

CIEDR 2018
The International Scientific and Practical Conference
"Contemporary Issues of Economic Development of Russia:
Challenges and Opportunities"

**OPERATION OF CONSUMER CREDIT UNIONS UNDER
DIRECTIVES OF THE BANK OF RUSSIA**

S.V. Borovik (a)*, I.V. Dobrycheva (b), V.A. Trifonov (c)

*Corresponding author

(a) Candidate of Economic Sciences, yrga_edinstvo@mail.ru, +79039447971

(b) Department of Yurga Institute of Technology, TPU Affiliate, 26 Leningradskaya, Yurga, eaktv@mail.ru,
+79236106992

(c) Yaroslavl-the-Wise Novgorod State University, ul. B. St. Petersburgskaya, 41, Veliky Novgorod, Russia,
v.trifonov@rambler.ru, +79609270303

Abstract

In the given paper the authors consider the issues of consumer credit unions' work under the conditions of changes in the legislation regulating activities of consumer credit unions, government regulation, supervision and control implemented by the Bank of Russia and introduction of the system of self-regulation. The authors reveal the most important changes in the order of credit unions' work resulting from introduction of self-regulation mechanism, Bank of Russia Directives limiting the maximum interest for the issued loans, obliging the credit unions to create provisions, regulating calculation of financial ratios, introducing new forms of reporting. The authors analyze the possible consequences of the new legislative acts, regulatory documents of the Bank of Russia implementation, difficulties and controversial points arising in the process of their application. The results of the given analysis can be used for development and realization of new approaches to the loan and savings policy, transformation of accounting and reporting procedures in the credit unions, improvement of government and self-regulation mechanisms regulating their activities to comply with legislative requirements, standards and ratios of the Bank of Russia, reduction of the risks for the consumers of financial services.

© 2019 Published by Future Academy www.FutureAcademy.org.UK

Keywords: Consumer credit union, financial ratios, loan-loss provisions, overall cost of the loan, secondary credit co-operative, self-regulation.



1. Introduction

The history of credit cooperation development goes back over 160 years. The Economist has published a review of the credit cooperatives / unions sector in the different countries of the world. According to the data of the journal the number of shareholders of credit unions doubled in the world during 2000-2015, from 108 mln. to 217 mln. people and the total volume of assets increased by 130% in real terms (Credit Cooperatives, 2016).

The issues of credit cooperation were studied by Perilleux and Nyssens (2017), Martin and Ventura (2016) and Townsend (2003). In their paper, Masa Lorenzo consider the specific features of cooperative associations with special attention to their economic and financial aspects (Lorenzo, del Campo, & Lopez, 2016). Caldarelli conducted an in-depth study showing how the ERM system allows credit unions and banks managing risks (Caldarelli, Fiondella, & Maffei, 2016).

Martinez-Campillo and Fernandez-Santos (2017) studied the effectiveness of Spanish credit unions and Iqbal (2017) studied the effectiveness of credit cooperative movement during the last four decades of colonial Bengal.

The ideas of credit cooperation gained ground in tsarist Russia and, by July 1st, 1913, the number of savings and loans associations reached 12 225 with almost 7.5 million participants but by 1930 the system of credit cooperation was eliminated and the credit functions were concentrated in the hands of the state (Volokhonsky, Kadrov, Kanovskaya, Kokhanova, & Samoilova, 2009).

Revival of credit consumer cooperatives in modern Russia started in 1991 and in July 2001 the Federal Act “On consumer credit cooperatives of citizens” № 117-FZ of 7.08.2001 was passed allowing clear definition of the regulatory status of the associations of citizens founded for mutual financial support in the form of consumer credit unions of citizens.

According to the Act the federal body of executive power acts as the regulator of the credit unions’ activities. Only in 2005 the functions of monitoring, supervision and control of the credit cooperatives activities were passed to the Financial Policies Department of the Ministry of Finance and after adopting a new Act “Concerning credit cooperation” 190-FZ of 18.07.2009 by the Decree of the Government of the Russian Federation on August 29, 2011, № 717 the functions of supervision and control were passed to the Federal Service for Financial Markets (FSFM).

