securities Market

The question of whether to regulate or prohibit Sberbank's equity securities investments is closely related to a broader debate in developing countries about whether universal banking or specialized banking is a more efficient capitalist model.\(^2\)\(^0\)\(^5\) This overall debate is beyond the scope of this article, but is significant enough to discuss briefly. There probably is no single answer to this question; the best solution is to make this choice on a case-by-case basis.\(^2\)\(^0\)\(^6\) The policy and prescriptive analysis on this factor admittedly relies to a certain degree on the premise of system development. System development is relevant here because it asks one to decide which system is "better": one promoting commercial banks like Sberbank or one promoting investment banks.\(^2\)\(^0\)\(^7\) This analysis of system development can be problematic because "the ability of any policy maker to predict future developments is limited" and because of public choice effects.\(^2\)\(^0\)\(^8\) On the other hand, examples of wealthier countries might provide a reliable means for prediction.\(^2\)\(^0\)\(^9\) This latter solution does not help here, however, because there is a significant debate about universal banking in developed countries.

Having stated these substantial caveats, this article will nonetheless make a brief analysis on the basis of the system development premise. As discussed above, allowing Sberbank to invest in equity securities might impair the development of other institutions such as investment banks, investment companies, and investment funds because of Sberbank's government-provided competitive advantages. Regulating Sberbank on this issue is unlikely to significantly address this problem, and leveling the playing field by giving the other institutions Sberbank's advantages is impractical and probably inefficient. Hence, prohibiting Sberbank from investing in equities gives new Russian investment funds and

205. See, e.g., Fry, supra note 3, at 336-37.
206. Id. For example, the World Bank has recommended removing universal banking in Brazil and Mexico but has recommended its adoption in the Philippines. Id.
207. Cf. Rubin, supra note 1, at 9-10 (describing the policy issues of system development).
208. Id. at 10. Rubin further notes there is a risk that according to public choice theory, "interest groups will distort the decision making process in their favor." Id. This author has tried to avoid such bias, but the caveat is worth noting.
209. Id.
investment companies a chance to achieve the level of their American counterparts. When such investment funds and investment companies become more established, then perhaps at that time, the policy prescription should change.

The advantage of giving investment banks and investment companies this effective subsidy is that Russia will have more of a chance to see if these companies can gain efficient advantages such as economies of scale over a commercial bank like Sberbank. Furthermore, it is quite possible that specialized investment banks will be able to encourage the growth of small, dynamic high-technology companies better than a large, quasi-state bank such as Sberbank. Limiting Sberbank’s equity investment activities could, therefore, indirectly stimulate the development of lucrative high-technology companies such as those in the Silicon Valley where there are a high number of specialized, highly expert venture capital and investment banking firms.

The counter-argument is that this policy prescription would forego Sberbank’s opportunities to gain efficiencies of economies of scope. The above analysis indicates, however, that Sberbank will probably be unable to take advantage of economies of scope in this area. Hence, it appears that prohibiting Sberbank’s equity securities investments will be an efficient means of promoting the development of the securities market.

Path dependence analysis is relevant to this discussion. Mark Roe describes three different types of path dependence. The first is weak-form path dependence, under which a country’s political and cultural institutions or chaotic chance events shape the paths “and determine which among equally efficient end results we have.” The second type is semi-strong-form path dependence, which leads to inefficient paths, but the benefits of rebuilding are not worth the associated costs. The third type is strong-form path dependence, which features an inefficient path that is worth transforming, but the path is not rebuilt. Public choice factors and information costs impede change in this third type. That is, an incumbent group created because of the chosen path may block change. Alternatively, assessing information justifying the change may be difficult and thinking about such change “clashes with our path-induced perception of ‘normal’ mechanisms.”

The analysis so far has shown that Sberbank’s equity investment activity is an inefficient path. It is quite likely that Sberbank’s officials could impede change through public choice influence. Thus, the issue of Sberbank’s equity

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210. BENSTON, supra note 69, at 212. Note, however, that Dean Benston believes that “economies of scale are not likely to be achieved through specialization, while economies of scope may be foregone from preventing banks from offering an unconstrained range of products and services.” Id.


212. Id.

213. Id.

214. Id.

215. Id. at 651.

216. Id.

217. Id. Note that Roe here appears to be referring to the obstacle of bias in dealing with new information.
securities investments appears to fit the strong-form dependence path and justifies legislative activism to put Sberbank on the "right path." On the other hand, one can argue that this analysis does not add much and somewhat begs the question. That is, the above argument regarding the inefficiency of Sberbank equity security investment activity merely rests on the analysis of this entire article.

