

Current Tendencies of Improving the Russian Banking System

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Abstract. Considering the stability and reliability of the banking system as a factor in the successful development of economic processes, the authors analyze the current trends in the recovery of the Russian banking sector and the prospects for its development.

Analyzing the key financial indicators of the banking sector for the period 2016-2018, the authors identify the main reasons for reorganization of the Russian banking sector, classifying banks by types of banking risks. The authors provide statistical data on measures taken to improve the Russian banking sector by the Deposit Insurance Agency in 2008-2017 and also the data regarding overall dynamics of reducing the number of banks and license revocation in 2012-2018.

Forecasting further reduction in the Russian banking sector in 2019 and following years, the authors distinguish three categories of banks that have the saddest prospects: 1) banks that have increased risks associated with compliance with the law on countering laundering of funds received from crime; 2) banks conducting high-risk lending policies, the loan portfolio of which is represented by knowingly non-performing loans; 3) banks that will voluntarily surrender a license due to the lack of prospects for business development.

The authors note that it is becoming more difficult for medium and small banks to compete in the traditional segments of the banking market against the background of consolidation of the banking sector, so the number of licenses voluntarily surrendered is likely to grow. A small-scale banking business does not withstand rising costs and is forced to leave the market. In order to continue their activities and not to be reorganized, small banks will have to merge with other market players, or offer a new viable product on the banking market. The main role in mergers and acquisitions will be played by regional banks with a strong brand, a stable client base and an extensive office network. The beneficiaries of reducing the number of players in the market will be mainly banks with state participation, and to a lesser extent - large private banks.

1. Introduction

In the economy of modern Russia there are several "pain points" – these are several problems that require immediate solutions. In this case, the “decision maker” can only be the state and its regulators [1]. One of these problems is the recovery of the banking system of the Russian Federation. The

banking sector is in the "heart" of the economic system of any country. Successful functioning of the banking sector directly influences both the performance of economic activity carried out in the state and the standard of living of each individual, because the banks control the main levers of influence on virtually every sector of the domestic economy. As a result, stability and reliability of the banking system is of great importance for the national economy [2; 3].

2. Relevance, scientific significance of the Issue

The relevance of the research topic is determined by the special role of the banking sector in the effective development of all economic and social processes in a country. This has been noted in their research by both theoretical and practical economists.

In his work "Theory of Economic Development" J. Schumpeter considered the positive impact of banks on both level and rate of growth of national income, which is based on the impact on the process of effective distribution of savings [4].

Later, authoritative economists R. Goldsmith, R. Levin, R. Rajan, A. Demirguch-Kunt, T. Beck and others theoretically and empirically proved the significant impact of the financial and banking sectors on economic growth and socio-economic development of countries [5; 6; 7; 8; 9; 10].

The banking sector has not lost its special role today, being a kind of "channel" through which impulses are transmitted to the entire economy of a country [1; 11; 12; 13]. It is for this reason that the state needs to focus its capabilities on ensuring stability of the banking system and its involvement in financial incentives for the implementation of innovative programs and projects. And in this regard, the issue of improving the Russian banking system becomes more urgent than ever.

3. Problem statement

The purpose of this study is to focus on the causes and trends of the recovery of the Russian banking system. The authors have analyzed:

1. Key financial indicators of the banking sector in 2016-2018, the reasons for the need of recovery of the Russian banking system and its current trends.
2. Statistical data on reorganization of the Russian banking sector in 2012-2018.
3. Prospects for reduction of the Russian banking sector in 2019 while highlighting the main trends in its structure.

In the article the authors used analytical, comparative, statistical and institutional methods of a systematic approach to research.

4. Theoretical part, practical significance and research results

Since 2012, the Central Bank of the Russian Federation has been actively engaged in reorganization - clearing the banking sector of problem players. Financial rehabilitation is a set of measures for certain restructuring of credit institutions. In fact, the reorganization takes place through the allocation on concessional terms at a low interest rate to a rehabilitator (the person who carries out the reorganization) long-term credit resources for the purpose of economic rehabilitation of a bank being reorganized.

