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# DEVELOPMENT BANKING IN RUSSIA

VEB, RUSSIA'S DEVELOPMENT BANK, LEADS THE WAY FOR  
INFRASTRUCTURE AND SMALL-MEDIUM BUSINESS FINANCING



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VNESHECONOMBANK



TERMINAL D SHEREMETYEVO AIRPORT

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INTRODUCTION

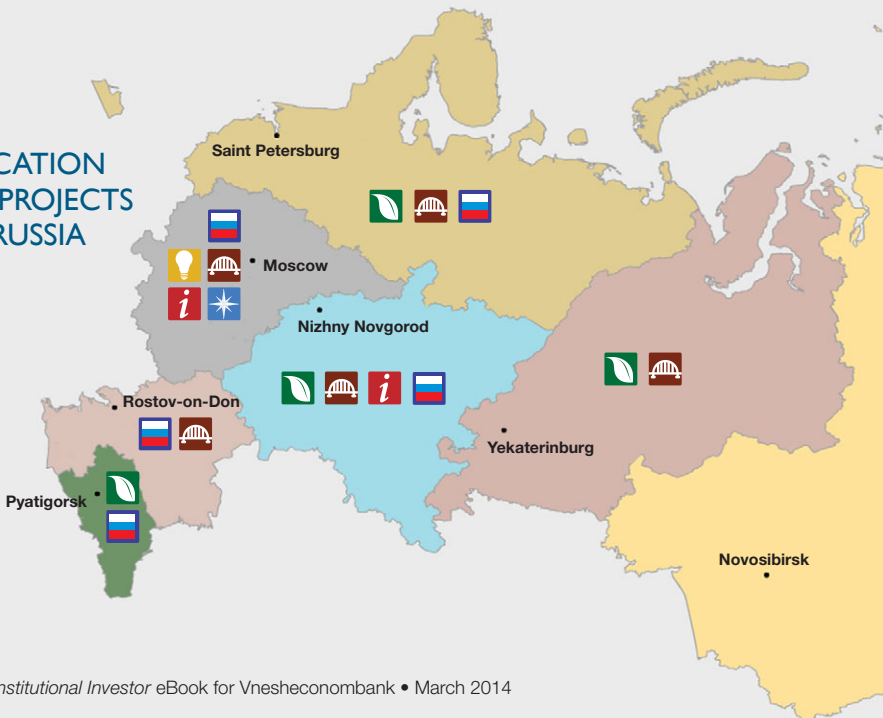
# VEB

AND ITS ROLE IN THE

# RUSSIAN ECONOMY

BY WILLIAM BLAND

LOCATION  
OF PROJECTS  
IN RUSSIA

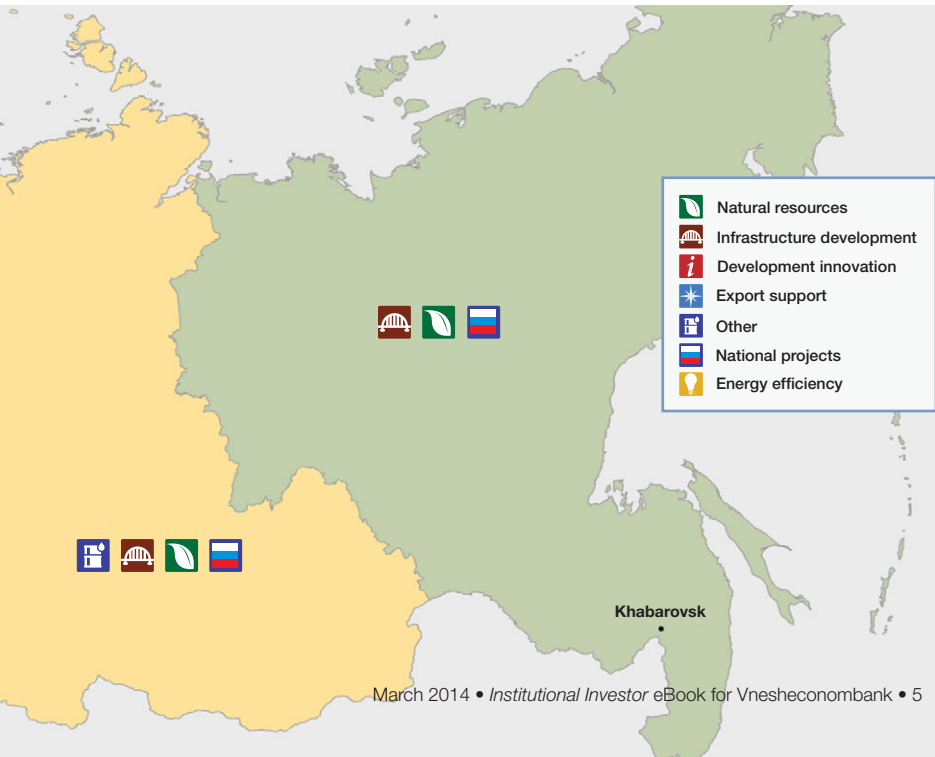


**T**he State Corporation ‘Bank for Development and Foreign Economic Affairs (Vnesheconombank)’ was established in the Russian Federation. Russian President Vladimir Putin signed a Federal Law “On Bank for Development” on May 17, 2007. The Bank for Development and Foreign Economic Affairs was registered with the State Registration Chamber under the Justice Ministry of the Russian Federation on June 8 that year.

The corporation’s main activity is financing long-term capital-intensive projects that commercial banks can’t afford, such as the new terminal at Russia’s biggest airport.

Vnesheconombank’s charter requires it to avoid loss-making operations, heed environmental concerns and give preference to public-private partnerships.

The state corporation that was signed into law in 2007 inherited the staff, offices and name of an older organization that had once handled import-



## INTRODUCTION

export financing on behalf of the Soviet Union.

Its role was transformed during the financial crisis. As commercial lenders withdrew credit to Russia's biggest borrowers in 2008, Vnesheconombank stepped in with loans that helped avert defaults, supported the stock market and kept factories operating.