One can argue that it is not clear what policy prescription this analysis suggests. Roe writes, "path dependence has another scar: it yields us, for now, little direct policy prescription."218 Roe recognizes that the policy potential is strongest for strong-form path dependence; however, he does not believe that path dependence alone can suggest legal prescriptions because it is hard to identify strong-form path dependence.219

Despite this criticism, path dependency analysis is helpful for the issue in this article. Even though it is difficult to recognize path dependence in the abstract, path dependence may provide an explanation and subsequent suggestions once one has discovered inefficiency. For example, this analysis suggests that Russia's policy leaders should carefully evaluate the costs involved in changing Sberbank by limiting its equity investment activities. Russian policy makers can make such evaluations by, for example, examining the experiences of the U.S., which earlier had chosen a different path by limiting the equity investment activities of commercial banks. It is best to face such issues now, while Russian capitalistic paths are relatively fresh, than to wait until transactional costs of established, but suboptimal, paths become even higher. Furthermore, this path dependence analysis emphasizes public choice hazards that can obfuscate clear decision making.

VI.
RECOMMENDATIONS

The Russian legislature should prohibit Sberbank from investing in equity securities. This outcome is based on a multiple factor test. No one factor has been completely dispositive. Some of the factors are ambiguous or do not necessarily require prohibition. In examining the issue of managing bank risk, the policies of efficiency and equity as well as the related policy of safety are important. Sberbank's banking practices, positioning, and abilities suggest that prohibition is the best policy to promote efficiency and equity. On the other hand, regulation might suffice to solve some of the potential problems in the area of conflicts of interest. It is not clear exactly how public confidence will be affected by Sberbank's equity securities investments, although there is a risk that such activity could damage public confidence.

In examining the issue of an efficient macroeconomic model, the policies of efficiency, equity, and system development are important. The desire for a level playing field suggests that prohibition of Sberbank's equity securities in-

218. Id. at 667.
219. Id.
vestments is the best way to promote efficient competition. Prohibiting Sberbank's equity securities investments is also the most effective policy in order to promote an efficient securities market by giving investment banks and investment companies a chance to reach economies of scale as their American counterparts appear to have done. In short, it appears that prohibition is the best prescription rather than mere regulation because regulation does not seem to solve these other problems.

This approach does not necessarily prescribe that pure legislative prohibition on all commercial banks' equity securities investments is the best means to attain the various above mentioned policy goals. Furthermore, more analysis is required to determine the scope of defining which types of equity security investing should be prohibited as to Sberbank.

In resolving this issue, the Russian legislature will need to face the realities of public choice politics. Indeed, Macey argues that public choice theory or interest group theory explains the passage of the Glass-Steagall Act.\textsuperscript{220} Macey believes that the legislature enacted the Glass-Steagall Act as an agreement with a special interest group (investment banks) at the expense of another special interest group (commercial banks).\textsuperscript{221} This theory may be correct in the U.S. and useful for analysis in Russia. Applying Macey's analysis might cut the other direction in Russia. Commercial banks are currently starting to gain much political power and influence. It is likely that the commercial banks generally have more political power than the investment banks and funds. Similarly, Sberbank probably has significant political influence given its large deposit holdings and close history with the government.

Macey's analysis is instructive but not conclusive. Special interest groups often shape legislation, and the Russian situation indicates that Sberbank (and other commercial banks) might win future legislative struggles at the expense of Russian investment banks. Macey's theory may explain what is happening, but does not, by itself, explain what should happen. This article recommends that the Russian legislature not allow special interest groups to dictate the outcome, but rather should examine the actual policy issues that this article discusses. Perhaps, the Russian legislature should appeal to the taxpayers, depositors, and investment banks for such a representation of interests even though the group size, relative stakes, and current positioning of Sberbank and the commercial banks might make this approach challenging.\textsuperscript{222} In short, although this article recognizes that public choice pressures may impede the Russian legislature's rational decision making, it recommends that Russian policy makers consider the issues discussed in this article.

Having concluded that Sberbank should not be allowed to engage in equity security investments, the next question is what Sberbank should be allowed to

\textsuperscript{220} \textit{Macey, supra} note 53, at 19-20.

\textsuperscript{221} \textit{Id}.

This article does not disagree with the general theory of Macey’s portfolio argument but only with its application to Sberbank. An efficient organization might be able to gain economies of scope by being allowed to engage in equity securities investments. This article argues only that Sberbank is not currently well-adapted to make such investment decisions especially given the undeveloped nature of the Russian securities market and given Sberbank’s positioning. This argument still leaves open the question of what Sberbank can do now.

