

## SCTCMG 2019

### International Scientific Conference «Social and Cultural Transformations in the Context of Modern Globalism»

#### **BANKING SUPERVISION IN THE RUSSIAN SYSTEM OF STATE REGULATION OF COMMERCIAL BANKS**

Anastasia Vasilyeva (a)\*, Elena Karpova (b), Nina Kuznetsova (c)

\*Corresponding author

(a) Nosov Magnitogorsk State Technical University, 38, Lenin Ave., Magnitogorsk, Russia  
agvasileva@inbox.ru, 8-902-617-66-62

(b) Nosov Magnitogorsk State Technical University, 38, Lenin Ave., Magnitogorsk, Russia  
e.v.karpova@mail.ru, 8-3519- 29-85-44

(c) Nosov Magnitogorsk State Technical University, 38, Lenin Ave., Magnitogorsk, Russia  
nina-kw@mail.ru, 8-902-618-84-03

#### *Abstract*

International economic integration that stimulates an increased mutual dependence of national financial markets and immediate spread of crisis in the globalizing space, has given new impetus to research in the field of banking supervision. In modern science and practice, banking supervision in the system of state regulation of commercial banks is increasingly interpreted not only as a function of the Central Bank of the Russian Federation aimed at overcoming negative effects of unique or systemic macroeconomic crises, but also as a permanent set of measures to prevent these. In this regard, the problem of effective state regulation of commercial banks by means of methods and tools of banking supervision, which provide a necessary condition for stability of the banking system and sustainable development of the national economy, is crucial and deserves a detailed and comprehensive study. The paper provides the results of the study of the Russian experience of state regulation of commercial banks through the most appropriate methods of banking supervision to regulate licensing procedures and bankruptcy, and tools to facilitate their implementation. An attempt was made to identify the advantages and disadvantages of the modern system of state regulation of banking activities in the Russian Federation. The results of the study can be used by regulatory bodies to perform regular monitoring of bilateral information asymmetry characteristic of the market of banking services, to develop proposals for formation of relevant and optimal areas for supervisory activities, to identify productive non-standard methods of crisis management of banking activities.

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**Keywords:** Banking regulation, banking supervision, licensing, commercial bank.



## 1. Introduction

An important condition for successful and stable operation of the modern banking systems of market type is effective state regulation of the commercial bank activities through the use of methods and tools of banking supervision. The statement formulated is confirmed by the changes in state regulatory bodies in the economies of various countries that have occurred over the past two decades – transformation of priorities, methodology and tools to increase efficiency, which means strengthening of the role of these bodies. According to the results of a special study of 60 countries with developed market economies, participation of the Central Bank was considered restricted only in 19 countries, whereas in 41 countries it was recognized as noticeable and significant (Vasilieva, Zaitseva, Ivlev, Puzankova, & Rakhimova, 2017). Justifying the relevance of the research, it should be emphasized that according to various estimates, approximately 35–40 countries experienced local or systemic banking crises since the beginning of the 2000s. During these crises, the largest commercial banks went bankrupt and exhibited the capital outflow from the financial market, devaluation of the national currency, the collapse of the system of mutual settlements, and domino and secondary effects, when recessionary trends in one country affect the economic situation in another country. The most notable banking crises for 1997–2017 are systematized in Table 1.

**Table 01.** Local and systemic banking crises over the period 1917–2017

Banking crisis period	Country which experienced banking crisis	Banking crisis period	Country which experienced banking crisis
2001–2002	Argentina	2008–2009	USA
2001–2002	Bolivia	1997–1998	Taiwan
1997–2002	Ghana	1997–2002	Thailand
1997–2002	Indonesia	2000–2002	Turkey
2008	Italy	2002	Uruguay
1997–2002	Korea	2008	Finland
1997–2002	Congo	1998–2002	Philippines
1999–2000	Colombia	1997–2002	Ecuador
1997–2001	Malaysia	1996–2000	Jamaica
2008–2009, 2014	Russian Federation	2007–2008	Japan

Note: Compiled by the authors based on data provided by A.G. Vasilieva, E.M. Zaitseva, A.V. Ivlev, E.A. Puzankova, and L.M. Rakhimova. Russian experience of practical application of banking supervision tools and techniques (Vasilieva et al., 2017).

