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SPECIFIC FEATURES OF BANKING SECTOR  
UNDER ECONOMIC INSTABILITY IN RUSSIA

*This article analyzes the development trends in the banking sector of Russia under the conditions of economic instability and reveals the main problems faced by banks in their business. It shows the dynamics in the volume and the number of deposits, the size of bank lending and the key trends in mortgage lending. The recommendations on effective risk management in the banking sector are offered.*

*Keywords:* banks; banking system; ruble; risk management; deposits; bank assets; sanctions.

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ОСОБЛИВОСТІ РОЗВИТКУ БАНКІВСЬКОГО СЕКТОРУ  
В УМОВАХ ЕКОНОМІЧНОЇ НЕСТАБІЛЬНОСТІ В РОСІЇ

*У статті проаналізовано тенденції розвитку банківського сектору в Росії в умовах нестабільності економіки, виявлено основні проблеми, з якими стикаються банки в процесі своєї діяльності. Представлено динаміку обсягів та кількості вкладів населення, розмірів банкового кредитування, показано тенденції зміни іпотечного кредитування. На основі проведеного аналізу запропоновано рекомендації з ефективного управління ризиками в банківському секторі.*

*Ключові слова:* банки; банківська система; рубль; управління ризиками; депозити; банківські активи; санкції.

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Галина А. Резник, Алексей Н. Молькин  
ОСОБЕННОСТИ РАЗВИТИЯ БАНКОВСКОГО СЕКТОРА  
В УСЛОВИЯХ ЭКОНОМИЧЕСКОЙ  
НЕСТАБИЛЬНОСТИ В РОССИИ

*В статье проанализированы тенденции развития банковского сектора в России в условиях нестабильности экономики, выявлены основные проблемы, с которыми сталкиваются банки в процессе своей деятельности. Представлена динамика объемов и количества вкладов населения, размеров банковского кредитования, показаны тенденции изменения ипотечного кредитования. На основе проведенного анализа предложены рекомендации по эффективному управлению рисками в банковском секторе.*

*Ключевые слова:* банки; банковская система; рубль; управление рисками; депозиты; банковские активы; санкции.

**Problem setting.** Russian banking system is currently experiencing serious difficulties in its operation. This has been provoked by crisis situations that affected the investment potential, assets concentration in territorial credit organizations, as well as non-transparent structure of banking financial instruments. Factors that negatively influence the performance of the banking sector of the economy include unfavourable investment climate, insufficient liquidity of the banking sector, and lowering trust of investors to the banking system. Under the instability of Russian banking sector, a significant negative effect has been also produced by sanctions imposed by leading economic states.

**Recent research and publications analysis.** The main problems of functioning and development of the national banking sector were investigated in the works

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G. Arutyunyan and T. Arutyunyan (1997), J. Geyvandov (2007), V. Ivanov and E. Ivanov (2010), O. Lavrushin (2012), E. Pletnev (2006), V. Stolyarenko (1999), and other domestic and foreign authors. Current problems associated with economic instability, including that of the banking sector, make us research this problem in more detail.

**The research objective** is the identification of development features of the banking sector under economic instability in Russia.

**Key research findings.** The scale of financial intermediation in the modern economy is enormous. This is demonstrated by the statistics of cash flows, inter alia.

A commercial bank is currently able to offer its customers up to 200 different types of banking products and services. Broad diversity of transactions allows banks retain customers and remain profitable even under very unfavorable economic conditions. However, not all banking transactions are performed by a banking institution on the daily basis (for example, international settlements or trust business) ([www.stud-port.ru](http://www.stud-port.ru), 2015).

But there is a certain basic set of banking transactions, without which any bank cannot function normally. Such major transactions include the following (Suhov, 2011):

- deposits;
- cash payments and settlements;
- loans.

A deposit can emerge in two ways: as a result of depositing by a customer of cash to a bank or in the process of bank lending. These transactions have very different effects on money supply in the country. If the customer deposits money until called for, it is transformed from cash to non-cash. The total amount of money in the economy is not changed. If the money was credited to a deposit, the total amount of money in the economy increases, because through its transaction the bank creates new means of payment. The opposite effect occurs when customer withdraws cash from an account or writes off money from the deposit to repay loans. The ability of commercial banks to increase and decrease deposits and money supply is widely used by the central bank, which regulates this dynamics through the system of obligatory reserves.