On September 1, 2013 the Federal Act of July 23, 2013 № 251-FZ “Concerning the introduction of amendments to certain legislative acts of the Russian Federation” was activated and the power for regulation, control and supervision in the sphere of financial markets was devolved to the Central bank of the Russian Federation and Bank of Russia Financial Markets Service was established in the structure of the Bank of Russia. When the Bank of Russia Financial Markets Service was abolished in March 2014 regulation, supervision and control of non-bank institutions including those of consumer credit unions were transferred to 5 departments and services of the bank of Russia. The Head department for the microfinancial market and financial inclusion methodology was charged with direct supervision of the problems of credit cooperatives development (The Central Bank of Russia. Microfinance, n.d.).

Let us consider the most important changes in the activities of consumer credit cooperatives regulated by the Bank of Russia and estimate the difficulties and the problems faced by the Russian credit cooperatives.

2. Problem Statement

The international experience of regulating credit unions' activities (the USA, Canada, Australia, China, countries of Western and Eastern Europe) showed that the government cannot withdraw from regulating the relations in cooperative finance sphere as this area is especially complex and important for all people. The social importance of credit cooperatives activities solving problems of improving financial awareness, growth of financial inclusion, development of households determine the specific features of their interaction with state government bodies . The main functions of the state in the area of regulation of consumer credit cooperation include regulatory control, supervision, ensuring right protection for the members of the unions as consumers of financial services, creating conditions for further development of financial co-operation philosophy.

3. Research Questions

In most countries there are special regulations forming the base for developing the credit unions activities and establishing their non-profit-making status. At the same time the forms and the methods of regulating the activities of cooperative financial institutions, as a rule, are based on the experience of banking sector regulating which does not provide enough economic incentives for the development of credit cooperation sector and, even on the contrary, results in contracting of the sector, instability and financial losses.

4. Purpose of the Study

The purpose of the research was to development and realization of new approaches to the loan and savings policy, improvement of government and self-regulation mechanisms.

5. Research Methods

An extensive literature review carried out to establish an exploratory basis for the study.

6. Findings

6.1. Self-regulation

The Federal Act “Concerning credit cooperation” 190-FZ of 18.07.2009 (further Act 190-FZ) establishes the institution of self-regulation involving obligatory membership of consumer credit unions in the self-regulated association of credit unions founded by the credit unions for the purposes of regulation and control of the credit unions' activities as well as for promoting and defending the interests of the members of the self-regulated organization. At the same time the Bank of Russia supervises the activities of the credit unions with over than 5 000 members and secondary co-operatives. According to the Federal Act № 210-FZ of 29.06.2015 “Concerning the introduction of amendments to certain legislative acts of the Russian Federation and annulment of the certain Acts of legislation of the Russian

Federation” (further Act № 210-FZ) the Bank of Russia supervises the credit unions which have more than 3000 members (Act № 223-FZ).

Federal Act 190-FZ introduced the requirement to the credit unions of joining the self-regulatory association not later than three months after the day of their foundation or after the day they cease being members of one of the self-regulating organizations. Until the credit union joins the self-regulating credit organization it is not entitled to raise its members’ money and to admit new members. Currently there are 9 self-regulating associations at credit cooperation market. By 01.01.2017 they had united 1452 credit unions of 3058 credit unions included into the Register of the Bank of Russia or 47% of their total number. The dynamics of credit cooperatives membership in the self-regulating associations looks as follows (table 01).