In their goal of stimulating Russia's infrastructure, the lawmakers who established Vnesheconombank were looking to the example of other development institutions, such as the European Bank for Reconstruction and Development, China Development Bank and Germany's KfW.

Vnesheconombank, which is also known as VEB, has since invested alongside several of the institutions who are now its peers in the industry's main group, the Long-Term Investors Club.

The corporation's mandate also covers support for industrial exports, the high-tech sector and small and medium-sized enterprises.

It's the only bank in Russia that is outside of the supervision of the central bank. Instead, its supervisory board is chaired by the prime minister and consists of several of Russia's most senior politicians.

VEB's funding comes from the Federal Budget, Central Bank and National Wealth Fund. These state bodies hold deposits with VEB, and the bank is the

## VEB IS THE CORNERSTONE INVESTOR IN MRIF

*Macquarie Russia & CIS Infrastructure Fund (MRIF) investor commitments of US\$630mm*

The investment objective is to make equity and equity-related investments in a diversified portfolio of infrastructure assets located in the Russian Federation and other CIS countries.



Target assets include, but not be limited to roads, airports, ports, electricity and gas transmission and distribution networks, heating networks communication infrastructure, rail networks, water and sewerage utilities and social infrastructure.

Macquarie Russia & CIS Infrastructure Fund

INVESTORS

VNESHECONOM  
BANK  
Cornerstone Investor  
US\$200mm commitment

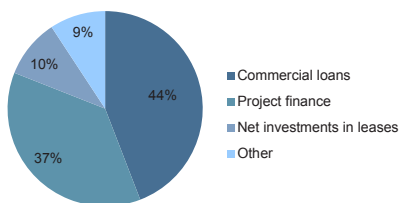
EBRD  
US\$100mm  
commitment

IFC  
US\$100mm  
commitment

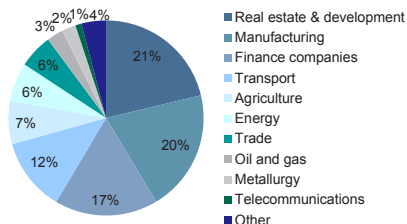
EDB  
US\$100mm  
commitment

KAZYNA CAPITAL  
MANAGEMENT  
US\$30mm  
commitment

## LOAN PORTFOLIO COMPOSITION



## DIVERSIFICATION BY INDUSTRY



only Russian organization eligible for this type of funding.

