

# Analysis of the transformation of the Russian banking system

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**Abstract.** The paper analyzes the development of the modern Russian banking system in the conditions of the trend of digital transformation. The aim of the work was to analyze the rehabilitation policy of the Central Bank in the field of banking sector regulation. The working hypothesis was that the reorganization of the financial system leads to an increase in monopolistic trends in the banking sector, while solving the key problems of the Russian banking system: a more objective reflection of problem assets in the balance of the banking system is achieved; the economic role of the “schematic” capital formation of the Russian banking system is declining, with the simultaneous growth of state ownership in the Russian banking system; a business model based on private business lending to its owners becomes inefficient. The paper conducts a qualitative and quantitative analysis of the development of the modern Russian banking system. A critical model of the activity of the Central Bank has been proposed, which allows a system analysis of the development of the Russian banking system at the transformation stage. The study clearly showed that monopolization of the banking sector leads to a decrease in the riskiness of the market strategy of individual banks, however, there is an increase in the probability of systemic shocks of the banking system as a whole.

## 1. Introduction

The central bank is the regulator of any banking system. The main goal of the central bank is to strengthen the institutions of money circulation, protect and ensure the stability of the country's monetary unit, its rate in relation to currencies of other countries, increase the efficiency of settlements within the state, and ensure the development and strengthening of the country's banking sector.

The relevance of considering the reorganization policy of the Central Bank in the regulation of the banking sector is determined by the fact that in the Russian Federation the formation of a single mega-regulator of the financial market represented by the Central Bank in recent years has simplified and improved control and supervision over all aspects and components of the state's banking system. However, there are problems in this area. The policy of consolidation and reorganization of banks increases the distrust of private commercial banks; there has been a significant increase in the share of banks with state participation.

The purpose of the work is to analyze the rehabilitation policy of the Central Bank in the field of banking sector regulation. The paper analyzes the development of the modern Russian banking system. The aim of the work was to analyze the rehabilitation policy of the Central Bank in the field of banking sector regulation. The working hypothesis was that the reorganization of the financial system leads to an increase in monopolistic trends in the banking sector, while solving the key problems of the Russian banking system: a more objective reflection of problem assets in the balance of the banking



system is achieved; the economic role of the “schematic” capital formation of the Russian banking system is declining, with the simultaneous growth of state ownership in the Russian banking system; a business model based on private business lending to its owners becomes inefficient. In the work were used as theoretical research methods, such as, deduction, generalization, classification and practical – comparison, modeling and observation. The paper conducts a qualitative and quantitative analysis of the development of the modern Russian banking system. A critical model of the activity of the Central Bank has been proposed, which allows a system analysis of the development of the Russian banking system at the transformation stage.

## **2. Review of theoretical and empirical studies to assess the impact of the monopolization of the banking sector on its stability**

Note that the topic of assessing the impact of the monopolization of the banking sector and its stability is sufficiently developed in the economic literature.

There are two scientific doctrines: the concept of “competition-vulnerability” and the concept of “competition-stability”.

So, Keeley (1990) [1], Beck, De Jonghe & Schepens (2011) [2] argued that as a result of increased competition, banks pursue a more aggressive policy, in particular, there is an increase in unsecured loans, which leads to a decrease in the stability of the banking system as a whole. Boyd, De Nicolo & Loukoianova (2009) [3], Schaek K., Cihak M., Wolfe S. (2009) [4], Leroy A., Lucotte Y. (2016) [5] conclude that the likelihood of banking crises increases with increasing concentration of the banking system.

## **3. Analysis of the world experience of crisis response measures in the banking sector**

Considering the experience of foreign countries, one can not ignore the experience of applying the US anti-crisis measures, where reorganization manifested itself in:

1. Creating and special authority to assess systemic risks, to propose regulatory measures to strengthen systemically important companies.
2. Development of strict rules for systemically important companies, in which the Fed began to provide collective support programs in place and individual GOVERNMENTAL crisis loans to individual institutions.
3. Recommendations and regulators to work out “Volcker rights and rights” for preventing commercial banks from engaging in securities trading in their own interests.

On the other hand, in Germany, it was also considered possible to construct a “bad bank” – the Sovereign governmental financial institution whose sole purpose would be buying up distressed securities and accumulation of private banks. After realizing that all measures taken by the state to support the financial sector do not have a positive effect, at the end of 2008 a Special Fund for Stabilization of Financial Markets in the Amount of 480 Billion Euros was created.

Similar experience is available in many countries around the world, including the UK, France, Spain and Greece. Governments in various countries have used their own models for creating “bad” banks. Some examples, such as the rehabilitation of banking systems in Norway and Sweden in 1991, recognize the entire world professional community as successful. However, there is no “absolute” model of a “bad” bank. Schemes depend on political and economic factors.