One might question whether Sberbank actually must make a profit during this transitional period. As originally conceived, the purpose of thrifts in the U.S. was charitable in nature. As a quasi-government creature, one could argue that profitability for Sberbank is not paramount because of the greater importance of its depository function for intermediation. In any event, we can assume that profitability for Sberbank is a good policy because profitability will help ensure that Sberbank is efficiently using its depositors’ funds.

Sberbank can continue to make loans because loans should be relatively safer than the equity securities market despite the fact that loans are also risky and notwithstanding Sberbank’s structural and positioning problems in this area. For example, Sberbank can continue to make loans to small businesses. Government securities should also be safe and profitable investments for Sberbank. Sberbank can continue to perform various government services in such areas as currency reform, and various other services such as bill collecting for utilities. Sberbank could also consider participating in the home mortgage business.

Sberbank can also continue to be active in the interbank loan market. This market should be profitable even though it has been a relatively risky market because of the recent banking crisis. Several factors can reduce this risk. First, it should now be easier for Sberbank to identify the safer banks because the crisis has shown which banks are especially weak and which banks are relatively strong. Moreover, Russia has recently created a list of about twenty to thirty banks which are considered to be the safest and closest to international standards. The Central Bank is in a unique position to help inform Sberbank which banks are especially safe. Second, enforcement of such loans should be relatively easier because the Central Bank has strong means of prioritizing loan repayments for Sberbank through various supervising and enforcement means.

This conservative role for Sberbank is consistent with some aspects of Celeste E. Greene’s model for Russian commercial banking. Her model, based on the Pierce Model of narrow banking, recommends separating banks into monetary service and financial service entities. Sberbank would essen-

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223. Another open question is how broad a prohibition the government should place on Sberbank’s investments in equity securities. For example, large-scale project finance investments, unlike typical corporate equity securities, might be appropriate for Sberbank. The author leaves this question for another day.

224. Macey & Miller, supra note 95, at 15.

225. Mstislav Korolkov, Remarks at the Conference on Russian Banking at the Haas School of Business at the University of California at Berkeley (Oct. 31, 1995).

226. Greene, supra note 153, at 63.

227. Id. at 64.
tially be a monetary service bank. Monetary service banks could make short-
term loans to financial service banks.228 The Pierce Model advocates highly
regulated monetary service banks that have governmental deposit insurance and
market-disciplined financial service banks that can offer a complete range of
financial products "without the regulation and supervision imposed on tradi-
tional full-service banks."229 While this article makes no conclusion as to the
financial service banks branch of the Pierce Model, a conservative monetary
service bank role is consistent with this article's recommended view of
Sberbank. This role has the advantage of promoting efficiency by improving the
safety and stability of the monetary system.230 This conclusion does not neces-
sarily mean that the Russian legislature should prohibit all commercial banks
from investing in equity securities. Also, this article does not necessarily recom-
mand the Pierce Model as a general model for Russian banking. These other
commercial banks may be necessary for equity investments because of the rela-
tive scarcity of other institutions. Moreover, it is quite likely that many banks
have not really defined themselves yet. Many of these banks might be very well
equipped to engage in investment banking activities.

The Russian government needs to examine the details of the structure of the
other banks in light of the policies and factors discussed in this article. For
example, if the Russian government decides to insure the deposits of other Rus-
sian commercial banks, this decision would be a large factor in deciding whether
these same banks should be allowed to invest in equity securities because of
moral hazard concerns. Similarly, the number and make-up of depositors in
other banks is another factor. For example, some other banks are trying to at-
tract more depositors, and some are succeeding in their efforts.231 As the num-
bers of depositors in these banks increases, the policy significance of protecting
the depositors might trigger more reasons for prohibition or regulation of equity
securities investments. The character of these depositors is also a factor because
the less sophisticated or more vulnerable the depositors are, the more likely it is
that an equitable policy will require either regulation or prohibition. The posi-
tioning of the various banks is another factor. If the bank is a former govern-
ment bank, this factor increases the likelihood of needing regulation or
prohibition. The state of the securities market is another factor. The personnel
of these banks is also a significant factor especially given that many Russian
banks are closely linked to the mafia.232

Lastly, these factors are dynamic because Russia is a transitional, develop-
ing country. If Sberbank's positioning improves and if the securities market
becomes more developed, then perhaps an efficient and equitable policy will be
to allow Sberbank to invest in equity securities.

228. Id. at 93.
229. Id.
230. Id. at 83.
231. See, e.g., Russia: Moscow Menace, supra note 117, at 38.
232. Who Will Buy Russia?, supra note 202, at 73.