The VEB's loan portfolio is growing dynamically. In 2013 it has increased by 31% and the loan portfolio of the Bank for Development itself has increased by 34%. The Bank plan a similar growth dynamics with somewhat lesser parameters for 2014. Loan portfolio will increase by 163 billion rubles to 1 trillion 475 billion rubles by the end of 2014. ●



VLADIMIR DMITRIEV, CHAIRMAN

VEB is modeled on world-class economic development banks.



# THE VEB MANDATE AND CHAPTER 1 MAJOR PROJECTS





**V**nesheconombank is required by its mandate to invest in a number of priority sectors: aircraft construction, the space industry, shipbuilding, electronics, the atomic industry, transport, machine-building, smelting, timber processing, defense, agro-industry, computer technology, communications systems and medicine.

One of the biggest weaknesses of Russia's economy is the difficulty of securing the long-term loans that are necessary to support these sectors, and VEB is one of the country's biggest providers of project financing.

Under its charter, the bank can extend credits and guarantees for projects that are worth at least 2 billion rubles and have payback periods of more than 5 years.

"VEB is currently the only provider of this type of long-term funding to projects. Commercial banks are not very interested in financing these long-term

## SHEREMETYEVO AIRPORT TERMINAL



## CHAPTER 1

projects in Russia,” says Alexander Ivanov, the bank’s deputy chairman.

Vladimir Dmitriev, who has been chairman since 2004, says that much of the financing provided by Russian banks bypasses the kind of investments that the economy needs.



Vladimir Dmitriev

“In 2012, 1.5 trillion rubles were spent on Russian mergers and acquisitions - twice the amount that commercial banks provided to support businesses’ capital expenditure,” he says.

“Money is being poured from one pocket into another without an investment in the real economy. The economy isn’t receiving enough long-term money, and that’s why the state has to give this area its attention, including through the use of VEB,” Dmitriev says.

For the projects that it finances, VEB usually holds land and structures as collateral and appoints representatives as board directors.

Typically the companies proposing a project would provide from 10 percent to 15 percent of the project’s funding, and the rest would come from VEB. There are, however, variations on this model.

VEB helped finance the \$650 million new terminal at Sheremetyevo, providing a 13-year loan in partnership with Russia’s VTB Bank and the Japanese Bank for Development.



Alexander Ivanov

“It was risky because it was the first project of this type in Russia, and there was no experience with structuring and financing this type of project,” says management board member Alexander Ivanov.

“Whenever VEB participates in a venture, it provides a certain comfort for commercial banks and for other investors because we’re a 100-percent government-owned institution whose supervisory board is headed by the Russian Prime Minister,” he says. “It’s a sort of commitment by the Russian State that shows major support for the project’s success.”

Another strategic project that was made possible by long-term financing

from VEB is the world's largest polypropylene plant. It was launched last October.

Russia, the world's largest gas producer, lacks downstream capacity to transform many of its resources into more valuable products. Until the launch of this \$1.4 billion plant, Russia had been importing polypropylene, which is used in plastics.

The financing arrangements agreed by VEB and Sibur, the plant's owner, were awarded "Best Petrochemical Deal of the Year" by Trade Finance Magazine.

Equipment from Italy, Germany and the U.S. was transported to Tobolsk, the Siberian town where the plant is situated.