## **4. Analysis of the banking system cleansing process**

The systematic process of cleansing the banking system by revoking licenses from banks that began with the regulator at the end of 2013 can be considered quite logical. There were objective problems in the Russian banking system:

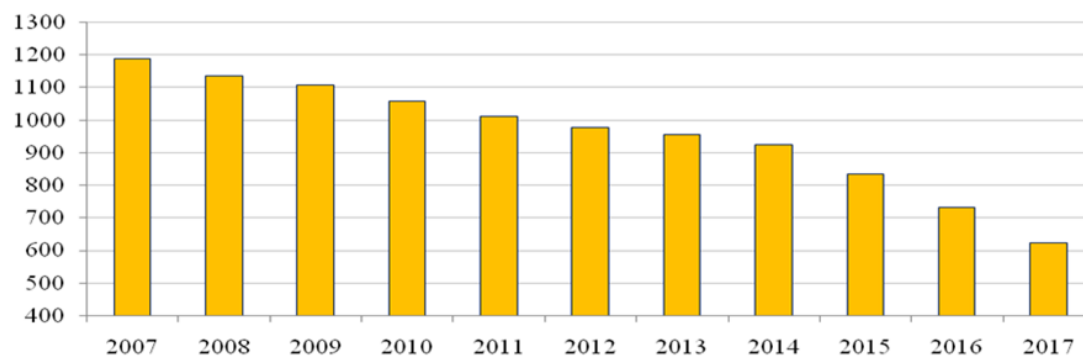
Banking risks of banks were not reflected in full. In fact, the banks did not fully conduct the reservation of the actual default borrowers, but proceeded to carry out permanent extensions.

The “schematic” formation of the equity capital of Russian banks was clearly pronounced and essentially it was a mechanism of capitalization of the administrative rent of elites.

The business model of many private banks was built on lending businesses of owners.

The trend that continued in the following years indicates that the Central Bank is purposefully pursuing a policy of reorganizing the banking sector. This is evidenced by the following trends.

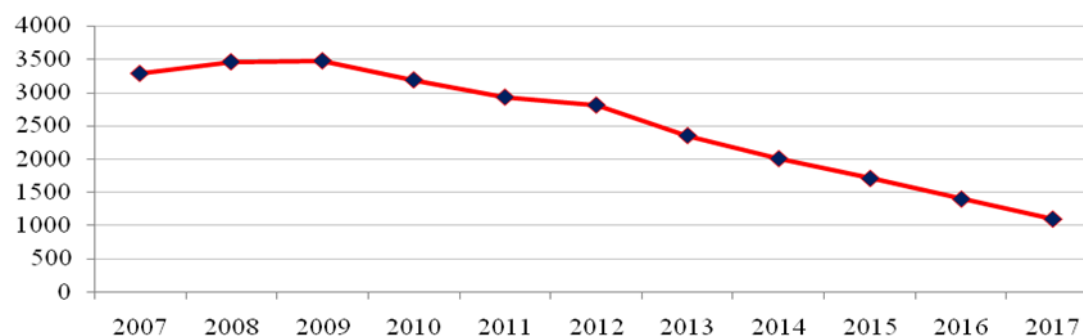
1. A significant reduction in the number of credit institutions and their branches over the past decade (most likely, the trend will continue in the near future) (figure 1).



**Figure 1.** Dynamics of the number of credit institutions in the Russian Federation.

Over the past 10 years there has been a clear downward trend in the number of credit institutions in the Russian Federation. As of January 1, 2017, as compared with January 1, 2007, the number of credit institutions decreased by almost 2 times (-48%), and amounts to 623 (against 1189 in 2007). Moreover, the decline occurred throughout the period under review (the annual decline decreased by an average of 6.2%, but in 2016-2017 the decline occurred at a faster rate – 13% and 15%, respectively).

Similar trends can be noted for the dynamics of the number of branches of credit institutions in the Russian Federation. Over the past 10 years, the number of branches decreased by 66.5% (1098 in 2017 against 3281 in 2007). Every year, on average, the figure decreased by 10%.



**Figure 2.** Dynamics of the number of branches of credit institutions in the Russian Federation.

2. The magnitude of the concentration of cash in the banking sector, with an increase in the share in the assets of the sector of the largest banks (most likely, the trend will also have a positive trend if macroeconomic instability persists).

If there are fewer credit institutions and their branches in the Russian Federation, their concentration will increase. The share of the top 200 in terms of assets of credit institutions in total assets COBOL banking sector rose to 98.0% in 2016 (based on 2015 ode – 97.2%). Over the year, the specific EU share in the sector assets of the five largest banks also increased from 54.1% to 55.3%. This suggests that in the industry is more competitive (in modern conditions) are large banks, small banks either leave the market or reduce the volume of their activities.