The main reason for crisis spread and, as a result, intensification of the regulatory impact by the state, is related to many factors, which include:

- firstly, "avalanche-like growth" of innovations in banking activities related to emergence of innovative financial instruments and banking services;
- secondly, intensive pace of development of new banking technologies and online payment forms;
- thirdly, active liberalization of capital movements.

Theoretical and practical understanding of the frequency and factors that increase instability of modern banking systems of market type has determined the priority area of our research aimed to study the effectiveness of the system of state regulation of commercial banks embedded in the market mechanism.

## 2. Problem Statement

The problem of state regulation of banking activities displays a variety of aspects investigated by many scientists and experts:

- fundamental theoretical concepts of state regulation of banking activities are reported in studies by Chortareas, Girardone, and Ventouri (2012), Mironov (2005), Semkin (2011);

- a methodological basis used to assess the effectiveness of state regulation of the commercial bank activities was suggested by Vidyakin (2010), Becht, Bolton, and Röell (2011), Laeven and Levine (2009), Summer (2003) and others;

- development and formation of banking supervision in the system of state regulation of commercial bank activities, general theoretical issues of banking supervision – the essence, principles, and types – are shown in studies by Vasilieva and Kuznetsova (2016), Dubova (2013), Kazakbieva (2004), Melnik (2013), and Sargsyan (2006),

An analysis of the degree of elaboration of the studied issues revealed that theoretical and methodological aspects of the study of state regulation of banking activities are currently incomplete:

- firstly, papers are devoted mainly to micro-prudential regulation and monetary policy, and crisis management is poorly studied;

- secondly, the stability of the banking system is often considered in the context of the stability of its individual components, but not the whole system.

We highly appreciate the results obtained by these authors and it has to be noted that many aspects still require in-depth analysis, clarification and refinement.

## 3. Research Questions

The object of the research is banking supervision in the Russian system of state regulation of commercial bank activities. The research subject is organizational and economic relations arising during its implementation. The object and subject of the research are relevant not only due to orientation towards meaningful, risk-oriented banking supervision characteristic of the current stage of economic development, but also due to significant qualitative changes in methodology and practice of analysis of banking risks and systemic stability implemented by the Central Bank of the Russian Federation:

- firstly, the work is underway to build individual behavioral models for the largest commercial banks and banking groups;

- secondly, a separate method of stress testing of commercial banks is being developed for curators to obtain additional forecast estimates of sustainability for the supervised economic entities on an on-going basis;

- thirdly, active work is being carried out with commercial banks to improve the quality of internal procedures – procedures for evaluating the response of key banking indicators to expert shocks closely related to the macroeconomic situation.

#### 4. Purpose of the Study

The purpose of the study is to investigate the effectiveness of the Russian experience in state regulation of commercial banks through the use of the most crucial methods of banking supervision, and tools used for their implementation.

The designated purpose identified the objectives of the study:

- to consider the main areas, methods and tools of banking supervision as the most important sphere of state regulation of commercial banks;
- to analyze the efficiency of regulation of commercial bank activities by the Central Bank of the Russian Federation by means of a system of methods and tools for banking supervision throughout the country;
- to identify the advantages and disadvantages of the national system of state regulation of banking activities

#### 5. Research Methods

The study of the efficiency of the set of methods and tools of banking supervision used by the Central Bank of the Russian Federation shows the need for:

- systematization of the main areas, methods and tools of banking supervision in the form of Table 2 to make the analysis more specific;
- consistent application of general economic analytical techniques – grouping of indicators, comparison, graphical representation of the analyzed data, as well as statistical analytical techniques – calculation of relative and average values, analysis of time series.

We should immediately admit that evaluation of complex systems involves the risk that the whole range of economic indicators, which show laws and trends of their development, can be covered incompletely.