Table 01. The dynamics of credit cooperatives membership in the self-regulating associations

Name of the self-regulating association	Number of credit unions		
	January 2015	January 2015	January 2015
Regional credit association (Gubernskoyekreditnoyetoovarishchestvo)	45	69	88
Co-operative finance (Kooperativnyefinansy)	200	201	195
Interregional association of credit unions (Mezhregionalnysoyuzkreditnykhkooperativov)	142	127	108
People’s cash offices “Soyuzsberzaim (Narodnyekassy “Soyuzsberzaim”	204	197	179
National association of credit unions (Natsionalnoyeobyedineniyekreditnykhkooperativov)	71	66	53
Support of cooperation (Oporakooperatsii)	154	175	139
Assistance (Sodeistviye)	219	246	173
Soyuzmikrofinans	355	440	431
Central credit association (Tsentralnoyekreditnoyeobyedineniye)	105	104	86
Total	1495	1625	1452

Source: Data provided by journal ‘Issues of credit cooperation’ (Directive of the Bank of Russia № 4083-U of 25.07.2016)

As of March 17, 2017, the number of the members included into the register of consumer credit unions is 2 936 existing consumer credit unions. Of the total number of existing unions 1 472 consumer credit unions or 50.14% of the total are members of the self-regulating associations. Among 1 464 unions that are not members of the self-regulating association, 897 have never been in self-regulating associations, 523 lost their membership three or more months ago, 44 lost their membership less than three months ago.

Federal Act № 223-FZ of 13.07.2015 “Concerning self-regulation in the sphere of financial markets” (Act № 223-FZ) stipulates that after January 1, 2018, no more than three self-regulating organizations should operate in the credit cooperation market, each of them uniting at least 26% of credit

cooperatives included in the State Register of Consumer Credit Unions. May 26, 2017, the Bank of Russia published the State Register of Consumer Credit Unions, which data can be used for including in a self-regulating organization at least 26% of the total number of credit unions as its members, in accordance with paragraph 1 of Part 3 of the Federal Act of 13.07.2015 № 223-FZ “Concerning the self-regulating organizations in the financial market”. In our opinion, such restructuring of the market of self-regulating associations of credit unions will lead to disequilibrium of the credit cooperation market, since, in the situation of unresolved charged issues, such as those concerning creating loan-loss provisions, necessity of incashment of cash resources, switch to the Unified Chart of Accounts and International Accounting Standards, etc., the management of the self-regulating associations will be engaged not in solving these problems and improving the standards of supervision and control of their members’ activities but in self-preservation. It is not by chance that the Federation Council of the Federal Assembly became concerned with this problem and, in April 2017, its members have proposed to postpone the entry into force of Federal Act 223-FZ “Concerning self-regulating organizations in the sphere of the financial market” concerning the self-regulating credit unions until January 1, 2020.

6.2. Physical cash flow

Despite the numerous appeals of self-regulating organizations and market participants to the Bank of Russia, one of unsolved and most acute problems for credit unions so far is the implementation of the Directive of the Central Bank 3073-U of 7.10.2013 “Concerning cash payments” (Directive of the Central Bank 3073-U of 07.10.2013). According to this decree, loans can be financed only from the cash withdrawn from the bank account. In our opinion, the current Decree does not contribute to the development of the microfinance market, but to that of the banks earning on commissions for each transaction when non-credit financial organizations withdraw their own money in cash from their own account. For example, under the terms of the agreement on cash and settlement services with Sberbank of Russia, when receiving cash from its account, the credit union pays 2% of the amount received, with a monthly turnover of up to 3 million rubles, and with a turnover of over 3 million rubles it already pays 10%. With the money turnover of an average credit union of 15-20 million rubles it has to spend 1.5-2 million rubles only on settlement and cash services per month, whereas the average monthly net income of a union is 200-500 thousand rubles.

On June 14, 2017 at the meeting of the Expert Council on Microfinance and Credit Cooperatives market representatives will raise the issue of the application of the Central Bank Directive 3073-U again. At the moment, the Central Bank is “analyzing the appropriateness of making changes to this Directive” and credit cooperatives have to wait for the checks of the Bank of Russia, improvement notices for not implementing this Directive, and penalties.