Table 1. Dynamics of reduction of banking sector of the Russian Federation (2012-2018) [14].

Indicator	2012	2013	2014	2015	2016	2017	2018
Number of credit institutions at the beginning of the year	978	956	923	834	733	623	561
Number of revoked licenses	21	29	71	87	93	47	57

During the period from 2012 to January 2019 the Central Bank of Russia has revoked licenses from more than 400 banks, including not only small banks but also medium and even large credit institutions. According to the head of the Central Bank of the Russian Federation Elvira Nabiullina, about 70% of the cases of the revocation of licenses from Russian banks are related to violation of the law on the fight against money laundering. Table 1 shows the data on the dynamics of reduction of the banking sector of the Russian Federation during the period 2012 - 2018.

On May 2, 2017, on the basis of the Federal Law of 01.05.2017 No. 84-FZ “On Amendments to Certain Legislative Acts of the Russian Federation”, the Banking Sector Consolidation Fund (FCBS) was created - the state supervisory authority pursuing the policy of the Central Bank of the Russian Federation in the field of rehabilitation of commercial banks. The specialized fund management company (MC), which is an autonomous unit of the Central Bank of the Russian Federation, oversees the work of the fund. Before the adoption of amendments to legislation, the recovery of commercial banks in the period 2008 - 2017 was supervised by the Deposit Insurance Agency (DIA). The distribution of rehabilitation projects and settlement of bank liabilities by types and kinds of rehabilitation was carried out by the DIA for the entire period of this activity as follows: 42 banks (65%) were involved in financial rehabilitation with the help of investors; in 6 banks (9%) there was a transfer of assets and liabilities; in 3 banks (5%) the shareholder was the agency itself; interim administration was introduced in 2 banks (3%); in 12 banks (18%), the implementation of measures to prevent bankruptcy did not begin due to withdrawal of the banking license by the Central Bank of the Russian Federation. Data on the results of DIA activity on recovery of the banking system of the Russian Federation can be seen in Table 2. [15]

Table 2. Number of projects for rehabilitation and settlement of bank liabilities (started and completed) for the period of the Deposit Insurance Agency activities [15].

	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Banks, during the rehabilitation of which licenses were revoked	–	–	–	–	–	–	1	1	5	5
Bankruptcy prevention projects completed	4	–	3	5	2	1	31	3	6	–
Number of new projects for transfer of assets and liabilities of banks	3	–	–	–	–	–	1	2	–	–
Number of new bank rehabilitation projects	12	3	–	1	–	2	13	16	7	5
Number of projects at the end of the year	11	14	11	7	5	6	16	30	26	26

Thanks to the creation of FCBS, the Bank of Russia intends to switch almost completely from the credit mechanism of financial recovery to a capital one, when, instead of a soft loan, the problem bank is directly capitalized by the Bank of Russia [16]. Table 3 presents the key financial indicators of the banking sector of the Russian Federation for 2016-2018.

Table 3. Key financial indicators of the banking sector [17].

Indicator	01.01.2017	01.01.2018	01.01.2019 (forecast)
Assets, RUR, billion	80 063	85 192	90 000
growth rate, %		6,4	5,6
Loans issued to legal entities and individuals, RUR, billion	40 939	42 366	45 000
growth rate, %		3,5	6,2
Loans to large businesses, RUR, million	25 666	26 023	26 800
growth rate, %		1,4	3,0
Loans to small and medium business, RUR, billion	4 469	4 170	4 700
growth rate, %		-6,7	12,7
Unsecured loans of individuals, RUR, billion	5 670	6 021	6 600
growth rate, %		6,2	9,6
Mortgage loans (portfolio), RUR, billion	4 538	5 187	6 000
growth rate, %		14,3	15,7
Share of overdue debt in individual loans (excluding mortgages), %	12,5	11,2	10,2
Share of overdue debt in the mortgage portfolio of individuals, %	1,7	1,3	1,1
Share of overdue debt in the small and medium business loan portfolio, %	14,2	14,9	13,0
Share of overdue debt in large business loan portfolio, %	4,9	5,0	4,9
Share of loans of IV and V quality categories in the total loan portfolio, %	9,4	10,0	10,5
Profit, RUR, billion	930	785	1 100