3. The increase in the number of banks that have cases of violation of mandatory regulations of the Central Bank and cases of violation of the law.

The Bank of Russia strictly controls the work of commercial banks. Strict measures are applied to violators of the rules of normative and legislative acts, up to and including deprivation of a license. Thus, statistics on the basis of the grounds for the revocation of licenses for banking operations for the most active period of such activities, the Central Bank (ie, 2014-2016) is presented in table 1.

After the revocation of the license, the Central Bank introduces a temporary administration and commits the procedure of voluntary liquidation (with sufficient funds) or bankruptcy (in the absence of funds from the organization).

**Table 1.** Grounds for revoking banking licenses.

Base	2014	2015	2016
Non-execution of federal laws regulating banking activities, as well as normative acts of the Central Bank, if within one year to KO several times to apply the measures stipulated by Federal Law No 86-FZ	thirty	75	83
Repeated violation within one year of the requirements of Articles 6 and 7 (with the exception of paragraph 3 of Article 7) FL 0 7.08.2001 No 115-FZ "On countering the legalization (laundering) of criminally obtained income and the financing of terrorism"	8	36	34
Establishing facts of significant unreliability of reporting data	7th	13	eleven
Reducing the amount of equity (capital) of a credit organization below the minimum value of the authorized capital established on the date of its state registration	6th	14	26
Capital adequacy is below 2%	5	12	27th
Inability to meet the requirements of creditors for monetary obligations within 14 days from the date of their satisfaction	2	26	13

Based on these trends, it is possible to designate the main thesis, according to which the elimination individual elements of the banking system were necessary, since most banks had financial and legal problems before the crisis, and such factors as fluctuations in the ruble exchange rate and the increase in overdue only intensified the problems.

If the license is not taken away from the bank, the bank can be sent for rehabilitation. In total, for the entire period, starting in 2008, when the reorganization mechanism was introduced, 49 credit organizations were put under financial rehabilitation. In case of reorganization, the relations with the bank are maintained. At the same time, the state changes the people managing the bank and transfers the bank to another bank so that it covers its obligations (usually transfers with the amount of money sufficient to eliminate the violations that have occurred). In the initial period, there may be some delays in payments (until the new bank and new management come in, do not check all the data), then usually all the work is restored. In addition, in this case, credit organizations have plenty of opportunities that allow them to rehabilitate, resolve the problems they have with low solvency and resume the usual pace of work characteristic of the organization [6].

In particular, the cases with the large banks "Otkritie" and "BinBank" suggest that these banks promptly appealed for help to the Central Bank in order to prevent even greater losses. However, as the head of the Central Bank Elvira Nabiullina emphasizes, these cases are private and do not reflect general trends [7].

At the same time, for the rehabilitation, the following trends can be identified.

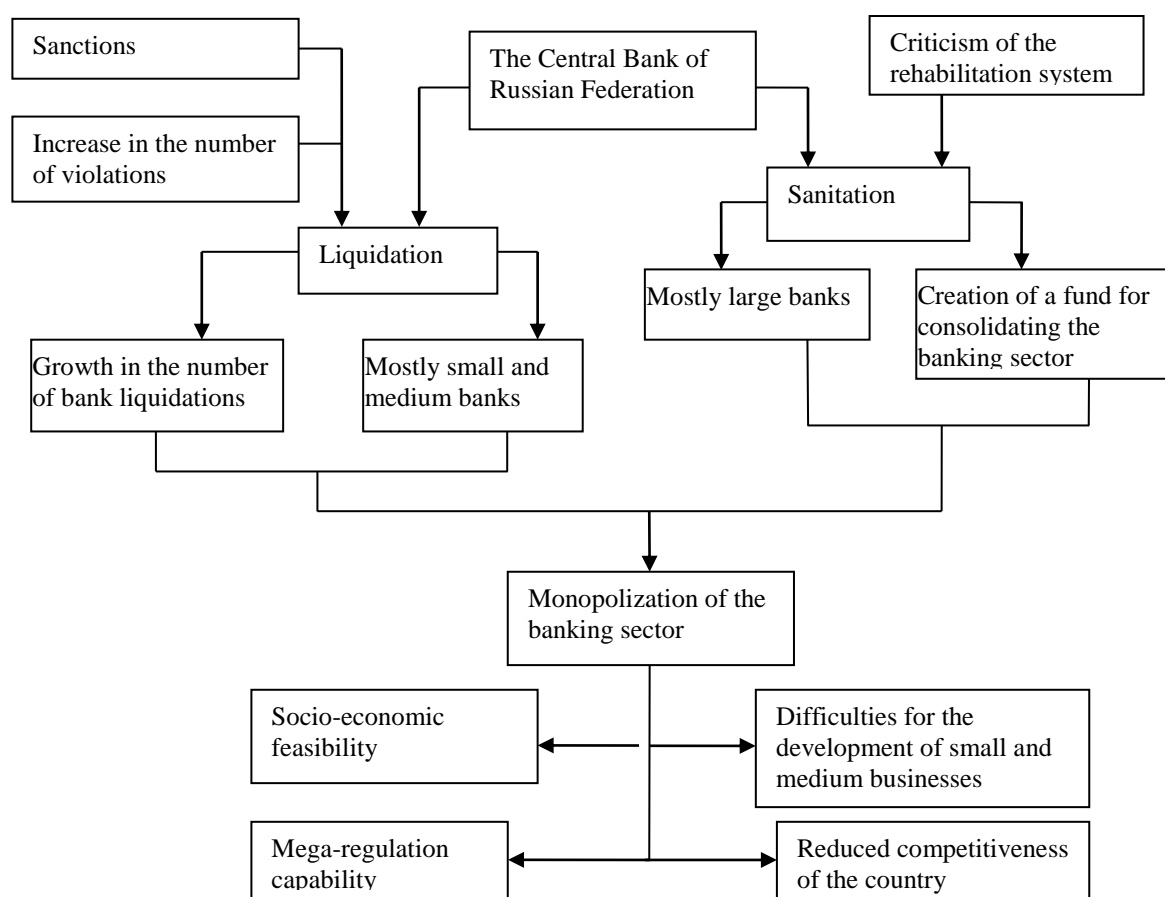
Firstly, the rehabilitation procedures mainly concern medium and large banks, for small players the most likely option is liquidation. Spanish scientists have mathematically substantiated a direct relationship between the size of the bank and the prospect of its reorganization (and not liquidation) [8].