6.3. Full loan value

With regard to the full loan value (hereinafter referred to as FLV), the trend is still negative. The regulator does not disclose the methodology for calculating the maximum values of the full loan value and selection of cooperatives which data is applied in the calculation. It is obvious that the share of large unions in the calculation should be reduced as they can afford cheaper loans than small consumer credit

unions. We are talking about the need to introduce the so-called “antimonopoly amendment”. The representatives of the Main Office of the Microfinance Market and the Financial Inclusion Methodology of the Bank of Russia agree with this but no changes have been observed so far.

In addition, as long as there are no Bank of Russia sanctions, some unions continue to include membership fees into their calculations of the full loan value, while others do not do this. This also results in incorrect reflection of the situation on the market.

At the end of 2016 the Bank of Russia, in its response to the letters from the sector, reported that the FLV will be calculated quarterly as it had been done before. At the same time, the methodology for calculating full loan cost and selection of consumer credit unions are still unknown to the representatives of the credit cooperative society.

In 2016 the average market and marginal values of FLV continued to reduce and in some categories this process was more rapid than in the other.

Analysis of the dynamics of changes in market average and marginal values of the FLV shows that, for the whole of 2016, the average market and marginal values of the FLV for all types of loans set by the Bank of Russia reduced, but over the course of the year the changes were multidirectional (Trifonov & Borovik, 2015).

It should be noted that since I quarter of 2017, the period for issuing loans is calculated not in months and years, but in days. This is especially important for calculating rates for short-term (“payday”) loans. For example, with this line of loans, the credit unions do not fit into the limit values of the FLV, if the month is taken for 31 days. According to the current position of the Bank of Russia, the month in calculating the FLV is 30 days, which allows us meeting the established limits.

It is of fundamental importance to note that the methodology for calculating the FLV hides the tendency for constant gradual reduction of the rates for consumer loans, as calculation of the average FLV values is based on the data on the value of the FLV 100 or one third of the largest credit cooperatives and the maximum value of the FLV cannot be more than 30% of the average market value. At the same time, all credit unions cannot simultaneously issue loans at the marginal rate, so the average market value of the CPM is constantly decreasing.

In general, the market has reconciled with the calculation and constant reduction of the FLV, and this topic is leaving the main discussion areas and cooperative events, it has also ceased to be a subject of discussion with the representatives of the Bank of Russia.

6.4. Forming loan-loss provisions

One of the most “painful” problems for the credit unions today is the necessity of generating loan-loss provisions (further LLP). This requirement for the microfinance market was introduced by the Directive of the Bank of Russia № 3322-U “Concerning generation of loan-loss provisions by the consumer credit cooperatives” of 14.07.2014. (Directive of the Bank of Russia № 3322-U of 14.07.2014)

According to the Directive the consumer credit unions which have past-due debts must generate the allowances for possible losses on loans, both for the principle debt and for the accrued interest. It should be noted that the loan-loss provisions are a special kind of reserve for doubtful debts. It is a loss allowance specifying the balance sheet evaluation of the financial investments of the loans issued for the

shareholders and debit interest for such loans. Furthermore, the financial statements show reduction of the loan portfolio by the value of LLP which has a negative impact upon complying with financial ratios.

Article 297.3 of the Tax Code states the right of the credit union that is on the common system of taxation to create loan-loss provisions, beside the doubtful debt provision, in its tax accounting. At the same time, since 2014 the bad debt provisions should not be created for the principle part of the loans but for the accrued interest, only if the loan is secured or guaranteed and this security is extended to the interest revenue.

At present time the difficult economic situation in the country results in the shareholders' debt growing every year and most of credit unions face the financial problems associated with creating such provisions. At the same time the main advantage of these provisions is that with their help a credit union forms its own "air bag", i.e. even with a significant amount of loan defaults it will be able to continue its operations.