VEB's Supervisory Board approved the bank's participation in the financing of this project in the amount of \$1.44 billion, which the bank itself borrowed these funds via a combined package from commercial banks and export credit agencies from those countries providing the equipment for the plant. ●



ALEXANDER IVANOV, DEPUTY CHAIRMAN





BRUNSWICK RAIL

Photo: brunswickrail.com



EXPORTING JETS WITH VEB FINANCING

## CHAPTER 2

# PUBLIC-PRIVATE INVESTMENTS AND INTERNATIONAL PARTNERS

## CONFRONTING THE INFRASTRUCTURE BOTTLENECK

**A**nother element of VEB's role is to improve the country's infrastructure and support regional development.

"Infrastructure is certainly a big bottleneck for a majority of our regions," says management board member Sergey Vasiliev.

The country's railways, road network, airports, pipelines and utilities require major investments.

The risks and durations of the loans are too great for private finance alone to bear, but the required investment is also greater than the federal government can afford.

"Our estimates of the volume of investment required to develop Russian infrastructure over the next five years show clearly that these projects can only be realized through a combination of state and private investment," says Vasiliev.

## CHAPTER 2



Sergey Vasiliev

“VEB is a very good vehicle to promote this partnership, because our large projects are generally public-private partnerships.”

“Once we have private investors co-investing alongside the state, the government can be sure about its money because private investors generally manage their money better than the government manages its own money.”

To this end, VEB in 2008 provided the cornerstone \$200 million investment for the formation of the Macquarie Russia & CIS Infrastructure Fund (MRIF).

The closed fund makes equity and equity-related investments in infrastructure across Russia and the Commonwealth of Independent States.

The fund has investor commitments of \$630 million, including \$100 million each from the European Bank for Reconstruction and Development, the International Financial Corporation and Eurasian Development Bank.

## RUSSIAN DIRECT INVESTMENT FUND (RDIF)

### KEY HIGHLIGHTS

- VEB holds 100% share in Management Company RDIF
- US\$6bn in medium term is expected to be contributed to the RDIF by the Russian Federation; US\$4bn already provided
- The purpose is to attract up to US\$50 bn of direct investments to key sectors of the Russian economy through the co-investment mechanism
- A significant interest in cooperation with RDIF was expressed by leading sovereign, PE funds, pension and insurance companies, direct investment funds

### FUND MANAGEMENT SYSTEM

- Investment committee considers and approves investment decisions
- Supervisory board is represented by senior government officials. Its role is to develop fund's investment strategy and approve large transactions
- Direct management of the fund is carried out by the CEO and the management board

### RECENT INITIATIVES

- RDIF and Abu Dhabi Department of Finance launched US\$5bn partnership fund focused on Russian infrastructure projects.
- US\$1bn committed to US\$2bn joint venture, created with Mubadala Development Company.
- RDIF and Fondo Strategico Italiano launched €1bn Russian-Italian investment platform.
- US\$1bn committed to Russia-China Investment Fund (target size US\$3-4bn, US\$1bn to be injected by CIC; US\$1-2bn - by 3rd party investors)
- RDIF invests in the Moscow Exchange IPO and attracts leading international co-investors from the US and China

The MRIF has made four investments in diversified infrastructure sectors, including transportation (Brunswick Rail), power (OGK-5 and GSR Energy) and telecommunications (Russian Towers).

VEB has also supported investment in Russian infrastructure through its management of the state pension funds.

VEB acts here as an agent of the Russian government and is required to hold almost all of the funds in government bonds. However, it has recently switched some of the investments into infrastructure bonds, such as those issued by Russian Railways, the state railroad operator.

VEB also invests alongside private funds through the Russian Direct Investment Fund. The government launched the fund in 2011 with a pledge of \$10 billion in capitalization over the following 10 years.

Financing Russian exports also is a major function of VEB. In 2013, these loans and guarantees increased 2.4 times, to 120 billion rubles. For 2014 the total should rise to 260 billion rubles (\$8 billion).