The second wide functional scope of banks' activities is intermediation in crediting. As mentioned above, commercial banks act as intermediaries between businesses, which need funds. They provide owners of depositable capital with a convenient means of storing money in the form of various deposits, which ensures safety of funds and meets customers' needs for liquidity. Many customers prefer this very form of storing money rather than investing in bonds or stocks. A bank loan is also very comfortable and in many cases irreplaceable financial service, which allows flexibly address the needs of a particular borrower and adapt the conditions for obtaining a loan to specific conditions (as opposed to the securities market, where terms and other conditions of crediting are standard) (Rybin et al., 2009).

Alongside with the basic functions, banks offer a variety of other financial services to customers. For example, they carry out all sorts of trust transactions for corporations and individuals associated with the transfer of property management to the bank in trust, the purchase of securities on behalf of customers, property management, and performance of guarantee functions with respect to bond issues.

Commercial banks are multifunctional institutions operating in various sectors of the loan market. Large commercial banks provide customers with a full range of services, including loans, deposits etc. In this respect they differ from specialized agencies, which are restricted to certain functions. Commercial banks have traditionally played the role of a basic element in the credit system.

Banking system has developed steadily: hundreds of banks have been created each year in Russia to provide credits to businesses operating in various fields. However, we observe the trend of reduction in the number of banks over the last 10 years; there were 834 banks as of January 1, 2015, that is the number of banks has reduced by 89 over the past year (923 vs. 834). Over the last 8 years (from 2007 to 2015), the number of banks has also declined, by 302 (1136 vs. 834), change amounting to 26.6%. The most worrying fact is that there has been a rapid decrease in the number of banks in all federal districts (Table 1).

*Table 1. Total number of banks in Russia, by federal districts*  
(www.bankirsha.com, 2015)

	Number of operating banks in Russia	As of 01.01. 2012	As of 01.01. 2013	As of 01.01. 2014	As of 01.01. 2015	decrease (-) / increase (+) to 01.01.2014
<b>1.</b>	Central Federal District	572	564	547	504	-43
<b>2.</b>	Northwestern Federal District	69	70	70	64	6
<b>3.</b>	Southern Federal District	45	39	46	43	-3
<b>4.</b>	North Caucasian Federal Districts	56	50	43	28	-15
<b>5.</b>	Volga Federal District	111	106	102	92	-10
<b>6.</b>	Ural Federal District	45	44	42	35	-7
<b>7.</b>	Siberian Federal District	54	53	51	44	-7
<b>8.</b>	Far Eastern Federal District	26	23	22	22	0
	<b>Total in Russia</b>	<b>978</b>	<b>956</b>	<b>923</b>	<b>834</b>	<b>-89</b>

Table 1 shows that the largest number of banks is registered in European part of the country, and there are very few regional banks beyond the Urals. Particular attention should be paid to the fact that there are very few regional commercial banks in the vast area of the Far East, the North and the Urals Federal Districts; moreover, this number has significantly decreased during the analyzed period, though the main Russia's wealth in the production process is located in these areas of the country.

The number of offices has also decreased in all federal districts. The maximum rate of reduction has been observed in the Volga Federal District, where the number of bank offices has decreased by 17.2% over the last year, while the minimum rate of reduction of bank offices has been observed in the Far Eastern Federal District – 7.3%. Reduction in the number of bank offices by 17.2% in the Volga Federal District can be explained by a decrease in the number of banks in the area overall (9.8%). Absolute reduction in the number of operational offices has been observed in all the regions. The greatest absolute reduction has been observed in the Central and Volga Federal Districts in 2015–2014.

Another trend is the decline in the share of state banks in the total number of Russian banks. This indicates activation of commercial banks, although it should be noted that there is a high proportion of state banks in total assets thus resulting in higher concentration of credit risks. However, the behavior of state-owned banks in

regional expansion is rather undalanced. This is caused by the closure of the western capital markets for Sberbank of Russia, VTB, Gazprombank (GPB), Rosselkhozbank and VEB. This led to reducing the number of offices of Sberbank, VTB, Gazprombank while the Rosselkhozbank increased the number of offices (Table 2).

*Table 2. Number of offices of non-profit and state banks, authors'*

	As of beginning of 2013 (data of the Bank of Russia)	As of beginning of 2014 (data of the RBC)	Change
<b>Sberbank of Russia</b>	18632	18292	-340
<b>Rosselkhozbank</b>	1584	1588	+4
<b>VTB Group</b>	873	746	-127
<b>Gazprombank</b>	333	259	-74
<b>State banks</b>	21422	20885	-537

The largest banks which are under sanctions for the year reduced the amount of debt load. Repayable debt of the Sberbank have decreased on 30 July in annual terms by 19% to 13.5 bln USD, Gazprombank by 28% to 12.31 bln USD, VEB – 15%, to 17.23 bln USD. Total debt of Rosselkhozbank and VTB declined to is 10.51 bln USD and 15,072 bln USD, respectively. In ruble terms the amount of debt to maturity showed an increase due to 40% devaluation of the ruble.