**Table 02.** System of methods and tools to regulate activities of commercial banks through banking supervision

Methods	Purpose/area of regulation	Tools
General	Ensuring the stability and reliability of a commercial bank	Improvement of the legislative and regulatory framework of commercial banks in accordance with internationally recognized approaches
		Standards of capital adequacy of a commercial bank
		Reserve requirements
		Maximum risk per borrower or group of related borrowers
		Maximum amount of large credit risks
		Liquidity standards of commercial banks
	Protection of deposits of individuals and legal entities and prevention of	Scope of currency, interest and other types of banking risks
		Deposit insurance

	investors panic in crisis situations	
Banking Licensing	Protection of commercial bank clients from non-professional management, and strengthening of confidence of economic entities in the banking system	Minimum authorized capital of a commercial bank
		Requirements to managers of commercial banks
Regulation of commercial bank bankruptcy	Ensuring the rights of depositors and creditors during bankruptcy of commercial banks	Special requirements to bankruptcy procedures of credit institutions

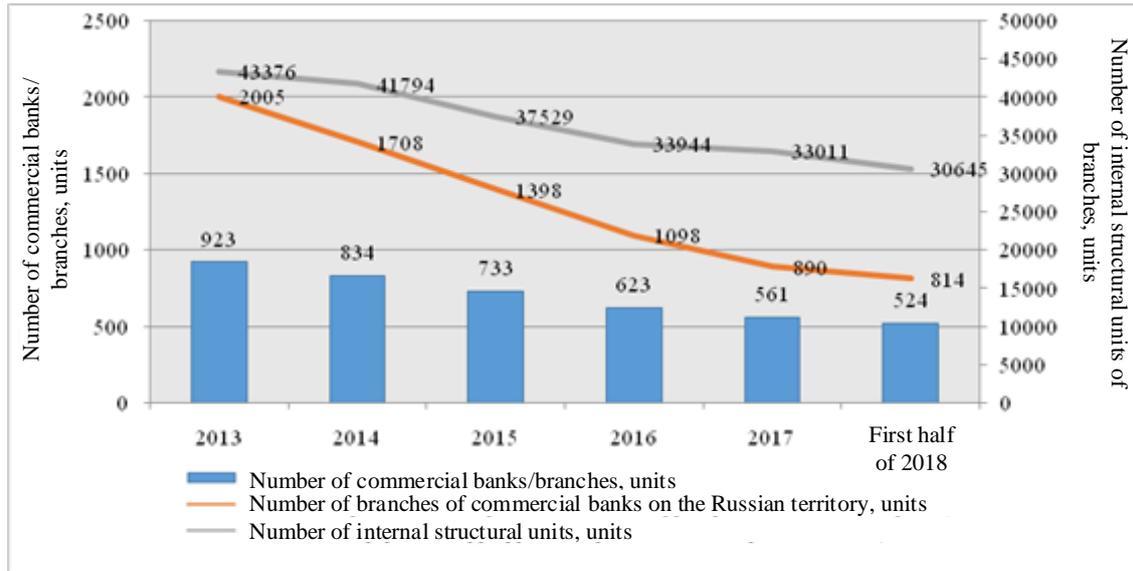
Note: Compiled by the authors based on data: Official site of the Central Bank of the Russian Federation (Banking Regulation and Supervision, 2018)

## 6. Findings

The paper attempts to analyze how actively and productively the Central Bank of the Russian Federation implements regulation of the activities of commercial banks registered and operating in the country using methods and tools crucial for bank supervision in current conditions in the following order: banking licensing and regulation of bankruptcy of commercial banks.

Banking licensing is employed as a method of state regulation to minimize the entry into the banking market for financially unsustainable, commercial banks at risk, and commercial banks with a dubious reputation.

As can be seen in Fig. 1, in 2018 the Russian Federation showed the trend of recent years towards reduction in the number of operating commercial banks. During the period under study, the total number of operating commercial banks with a banking license decreased from 923 in 2013 to 524 in the first half of 2018, or by 43.2% due to termination of licenses and reorganization procedures. From 2013 to the first half of 2018, large multi-branch commercial banks continued to optimize their regional divisions. The total number of internal structural divisions of commercial banks decreased by 12,731 units from 43,376 units in 2013 to 30,645 in the first half of 2018. At the same time, the number of additional offices decreased from 24,486 to 20,592, the number of credit and cash offices reduced from 2,463 to 1,921, the number of operating cash offices outside the cash center dropped from 7,845 to 1,640, and the number of operating offices reduced from 8,436 to 6,492. As a result of these structural changes, the number of internal structural units per 100 thousand of inhabitants decreased from 43.4 at the end of 2013 to 20.9 in the first half of 2018. It should be noted that many experts argue that "...identified trends primarily have a negative effect on the socio-economic development of the country, which, according to the Constitution of the Russian Federation, should be socially oriented" (Tarasova, Vasilieva, & Sushko, 2009, p. 499).



