

Insolvency of Banks in Russia: A threat to the economy?

Dmitry Konstantinov reports on the Central Bank of Russia's reforms intended to significantly reduce the number of banks... but have they worked?



DMITRY KONSTANTINOV
Associate, Ilyashev & Partners,
Moscow, Russia



After the collapse of the Soviet Union the banking sector in Russia was quickly developing and at the start of the twenty first century it consisted of more than 1,000 banks.

Most of these banks had been established to serve the main business of the shareholders or for money laundering. Some, of course, did classical banking business, but frequent failures of such banks were harmful to the market. Finally, the Central Bank of the Russian Federation announced the new policy – strong financial requirements for the banks were introduced. The Deposit Insurance Agency became the liquidator of banks and since that time almost 70 bank licenses have been cancelled every year. Surprisingly, the process still goes on, and there

are about 600 banks in the market. Less surprisingly, the Central Bank has been widely criticised for many of its activities in the field.

Deposit insurance in Russia covers only deposits of individuals while businesses are not protected by the scheme

In 1998 the Russian government faced with the social protest caused by the loss of savings in the failed banks; banks, nevertheless, remained the only way to save money and the deposit insurance scheme became a political issue. When in 2004 the scheme finally appeared, the Deposit Insurance Agency (DIA) protected only the deposits of individuals and only to the limit of 100 000 rubles (about 3000 euro at that time). Undoubtedly, such conditions were imposed only to the poorest bank depositors, who, probably,

were the key electorate of the government. However, in the next 13 years the government managed to increase insured sums to 1 400 000 rubles and even gave protection to accounts of auto-entrepreneurs. At the same time, the banks' insolvency regime was changed - individuals were ranked as the first class priority creditors and, therefore, their claims were to be recovered before any other claims¹.

In the case of a bank's failure, companies do not get compensation from the deposit insurance scheme and their claims are very unlikely recovered through insolvency liquidation.

The majority of businesses have not enjoyed the deposit insurance; and even suffered from that. Deposit insurance encouraged people to choose the banks not

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because of their financial stability and companies initially followed them. When the banks failed, the individuals recovered their money from DIA, but the companies did not. What is more, after the DIA has made the insurance payment, they replaced the individuals as creditors; and businesses lost the chance to recover deposits. Let's look at the figures: 34.2% of claims in bank insolvencies have first priority; from the previous years we know that about 74% of the first priority claims belong to the DIA³. The liquidator of the banks recovers 65% of the first class claims and only 16% of the third class claims; in other words, DIA as the liquidator of banks normally pay only to themselves.

Therefore, companies in Russia are forced to choose state-owned banks whose financial condition is actually guaranteed by the government; even subsidiaries of the multinational banks are not an option as they are currently leaving the market. For example, the state-owned banks (Sberbank, VTB-24, Rosselchozbank, Gazprombank) have received more deposits from companies than the private-owned banks⁴, even though the overall assets of the state-owned banks are smaller⁵. This disproportion is raising - deposits in such banks as Sberbank increase much quicker than in the market⁶.

Thus, the current insolvency regime of banks put their corporate clients in an unfavourable position; to avoid the risk of bank failure, they need to use banks owned and supported by the government. It clearly influences the banking market and creates additional costs for the businesses.

In the first years of the banking reform, mainly small banks were removed from the market, but in the last years some banks from the national top 100 lost their licenses.

Initially the Central Bank declared that the reform of the banking sector was aimed at supporting ordinary banking business and removing from the market banks

involved in money laundering and fraud, while in order to protect banks facing financial difficulties the new restructuring scheme was introduced.

But the government followed the programme only in the first few years; then the Central Bank cancelled licenses of some key players. So far, six banks from top-100 2010 have lost their licenses (TranskapitalBank, Tatfondbank, Master-Bank, VneshpromBank, AMT Bank (BTA Bank-Russia), Investbank); all these banks went into liquidation. More banks were restructured and among them, two (Bank of Moscow and Bank Uralsib) were from the top-20. What is worse, the process of license cancellation and insolvency restructuring of banks is not accountable.

Even though the Central Bank's regulations contain the formal requirements for banks, the key question is how the regulator supervises compliance with these requirements. Almost in every bank insolvency, it appeared that the bank did not meet the capital requirements and falsified its books for years⁷. There are two possible explanations of this fact: the Central Bank of the Russian Federation is not able to supervise banks, or the regulator does not normally respond to the breach of the requirements unless it decides to do so. But the outcome is the same – the vast majority of banks might be faced with license cancellation. The situation creates significant uncertainty for the banks and their clients and might have a negative economic effect.

The option to insolvency liquidation is restructuring; however, this procedure is even less predictable. For example, restructuring with participation of the state (sub. 4 sec. 1 art. 189.9 of Russian Insolvency Law) is made on a decision of the Central Bank of the Russian Federation; such a decision is not controlled and cannot be challenged. The total funding made by the government under such uncontrolled process is of 1,229,98 billion rubles⁸. Probably, bank restructuring was expected to serve the “too big to fail” concept, but the choice of

“big” banks is still unclear.

Currently 25 banks are under restructuring proceedings, and some of them are much smaller than the listed banks whose licenses have been cancelled.

Following the global mainstream, Russia has a different insolvency regulation for banks and other debtors; however, it created a number of new problems. The regime of bank insolvency is firstly aimed at protecting individuals as deposit holders and this function has been fulfilled perfectly. Nowadays, deposits by most individuals are covered by the deposit insurance scheme, and their claims have the highest priority through the insolvency liquidation. The dark side of the regime is the weak position of other creditors, mainly businesses that are forced to keep their liquidity in the banks, but are not protected by the deposit insurance scheme and are very unlikely to be paid through the insolvency. The companies are forced to select banks whose licenses are not expected to be cancelled, and the first choice is the state-owned banks. At the same time, the Central Bank is cancelling the licenses of unstable banks, but the process is becoming a threat to the whole market.

In conclusion, when deciding to cancel a license or restructure a bank, the Central Bank of the Russian Federation appears to be absolutely unpredictable and unaccountable. ■

Footnotes

- 1 The second-class priority has been given to employees and all other creditors are third class priority.
- 2 The annual report of DIA 2016 - <https://www.asv.org.ru/agency/>
- 3 <https://www.asv.org.ru/agency/annual/2012/en/page3/page35/index.html>
- 4 <http://mir-procentov.ru/banks/ratings/sredstva-ul.html?date1=2017-07-01&date2=2016-07-01>
- 5 http://www.forbes.ru/sp_data/2017/rating-bank/all.html
- 6 Compare: http://www.cbr.ru/statistics/UDStat.aspx?TbID=302-21&pid=sors&sid=ITM_30761 and <http://www.sberbank.com/ru/investor-relations/reports-and-publications/key-data>
- 7 <https://www.asv.org.ru/agency/appearance/322554/>
- 8 <https://www.asv.org.ru/sanation/>. This figure is comparable to the whole amount of commercial banks' deposits in the Central Bank. http://cbr.ru/hd_base/?PrId=ostat_base&pid=idkp_br&sid=itm_31037.



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