In fact, by the end of 2018, banking assets had grown by 10.4% (6.4% a year earlier), but without taking into account currency revaluation, the sector's growth rate had decreased (6.2% versus 7.7%). Key contribution to dynamics of the sector was made by the client loan portfolio, which showed an increase in nominal terms by 13.9% (3.5% in 2017). The growth of the portfolio was ensured by

accelerating both retail lending, which is leading in terms of growth rates for the third year in a row, and loans to non-financial companies [18].

Important activities in the field of financial rehabilitation of banks were the work of temporary administrations to manage rehabilitated banks, as well as regular and comprehensive monitoring of the course of financial rehabilitation of banks. This made it possible to gain control over the activities of problem banks in the shortest possible time, to organize their work, taking into account the existing financial possibilities, thus preventing any unrest among creditors and depositors. A comprehensive analysis of the financial situation of banks was also carried out, the results of which directly influenced decisions about possibility and feasibility of their future activities.

Table 4 presents data on the state of the banking system of the Russian Federation at the beginning of 2019.

Table 4. Information about the banking system of the Russian Federation (18.01.2019) [19].

1. Credit institutions (CI) eligible for banking operations, total	484
including:	
— banks	440
— non-bank credit institutions	44
of them:	
— with a universal license	291
— with basic license	149
1.1. Credit institutions that have licenses (permits) entitling to:	
— attracting deposits	400
— operations in foreign currency	475
— conducting operations with precious metals	214
1.2. Credit institutions included in the register of banks participating in the system of compulsory deposit insurance, total	407
2. Registered authorized capital of operating credit institutions (RUR, million)	2 655403
3. Branches of operating credit institutions on the territory of the Russian Federation, total	709
including: — PJSC Sberbank	90
4. Branches of operating credit institutions abroad, total ⁵	6
5. Representative offices of operating Russian credit institutions, total	316
including: — on the territory of the Russian Federation	292
— in foreign countries	16
— in the near abroad	8
6. Additional offices of credit institutions (branches), total	20 499
including PJSC Sberbank	13160
7. Operating cash desks outside cash office of CIs (branches), total	1 068
including PJSC Sberbank	219
8. Credit and cash offices of CIs (branches), total	1 918
including PJSC Sberbank	0
9. Operating offices of CIs (branches), total	6 015
including PJSC Sberbank	581
10. Mobile cash points of CIs (branches), total	283
including PJSC Sberbank	279

The growth of the banking sector in 2018 was provided mainly by banks from the TOP-30 by assets. At the same time, the number of inefficient banks was growing. As of December 1, 2018, 43% of all banks placed a significant (more than 20%) share of assets in low-income investments. Against this background, more and more shareholders are losing interest in the banking business: in 2018,

licenses were revoked from 57 banks. Key reasons - violation of the 115-FZ law and high-risk credit policy. Another seven banks voluntarily surrendered their banking license. As a result, at the beginning of 2019, 440 banks remained in the sector. The growing consolidation of the sector is accompanied by steady growth in the share of state banks, which reached a record of 72%, including an increase due to intensification of their participation in M & A transactions [18]. In English, this abbreviation stands for “mergers and acquisitions”. This is a set of measures aimed at integrating one financial organization into another, combining them or merging. The objectives of such operations may be different - expanding the customer base, creating branches, optimizing the banking products offered, etc.