In January 2014, for example, VEB financed the sale of three Sukhoi Superjet 100 aircraft to Sky Aviation Airlines of Indonesia. ●



**SERGEY VASILIEV, MANAGEMENT BOARD MEMBER**

Infrastructure  
is Russia's big  
bottleneck.



CHAPTER 3

# INFRASTRUCTURE AND REGIONAL DEVELOPMENT

HOW REGIONS COMPETE FOR FOREIGN INVESTMENT





**T**he Russian government wants to reduce the prosperity gap between different areas of the country, and Vnesheconombank’s Department of Regional Policy helps to realize this goal.

“One of the concepts which we developed is a competitive federalism - regions should compete for foreign investment and in doing so create a better business environment,” says Sergey Vasiliev.

“This works because we have 85 regions in Russia and they really do compete. For example, just three or four foreign investors can change the technology base and employment pattern of a region”.

This ties in with the bank’s role supporting infrastructure, since



## CHAPTER 3

inadequate communications hold back investment in many parts of the country.

“When we speak about Russia’s provinces, we need smaller airports so that businessmen can reach the smaller cities. This is one of the big challenges for development in Russia,” said Sergey Vasiliev.

“In the Soviet Union all the cities were connected by heavily subsidized airlines, but now it has to be done on a commercial basis.



Mikhail Kopeikin

Most of the cities are big industrial and business centers. Some of them have new airports, some of them don’t. By 2018, we’ll have new airports in all the cities.”

Vasiliev says that these improvements will also benefit small and medium-sized enterprises - this sector too falls with VEB’s mandate. SME Bank, one of its units, has provided such businesses with more than 20 billion rubles in the last four years. In 2012, VEB also formed an international entrepreneurship fund in partnership with Germany’s KfW.

VEB is particularly keen to foster entrepreneurship in Russia’s so-called single-industry towns. The imbalance in these towns represent a major challenge for the Russian government

One such town is Tolyatti, the home of AvtoVAZ, the country’s biggest car maker. The global economic slump in 2008 hit Russian industry hard and VEB’s support was essential to cities like Tolyatti.

The government identified 342 “single-industry towns” with a total population of 15 million people and mandated VEB to support them with finance for new infrastructure and industry.

“In order to answer the challenge, the government organized a task force with special funding to serve their problems,” said Mikhail Kopeikin, Deputy Chairman of State Corporation ‘Bank for Development and Foreign Economic Affairs (Vnesheconombank)’.

“There is very close and tight cooperation with both the local authorities

and our bank for the support of small and medium-sized businesses.”

Vasiliev notes that Russia’s less-developed regions present the best opportunities for investors “You have less pressure on wages, more land and more capacity, in electricity, for example,” he says. “Wherever there are regions showing the initiative and presenting economically viable projects, we’re willing to come with our money. We see a lot of such projects.”

Vnesheconombank is particularly active in the North Caucasus and in the underdeveloped Far East, where improvements in infrastructure can open up big returns for those businesses that cater to Asia’s growing demand for resources.

“Right now, there are no pipelines and each zone has its own small grids,” says Vasiliev. The major task is to get the resources, convert them into something exportable and then get them to the ports.” ●

**MIKHAIL KOPEIKIN, DEPUTY CHAIRMAN**

VEB has funded 36,000 small and medium companies in the past three years.



## CONCLUSION

# UNLOCKING OPPORTUNITIES IN RUSSIAN INFRASTRUCTURE

**R**ussia's roads, airports and factories are in a far worse state than the country's economy, and this means there are dozens of profitable investment projects.

The government's solid fiscal position has provided the development bank with a strong basis from which to modernise Russia's infrastructure.

VEB has a key role in unlocking potential across Russian industries, regions and business sizes.

Without VEB, many areas had suffered for lack of long-term financing. Private investors were deterred by the risks.

VEB's commitment to Russia's long-term development has now mitigated those risks. For those private funds with an opportunity to invest alongside Russia's state development bank, it is a time of opportunity.

## CONTACT INFORMATION

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