The growth of bank deposits of Russian citizens as of January 1, 2015 amounted to 9.4% (1.6 trln RUB). As of January 1, 2014 the volume of deposits attracted from population amounted to 16.96 trln RUB, showing the growth by 2.7 trln RUB (or 19%) during 2013. According to this statistics, 41% less were raised in 2014 than in 2013.

The weakening of the saving activity is the result of the growth in the value of world currencies against the ruble, increase in interest rates and high inflation. Moreover, it could be much worse, but general weakening of national currency over the year had a negative impact on market dynamics.

Statistics shows an increase in the number of deposits, which are closer to the upper limit of insurance compensation. Thus, in the first half of 2014 deposits in the amount of 400–700 ths RUB grew very fast, by 12.5% in terms of deposits volume and by 11.3% by the number of opened accounts. Deposits in the amount of 0.7–1 mln RUB increased by 2.8% in terms of volume and by 2.9% in the number. The volume of deposits of more than 1 mln RUB did not change, and their number decreased by 2.5%. Deposits in the amount of 100–400 ths RUB decreased by 1.5% in terms of volume and increased by 0.4% in terms of number. Minor deposits in the amount of less than 100 ths RUB decreased by 8.1% in terms of volume and by 0.9% in terms of number.

In the middle of the year the share of deposits of more than 1 mln RUB decreased from 40.0 to 39.6% in the total number of deposits. Deposits in the category 0.7–1 mln RUB increased from 7.6 to 7.8%, while the share of deposits of 400–700 ths RUB increased from 16.2 to 18.1%. The share of deposits of 100–400 ths RUB decreased from 22.8 to 22.3%, while the share of deposits of less than 100 ths RUB decreased from 13.4 to 12.2%.

The average size of a bank deposit as of July 1, 2014 did not change and amounted to 104 ths RUB less small and dormant accounts ([www.asv.org.ru](http://www.asv.org.ru), 2015).

Since the beginning of 2014, there have been a gradual weakening of the national currency against foreign currencies. Thus, the ruble has lost 7.38% of its value against RUB during the first quarter. Some investors left Russian market as such. This eventually led to the disruption of Russian stock market by 5.9% in the first 3 months of the year.

One of the key areas in banking activity is mortgaging. Over 2014, the banks provided population with mortgage loans totaling to 1.7 trln RUB as opposed to 1.3 trln RUB in 2013. Thus, there was an increase of 30%, which is a record among other segments. As of 01.01.2015, the size of overdue mortgage indebtedness amounts to about 48 bln RUB, which is 19% more than in the previous year. At the beginning of the 4th quarter of 2014 the situation began to change dramatically – the increase of overdue indebtedness in September compared to the previous month was less than 0.2%, by the end of October – already 4.5%, and in December – more than 5% ([www.politrus.ru](http://www.politrus.ru), 2015). Deterioration in banks' loan portfolio due to sanctions led to an increase in the proportion of overdue loans, including corporate and retail portfolios.

The growth of the mortgage market was due to the expected growth in interest of mortgage loans. In early 2014, the average interest rate of mortgage loans in RUB was 12.2%, which roughly corresponds to the level of the fourth quarter of 2012, but in September mortgage loans were granted at the rate of 12.5%, which is 0.2% higher than in the previous month.

In January 2015, the assets of the banking sector increased by 4.0% (as adjusted to the exchange rate – decreased by 2.6%) and amounted to 80.8 trln RUB. Loans to non-financial organizations increased by 7.0% (-0.5%) and amounted to 31.6 trln RUB, loans to individuals (11.3 trln RUB) decreased by 0.7% (-1.3%). The total volume of loans granted to non-financial organizations and retail loans increased by 4.9% (-0.7%) over the month and amounted to 42.9 trln RUB. The sanctions influenced the growth in assets of the banking sector and, consequently, profit growth, leading to a decrease in the return on assets.

The rate of growth in the period from 02.01.2014 to 02.01.2015 was as follows: in terms of assets – 38.2% (14.7%), in terms of loans granted to non-financial organizations – 36.6% (11.3%), in terms of loans granted to individuals – 12.8% (11.0%), in terms of total amount of loans granted to non-financial organizations and retail loans – 29.5% (11.2%).