The work experience of the years passed after the adoption of the given Directive showed that the credit union does not always have enough profit to form the required loan-loss provisions. Thus, at the end of the year the profit of the credit union may be negative. According to the Federal law 190-FZ of 18.07.2009 "On credit cooperation" the negative profit is to be covered on the base of the General meeting's decision either from the previously saved money of the union including that of the reserve fund, or, if this is not enough – from additional membership fees of the shareholders of the credit union. The situation when the members of the credit union have to cover the negative profit of the union resulting from LLP generation from their own money can make a significant amount of the shareholders leave the union and withdraw their money which may result in the bankruptcy of the credit union. The participants of the market have applied to the regulator many times suggesting either to increase the term of the loan-loss provisions creation or to divide the provisions into two constituent parts: the first – the provisions which need to be created according to the Directive for the loans issued after the Directive came into force and the second – the provisions for the loans issued before the Directive came into force and increase the terms for the second group of provisions (the so called "accumulated overdue") up to 8-10 years. But the regulator rejected these proposals.

7. Conclusion

According to the Bank of Russia requirements the report includes the subsection concerning the credit rating of the credit union. Today none of the credit unions in Russia have been assigned a credit rating. Analysis of the trends of the financial markets brings us to the conclusion that in the future the requirements for the level of the credit rating of the credit union will be surely worked out but at the present moment the primary credit unions are not ready for such assessment of their activities.

Acknowledgments

The research is carried out at Tomsk Polytechnic University within the framework of Tomsk Polytechnic University Competitiveness Enhancement Program grant.

References

- Caldarelli, A., Fiondella, C., & Maffei, M. (2016). Managing risk in credit cooperative banks: Lessons from a case study. *Management accounting research*, 32(1), 15. <https://dx.doi.org/10.1016/j.mar.2015.10.002>.
- Credit Cooperatives (2016). Retrieved from: <http://www.vestifinance.ru/articles/64212>.
- Iqbal, I. (2017). Cooperative credit in colonial Bengal: An exploration in development and decline, 1905-1947. *Indian economic and social history review*, 54 (2), 221-237. <https://dx.doi.org/10.1177/0019464617695673>.
- Lorenzo, C.I.M., del Campo, J.I., & Lopez, S.M. (2016). Determinants of Corporate Failure: Effect of Social Projection of Cooperative Societies against Other Legal Forms. *Ciriec-espanarevista de economia publica social y cooperativa*, 88, 93-125
- Martin, A., & Ventura, J. (2016). Managing Credit Bubbles. *Journal of the European Economic Association*, 14 (3), 753-789. <https://doi.org/10.1111/jeea.12161>
- Martinez-Campillo, A., & Fernandez-Santos, Y. (2017). What About the Social Efficiency in Credit Cooperatives? Evidence from Spain (2008-2014). *Social indicators research*, 131 (2), 607-629. <https://dx.doi.org/10.1007/s11205-016-1277-6>
- Perilleux, A., & Nyssens, M. (2017). Understanding cooperative finance as a new common. *Annals of public and cooperative economics*, 88 (2), 155-177. <https://dx.doi.org/10.1111/apce.12160>.
- Russian Federation. Acts. Concerning credit cooperation. Federal Act 190-FZ of 18.07.2009. Moscow. Received 23 June, 2017, from http://www.consultant.ru/document/cons_doc_LAW_89568/.
- Russian Federation. Acts. Concerning self-regulation in the sphere of financial markets. Federal Act № 223-ФЗ of 13.07.2015. Moscow. Received 23 June, 2017, from http://www.consultant.ru/document/cons_doc_LAW_182662/.
- The Central Bank of Russia. Microfinance (n.d.). Received 23 June, 2017, from http://www.cbr.ru/finmarket/supervision/sv_micro/.
- Townsend, R. M. (2003). Microcredit and Mechanism Design. *Journal of the European Economic Association*, vol.1 (2-3), 468-477. DOI: <https://doi.org/10.1162/154247603322391107>
- Trifonov, V.A., & Borovik, S.V. (2015). Organizing and managing credit unions activities aimed at limitation of loan interest rate in the monotown of Yurga. *Economics and Enterprise*, 10(2), 352 - 356.
- Volokhonsky, Yu. N., Kadrov, A. M., Kanovskaya, E. A., Kokhanova, M. A., & Samoilova, K. N. (2009). *Study guide for credit cooperation*. Rostov-on-Don: South-Russian Association Credit Union publ..