**Figure 01.** Dynamics of the number of commercial banks and their branches in the Russian Federation in 2013 and in the first half of 2018

Compiled by the authors based on data: Official site of the Central Bank of the Russian Federation. Banking Sector Statistics

An important tool for licensing banking activities are the requirements for the minimum authorized capital of newly registered credit organizations. According to Federal Law N 395-1 dated 02.12.1990 On Banks and Banking Activities, the minimum authorized capital of a newly registered credit organization on the day of application for state registration and a banking license is set at 300 million rubles for commercial banks with a basic license and 1 billion rubles for commercial banks with a universal license. Classification of operating commercial banks by the size of the authorized capital for 2013 and the first half of 2018 is presented in Table 3.

**Table 03.** Classification of operating commercial banks by the size of the authorized capital for 2013 and the first half of 2018

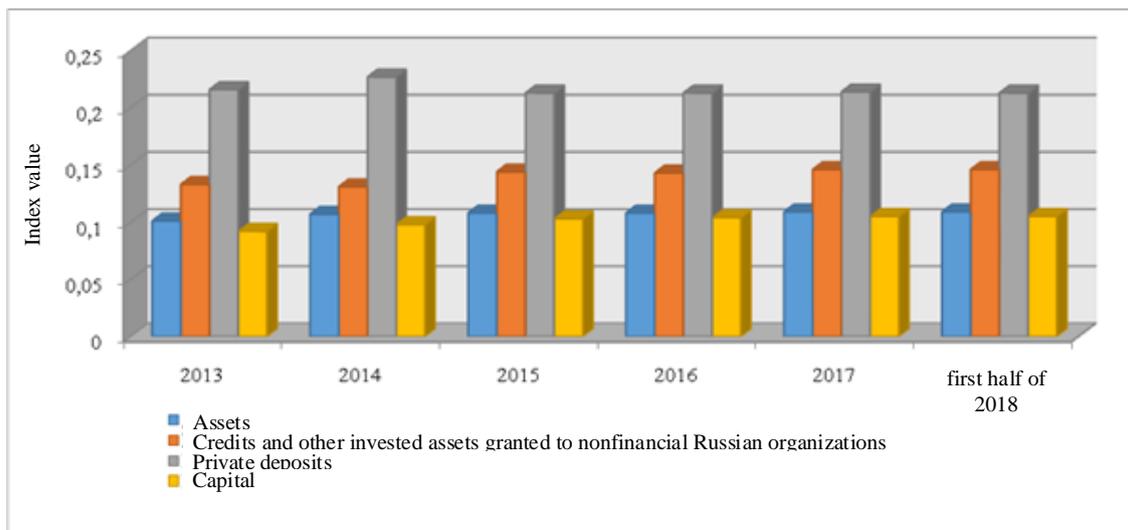
Authorized capital	2013		2014		2015		2016		2017		First half of 2018	
	Number, units	Share, %	Number, units	Share, %								
Less than 3 mln rub	15	1.6	10	1.2	12	1.6	10	1.6	9	1.6	6	1.1
3 to 10 mln rub	15	1.6	13	1.6	12	1.6	10	1.6	9	1.6	9	1.7
10 to 30 mln rub	45	4.9	38	4.6	40	5.5	37	5.9	31	5.5	31	5.9
30 to 60 mln rub	36	3.9	30	3.6	28	3.8	26	4.2	23	4.1	22	4.2
60 to 150 mln rub	143	15.5	112	13.4	86	11.8	67	10.8	68	12.1	65	12.4
150 to 300 mln rub	251	27.2	212	25.4	168	23.1	137	22.0	113	20.1	99	18.9
300 to 500 mln rub	116	12.6	118	14.1	103	14.1	90	14.4	78	13.9	79	15.1

500 mln rub to 1 bln rub	116	12.6	111	13.3	98	13.5	77	12.4	78	13.9	66	12.6
1 to 10 bln rub	161	17.4	163	19.5	152	20.9	136	21.8	117	20.9	111	21.2
10 bln rub and more	25	2.7	27	3.2	29	4	33	5.3	35	6.2	36	6.9
Total	923	100	894	100	733	100	623	100	561	100	524	100

Note: Compiled by the authors based on data (Statistics of the banking sector, 2019).

