

Basel is not a panacea for crisis: advancing the discussion on the sustainability of credit institutions

G Gavrilchenko^{1*}, and I Astrakhantseva¹

¹ School of Economics and Commerce, Siberian Federal University, 79 Svobodny prosp., Krasnoyarsk 660041 Russia

E-mail: gavr368@mail.ru

Abstract. The article discusses aspects of the effectiveness of the implementation of international standards developed by the Basel Committee to strengthen the sustainability of credit institutions, reducing the cost of eliminating the effects of economic and financial crises in the regions and in the whole country. The authors are invited to consider deeper causes, ensure reliable creditworthiness and solvency of bank borrowers, and achieve greater efficiency in reducing risks.

Keywords: Basel Committee, bank, banking system, credit institution, crisis

1. Introduction

In 1975, the managing directors of the central banks of the G-10 countries (G-10) organized the Basel Committee on Banking Supervision. The committee included senior representatives of banking supervisors and central banks.

The formation of such a transnational institution was a response from the banking community and supervisory agencies in cases of large losses and bankruptcies of banks, hedge funds and institutional investors [1], [7], [8]. This required the development of standards, rules, and methods to prevent financial losses during the crisis period. The committee has developed the following standards: Basel I, Basel II, and Basel III.

Practice has shown that the implementation of the standards of the Basel Committee has a positive impact on the stability of the banking system, but it does not provide security and is associated with high costs [2]. We consider it advisable to consider the underlying causes that are born from the borrower of the bank itself.

2. Materials and Methods

In 1988, the Basel Committee on Banking Supervision developed the first global document, the “Capital Adequacy Agreement” (Basel I). Initially, the agreement was considered as a recommendation, but it has become an obligatory norm for G-10 countries since 1992. After that the Basel II and Basel III documents were developed. The main purpose of Basel I was to limit credit risks (losses from default by borrowers, etc.) by developing a number of supervisory principles.

Currently, more than 100 countries (including Russia) have fully or partially joined Basel I. The main thing in the document is the determination of capital adequacy at a credit institution.

In 2004, Basel II was published, it was a refined framework of approaches, which consisted of three main components: minimum capital structure requirements, a supervisory process, a market discipline. Further practice has shown that meeting the requirements of the minimum allowable amount of capital cannot ensure the safety of the bank and the entire banking system. Basel I defined capital requirements formally, without taking into account the real (economic) needs of banks for it.

However, the global financial crisis of 2008 showed failures in the regulation of banking activities. For this reason, Basel II again had to be reviewed.

Basel III tightened the requirements for the composition of first-level capital and established the need for credit institutions to form at the expense of the net profit of an additional reserve buffer.

Buffer capitals allow banks in the event of a systemic crisis and a reduction in the capital adequacy ratio below the minimum allowable amount of additional liquidity without the sanction of the regulator. However, after the crisis, credit organizations are obliged to recover this capital.

At the same time, Basel III introduces regulations aimed at limiting the financial leverage (capital gearing ratio of borrowed and equity capital), which is valid for financial intermediaries. In particular, we are talking about the revision of standards for current and long-term liquidity.

Currently, Basel I in Russia is applied in full scale, Basel II is in a modified form. But, nevertheless, from January 1, 2016, the Central Bank strongly insisted on the implementation of Basel III standards. The main reason for introducing Basel is to increase the quality of risk management in banks, which should ensure the stability of the banking system and real protection of the rights of depositors and creditors. What is especially important in times of crisis. In addition, the overwhelming majority of Russian banks operate on the international market, have correspondent accounts with foreign credit institutions. Therefore, following the rules adopted in the international market is the only correct way.

The implementation of Basel III standards in the current environment has an impact on banks, as capital requirements and risk assessment increase. The Central Bank of the Russian Federation conducted a thorough assessment of the impact of the implementation of Basel on the banking system as a whole, on individual banks and groups of banks. Moreover, the Central Bank of Russia adopted a number of serious easing of its own regulation, because in some respects the Russian regulation was tougher than Basel I, II, III. For example, the standard of capital adequacy decreased from Russian 10% to the minimum of 8% required by Basel. Mitigating the requirements of the regulator has allowed banks to free up a certain amount of funds, which is now reserved for bank risks. As a result, the banking sector had the opportunity to increase some activity in the credit market.