The volume of overdue indebtedness for corporate loans increased by 14.4% in January, for retail loans – by 6.0% (up to 1.4 and 0.7 trln RUB, respectively). As a result, the share of overdue indebtedness for loans granted to non-financial organizations increased from 4.2 to 4.5%, and for retail loans – from 5.9 to 6.3%.

The amount of claims of credit organizations to the Bank of Russia (on deposits and correspondent accounts) decreased by 31.0% and amounted 1.9 trln RUB in January. As a result, the proportion of these claims in the assets of the banking sector significantly reduced – from 3.6 to 2.4%.

The volume of interbank credits (IBC) granted to resident banks (3.3 trln RUB) decreased by 13.9%, but the IBC granted to non-resident banks (4.0 trln RUB) increased by 29.5% ([www.cbr.ru](http://www.cbr.ru), 2015).

Excessive loan growth rates, aggressive policy of banks aimed at increasing credit limits, the race of consumer economy lead to an increase in problem loans since many people overestimated their financial capabilities.

Thus, the banking sector development strategy should focus on the development of the banking system as such, including not only commercial banks, but also the Bank of Russia. It would be reasonable to pay more attention to the development of regional banking, at the level of which various forms of banking institutions and banking infrastructure should be developed, which would ensure a significant increase in lending to the real sector of the economy and faster modernization of Russian economy.

We should proceed from the fact that a truly contemporary bank is not so much a credit institution as an information and advisory center, orienting its customers in market trends, performing a vast range of transactions and services including stock management, audit services, consulting, trust business, provision of letters of credit, foreign currency exchange, protection of property, leasing etc.

Russian banks should improve the efficiency of transactions, and to do this it is necessary to improve the system of internal control and develop the risk management system. When organizing risk management in a bank, to make this system better, a bank needs to take into account international experience and best practices in this area. It is necessary to implement a centralized risk management system. Risk management process should be controlled by a collective body managing bank's liabilities and assets.

A risk management system of commercial banks should be able (www.doris.ru, 2014):

- prudently solve the problems of interest, price and exchange rate policies;
- regulate credit risks;
- ensure personal responsibility of office managers and staff who perform banking transactions.

Banks need to adhere to a strict and wise policy on risk management. They need to increase efforts to account the use of risk limits, to centralize the system of evaluation and standardization of active transactions, and to keep a record of regional and industry-specific risks. To do this, the following activities are required:

- formalization of risk management process upon determination of common approaches with the use of IT;
- improvement of the currency control system;
- strengthening the control over questionable transactions;
- creation of a system for assessing the efficiency of banking products management, both at the level of business, and at the level of structural bank units;
- creation of a system for controlling the activities of individual units of the bank.

One of the major problems of Russian banks today is insufficient development of risk assessment methods. In this area, banks cannot use traditional foreign techniques due to significant differences and peculiarities of Russian financial system and the history of its development.

In addition, legislative regulation of market risks is still underdeveloped, there are no direct restrictions on the losses incurred as a result of stock exchange and currency exchange transactions, as well as losses associated with changes in interest rates (www.riskovik.com, 2015).

In order to implement risk management in a commercial bank, the concept "risk" should always be considered in conjunction with such concepts as "liquidity"

and "profitability". There is an inverse dependence between risk and liquidity (the higher is the risk, the lower is the liquidity of a transaction), and there is a direct dependence between risk and profitability (the more profitable are banking transactions, the more risky they are).

The increase in income will lead to increased risk, but competent risk management will allow reducing bank's costs. Market risk management in a bank should be primarily based on the creation of a unit performing analysis, planning, forecasting, and control of all kinds of risks, and it is very important to find competent staff, analysts with experience in risk analysis in a credit institution; to select and develop techniques, coefficients, to establish limits and standards allowing adequate and comprehensive evaluating of a particular market risk of credit institutions, based on the specifics of ongoing transactions. This would be impossible without automation of all calculations, which will allow analysts pay more attention to data analysis, drawing conclusions and searching for measures to manage and reduce market risks.

Compliance with these requirements by a bank will allow its managers make timely and competent decisions concerning market risks, based on the results of data analysis and conclusions, to choose the most appropriate management techniques in each case (monitoring, hedging, diversification, setting limits, restrictions etc.) (www.eco-nomicus.ru, 2015). Thus, competent risk management in a commercial bank is impossible without a reliable system for market risk analysis.

This is a reason for the need to use most advanced approaches to assessing market risks in bank activities, including Basel-II provisions. Difficulties and costs of this system implementation will be compensated due to the absence of accidental losses, income volatility and, consequently, increase in bank profits, improvement of its financial stability and rating.

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