According to Table 3, the number of commercial banks with authorized capital that meets the requirements of the Central Bank of the Russian Federation decreased by 87 units for economic entities with a basic license and decreased by 39 units for economic entities with a universal license. However, the dynamics is due only to a decrease in the total number of commercial banks registered and operating in the country. The share of credit organizations with authorized capital that meet the requirements of the Central Bank of the Russian Federation increased from 25.2% in 2013 to 27.7% in the first half of 2018 for commercial banks with a basic license and increased from 20.1% in 2013 to 28.1% in the first half of 2018 for commercial banks with a universal license, which indicates an increase in the reliability of national commercial banks and the effectiveness of the studied tool for bank supervision in the system of state regulation of banking activities.

In addition, during the period under study, indicators characterizing the concentration of banking activity keep growing, as illustrated in Fig. 2. International concentration indicators, the Herfindahl-Hirschman index in particular, show that the concentration for major groups of assets and liabilities in 2013 and in the first half of 2018 was at an average level though the trend towards increase remained stable, except for the deposit market.



**Figure 02.** Concentration indicators of the Russian banking sector in 2013 and in the first half of 2018  
 Compiled by the authors based on data retrieved from the Official site of the Central Bank of the Russian Federation. Banking Sector Statistics

Of great interest is practical implementation of the method of banking supervision in the system of regulation of commercial banks – bankruptcy. During the period under study, the Central Bank of the Russian Federation and the state corporation Deposit Insurance Agency carried out work in the field of bankruptcy of commercial banks in the framework of Federal Law No. 40-FZ dated February 2, 1999 On Bankruptcy of Credit Organizations. The number of commercial banks declared bankrupt within the analyzed period increased by 42.7%, and the growth rate of the number of economic entities with terminated licenses amounted to 137.4% from 2013 to the first half of 2018.

The reasons for termination of licenses for banking activities during the period under study are mainly the failure to comply with federal laws regulating banking activities and with regulatory acts of the Central Bank of the Russian Federation, if the measures provided for by Federal Law No. 86-FZ dated July 10, 2002 On the Central Bank of the Russian Federation (Bank of Russia) were applied to the bank several times within a year; facts of material unreliability of the data reported; decrease in the amount of own funds (capital) of a commercial bank below the minimum value of the authorized capital established on the date of its state registration; inability to meet the creditors' claims for monetary obligations within 14 days from the date of their satisfaction. In addition, in the analyzed period, the Central Bank of the Russian Federation revoked the licenses of credit organizations due to the decision on voluntary liquidation adopted by the shareholders.

Thus, from 2013 to the first half of 2018, the measures were implemented to clean up the national banking system of market type from financially unstable commercial banks unable to ensure safety of depositors' funds, which conduct dubious operations.

## **7. Conclusion**

The results of the study enabled the following conclusions.

Firstly, the Central Bank of the Russian Federation in modern conditions focuses on implementation of the function of the subject that regulates the activities of commercial banks through banking supervision to maintain the financial stability of the banking system, to ensure conditions for effective banking by regulation of its main aspects, and protection of the interests of creditors and depositors.

Secondly, the Central Bank of the Russian Federation has significantly expanded the range of methods and tools for banking supervision. At the same time, the Central Bank of the Russian Federation expands its power and implements tools for international regulatory with due account for the current economic conditions. These tools include a reasoned judgment to determine those associated with a commercial bank; consolidated supervision of commercial banks; establishment of the requirements for banking risk management and quantitative risk assessment models used by commercial banks, in banking groups, and assessment of these methods and models; granting the regulatory bodies the power to assess the remuneration system in a commercial bank and to impose requirement to bring it in line with the nature and scale of operations, performance, level and combination of risks taken, etc.

Thirdly, an analysis of the effectiveness of the modern system of methods and tools used to regulate the activities of commercial banks by the Central Bank of the Russian Federation showed their efficiency in enhancement of the banking sector and its sustainability throughout the country. It should be noted that in the period from 2013 to the first half of 2018, licenses of 399 commercial banks or 31.6% of those

operating at the beginning of the decade were terminated primarily due to the lack of measures taken by holders and management to normalize the activities of a commercial bank or unfair behavior and unwillingness to assist employees of the temporary administration.

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