The gradual transition to new standards began in 2013 and was planned to continue over the next 6 years (until January 1, 2019). The Central Bank of the Russian Federation believes that the Russian banking system can withstand the introduction of Basel III. And so, taking into account compensatory measures, the effect of the introduction of Basel on the Russian banking system will be neutral.

The regulator made allowances for clients of credit institutions. For loans of the "best" quality to small and medium businesses, the risk ratio was set at 75% (each such a "soft" loan should not exceed 50 mll. rub., 0.2% in the loan portfolio size). This decision should help revitalize small business lending.

The following easing is 35%. Analysis of the prospects and problems of adaptation of Basel III components in the practice of Russian banks shows that all leading Russian banks successfully operate under international financial reporting standards and comply with capital adequacy requirements; therefore, at first glance, the transition to new standards does not cause them serious problems. However, there were several groups of problems that involved the process of introducing new requirements. Small and medium-sized banks could not afford to move to the international standards of Basel III.

The Central Bank of Russia has become actively engaged in closing, merging, and bankruptcy of credit institutions that do not withstand the pace of improvement of the banking system, including according to the international Basel standards. Every year, 60-110 banks were closed. From 2013 to 2019, 472 banks were closed (as of January 1, 2013, there were 956 banks, and there were 484 banks

as of January 1, 2019). In 2017, 140 banks with a loss of 561 bln. rub. worked at a loss during the year, 102 banks with a loss of 585 bln. rub. in 2018.

According to some economists, the direct costs for improving the banking system amounted to more than 1 tln. rub. The main problems of implementing Basel III were associated with the need to make significant changes to existing banking IT systems. The introduction of new standards directly affected the processes of internal management of the bank. Changes in methodological procedures, reporting forms (internal and external). Consequently, given the costs of organizational, technological, legal, caused by the introduction of Basel, the financial problem touched all credit institutions. The process of introducing new requirements is costly for staff and software. Most of the costs fell on the methodological component, primarily on the development of new risk management principles.

With all the positive actions of the Basel I, Basel II, Basel III methods, it is impossible to achieve the goal of effectively limiting credit risks without attracting the main link, which is the loan consumers (borrowers).

An analysis of domestic and foreign practice shows that the main cause of the decline of problem banks continues to be the poor quality of assets, which ultimately depletes the bank's capital. In the practice of American research, when examining the causes of poor asset quality, several groups of banks were identified, differing in the nature of insolvent loan portfolio management practices:

- Credit liberalism (85%);
- Big omissions in financial statements (79%);
- Over excess lending (73%);
- Incomplete documentation (67%);
- Loans secured by the goods (55%);
- Excessive growth in the number of personnel and structural units and the funds allocated for it (52%);
- High concentration of non-guaranteed loans (37%);
- Lending outside their area (23%).

These indicators reflect the simultaneous presence of several negative factors in the management of bank assets, i.e. management errors are complex, which also requires an integrated approach to their study.

The list of asset quality deficiencies is no exception for a number of banks in the Russian Federation. The current lending system requires serious improvement. In the balance of credit institutions, the main share among the assets are loans issued to non-financial organizations and individuals.

Loans as cash capital operate in various fields and sectors of the national economy. However, the cumulative share of loans to the non-financial sector in the Russian Federation is only one-third of the total assets and even less than GDP.

The liquidity of assets depends on the state (level of activity) of specific segments of the financial and commodity market. The higher the demand for certain objects of bank investments, the higher the liquidity of the respective assets.

Based on the analysis, it can be judged that the results show that the quality of assets is largely determined by the quality of the loan portfolio. Analyzing credit investments by composition, structure, and also in dynamics, managers identify low-quality loans, as well as the reasons for the appearance of such assets in the credit institution's portfolio. Among the most frequently occurring causes are management mistakes, abuses of power, a lack of an effective internal audit and control system, a concentration of loans, as well as external, macroeconomic factors affecting, in particular, the profitability of active operations.

The results of the current analysis of asset quality are used to assess the strategic potential of a portfolio of banking assets at the final stage of the analysis of the financial stability of a credit institution.