Secondly, if readjustment previously carried through the Deposit Insurance Agency (DIA) the path is then from the current scheme is that the ACB be removed from readjustment (partly due to economic inefficiency, Fitch Ratings estimates the total exceeding about 0.5 bln. rub.), instead, the Central Bank created its organization for the rehabilitation – the Fund for the Consolidation of the Banking Sector. The Central Bank decided that the entry into capital during the reorganization will allow spending 1.6 times less money on the recovery of banks than on the DIA [9].

In addition, the former reorganization system was criticized, in particular, the rating agency Fitch Ratings noted that the investor selection procedure is not transparent, there are no strict requirements for participation, and monitoring of the rehabilitation process is weak. And, according to an analysis of 27 Russian banks, for which the reorganization procedure is currently being applied, in most cases the cost of providing support to banks substantially exceeds the cost of their liquidation.

## 5. Summary

Taken together, the identified trends make it possible to form the following critical model of the activity of the Central Bank (figure 3).



**Figure 3.** Critical model of activity of the Central Bank.

The growth in the number of liquidations of credit institutions (mainly small and medium) in combination with the reorganization of the banking reorganization system leads to an increase in the influence of the Central Bank on the regulation of the banking sector as a whole, which can be generally described as monopolizing the banking sector.

In other words, in the process of readjustment problems arise as well: Increased monopolistic tendencies in the banking sector (reduced level of competition) – increased share of the major players

in the market, but also reduced number of smaller players (small and medium businesses). This problem, like any problem, can be viewed from two sides (table 2): positive and negative.

If we recall the words of the head of the Central Bank Elvira Nabiullina said at the beginning of 2017, cleaning the banking sector completed by half: it started in 2013, and, if you count two or three years the process will continue – could be the revocation of licenses from small banks and cases of saving the banks bigger [10].

**Table 2.** Strengthening monopolistic trends in the banking sector.

Positive value	Negative meaning
Strengthening the state banking system in the context of macroeconomic instability (large banks occupy a more significant place in the banking system)	Reduced competition in the sector (the principle of market economy is violated), as well as domestic players in the global financial market
Reducing socio-economic risks in the banking sector (banks leave the market which have a higher level of risk)	Difficulties for the development of small and medium-sized banks (although the development of small and medium-sized businesses is the basis for a stable socio-economic development of the country)

Let's sum up. On the one hand, the reorganizations sanitation systems leads to an increase of monopolistic tendencies in the banking sector, but on the other hand it can be stated that in order to maintain the stability of the country's financial system, especially in the context of economic sanctions imposed on Russia by the West, due to the Ukrainian crisis, the imbalance in the whole international situation, the Bank of Russia objectively establishes strict conditions for banking supervision and increases its competencies. The study made it possible to consider this issue from a critical point of view.

As a result of the study, we can single out the thesis that monopolization of the banking sector leads to a decrease in the riskiness of the market strategy of individual banks; however, there is an increase in the probability of systemic shocks of the banking system as a whole.

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