According to “Expert RA” rating agency, in 2019 more than 50 banks will leave the market, including through voluntary surrender of licenses, as well as M&A transactions. The agency divides the banks that might leave the market into three categories:

- 1) Banks, which conduct a significant volume of client operations relative to their balance sheet and, as a result, bear increased risks associated with compliance with the law on countering the laundering of proceeds from crime (115-FZ).
- 2) Banks conducting high-risk lending policies whose loan portfolio is represented by deliberately bad loans. Their key risk is associated with the loss of capital due to the need to complete adequate reserves at the request of the Central Bank.
- 3) Banks that will voluntarily surrender the license due to the lack of business development prospects. First of all, these are banks with a stagnating or shrinking loan portfolio, with a significant amount of investments in highly liquid but low-income assets (interbank loans or deposits in the Central Bank). As a rule, such banks are distinguished by extremely low interest margins and loss-making businesses [14].

Most experts in the banking market agree that it is becoming more difficult for small banks to compete in traditional segments against the background of consolidation of the banking sector, so the number of licenses voluntarily surrendered will grow. A small-scale banking business does not withstand rising costs and is forced to leave the market [20].

In order to continue their activities and not be reorganized, small banks will have to merge with other players or offer a new viable product in the banking market. The main role in M & A transactions will be played by regional banks with a strong brand, a stable customer base and an extensive office network. The beneficiaries of reducing the number of players in the market will be mainly state-owned banks, and, to a lesser extent, large private banks. As a result, the share of banks from the TOP-30 may increase by another 1-2% and approach 90% by the end of the year. State and large private banks have been enjoying advantages of the policy of the Central Bank of the Russian Federation for about five years. Their share is growing amid the revocation of licenses with an almost unchanged deposit insurance system, which, despite its expansion to small business, does not protect the interests of the real sector. As a result, entrepreneurs place funds mainly in systemically important credit organizations, while for the rest the situation is worsening. Some bank analysts believe that in the coming years, 40 banks will withdraw from the market, surrendering their license voluntarily or through a merger [14].

As of early February 2019, there are 149 banks with a basic license in Russia. These are small regional credit institutions that traditionally work only with clients of their own region and do not have a wide branch network. Since this year, their risk of bankruptcy has increased due to the fact that not only funds of citizens and individual entrepreneurs, but also small and medium-sized businesses are covered by the law on deposit insurance. The fact that the burden of too high deductions is one of the main problems of small banks is also recognized in the Association of Banks of Russia (ABR). In addition, small banks automatically pay higher fees on any prescription of the Central Bank of a restrictive or prohibitive nature. There are standard and higher contributions to the deposit insurance fund in the Russian banking market. The bases of their application are the same for both large banks with a universal license and for banks with a basic one. The reasons for the establishment of increased contributions are low assessment of indicators of capital, assets, liquidity, risk management system

and the state of internal control. However, small banks, in contrast to large ones, face the risk of bankruptcy while raising the interest rate. All risks of credit institutions are included in the price of banking products. Obviously, a reduction in contributions to the deposit insurance fund will improve the financial position of banks with a basic license, as it will allow them to make more attractive terms for their products for customers (improve their servicing capabilities, lower interest rates on loans, etc.). In mid-February 2019 the first meeting of a separate working group specially created by the Central Bank will be held to address the problems of small banks [21].

5. Findings (conclusion)

1. The main reasons for reorganization of the Russian banking sector are: increased risks associated with non-compliance with legislation on countering the laundering of funds received from crime; high-risk credit policy; voluntary surrender of licenses due to the lack of business prospects.

2. The main trend in the current 2019 will be the consolidation of banks through mergers or acquisitions due to the fact that a small-scale banking business does not stand the rising costs. The main role in mergers and acquisitions will be played by regional banks with a strong brand, a stable client base and an extensive office network. The beneficiaries of a reduced number of players in the market will be mainly banks with state participation, and to a lesser extent - large private banks.

3. Thanks to the creation of FCBS, the Bank of Russia intends to switch almost completely from the credit mechanism of financial recovery to a capital one, when, instead of a soft loan, the problem bank is directly capitalized by the Bank of Russia. A special working group to address the problems of small banks has been created.

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