To conduct an effective credit and investment policy, the bank needs to maintain an adequate level of asset liquidity at a given level of risk. Higher risk leads to higher return on assets, but at the same time, it may adversely affect the financial stability of a credit institution.

The main disadvantage of the quality of assets of the modern banking system of the Russian Federation (and of the world) remains the primary legislative guidelines for banks to receive maximum profits at any price. Whereas the main task of banks should be the solution of national interests, rather than individual private groups, through reasonable lending to real sectors of the economy and a balanced linkage of commodity-cash flows.

Achieving these goals requires a fundamental reform of the banking system and the improvement of the (constitutional) legislative framework for the development of the state. The economy of the Russian Federation is considered undercredited, due to the high key interest rate of the Bank of Russia, as well as the absence of the obligation of commercial banks to prioritize cash loans to the real economy. The legislative and regulatory framework for cash flow was created in the 90s of the last century, there was complete hope for the effectiveness of a market economy. But life has shown that the cash flows in market conditions must be managed.

During the crisis period, the financial relations between banks and borrowers are aggravated, arrears for non-repayment of loans are growing, the volume of resources and the indicators of banks are decreasing. In order to prevent the bankruptcy of a bank where enterprises and individuals may suffer, the Bank of Russia is forced to provide monetary assistance only to systemically important banks. The amount of assistance reaches trillion rubles. The rest of the banks that failed to cope without the help of the Central Bank are subject to closure.

3. Results

The under-lending of the Russian economy is confirmed by the low level of credit investments in the country's economy. Lending to the real sector of the economy is only 1/3 of all credit investments, this is 2-3 times lower than the level of developed countries [4]. Systemic economic crises necessitated the development of standards, rules, and methodologies. The main purpose of the Basel Agreement was to limit credit risks (losses from borrowers' default, regulation of supervisory functions).

The recommendations of the Basel Committee on the Elimination of Bank Credit Risk did not reach the goal. It is necessary to more specifically consider the risk assessment of a potential borrower before issuing a loan. For this, it is necessary to develop methods for determining creditworthiness, taking into account industry-specific features. Exploring the Russian experience of the modern period and 50-70 years of the 20th century, the following activities are proposed [3].

1. In order to reduce credit risks, it is advisable to change the practice of lending for all banks. It is necessary to develop common criteria and basic parameters for assessing the creditworthiness of borrowers, guarantors.
2. To require large banks to give priority to crediting the real sector of the economy for the creation of new industries, participation in the implementation of new projects stipulated by the state plan, and the creation of new jobs.
3. To do this, at the legislative level to secure the priority activities of banks in lending to the real sector of the economy, including under the guarantee of the state. The current priority in the Federal Law "On Banks and Banking Activities" on "making profits" can be saved, but only in the background.
4. Banks, including the basic ones, which successfully lend to the real sector of the economy, are actively involved in fulfilling the tasks of import substitution, industrial development and other measures of the state plan to provide benefits, including expanding access to the resources of the Central Bank.

4. Discussion

The implementation of the Basel I, II, and III standards was widely discussed in the press [5]. In particular, we can observe identical opinions among practically all authors regarding the main goal,

which is to limit credit risks, losses from default by borrowers, and avoid the costs of implementation. However, the methods of achieving the goal are limited to the development of a number of supervisory principles by the regulator (Central Bank of Russia).

The introduction of standards has shown that the goal is not achieved, but only has a positive effect on the situation. In addition to supervising a credit institution, the article proposes to focus on the borrower, where credit and interest arrears are born, and the reason is mainly poor creditworthiness, low professionalism from the borrower or the bank. This question is not simple, creditworthiness is multifaceted; therefore, the standard of methodologies should be developed taking into account industry specifics. Before issuing a loan, the bank must see the development strategy of the enterprise and the reality of the loan repayment. In the Russian banking practice, there is such experience (second half of the 20th century).

5. Conclusion

The global financial crisis in 2008 showed failures in banking regulation. The emergence of the standard Basel III introduced additional requirements for capital, liquidity, restrictions on financial leverage (leverage), but these requirements did not achieve the goal of ensuring the stability of banks and reducing credit risks. According to a study on the experience of Russian banks are invited to work with the borrower. It is necessary to raise the level of creditworthiness of borrowers, strategically evaluate them, and increase the professionalism of bank employees.

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