

Elvira Nabiullina: Competition as the key driver for growth

Statement by Ms Elvira Nabiullina, Governor of the Bank of Russia, at the meeting of the Association of Russian Banks, Moscow, 28 March 2017.

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Good afternoon, distinguished colleagues!

The Association has chosen the right title for today's discussion - Competition as the Key Driver for Growth.

A comprehensive look at what the Bank of Russia does in the banking sectors - both as a regulator and a supervisor - suggests that it is engaged in shaping a healthy competitive environment and fair competition. The competitive environment is key to the sustainable development of the banking industry.

Supervision objectives are often contrasted with market development goals. However, this is a serious mistake. I believe there is no need to remind you that removing fraudulent, unstable and - unfortunately - often criminal actors from the banking sector is the Bank of Russia's top priority.

We resort to licence revocation when we see that the bank's management and owners act against the interests of its depositors and creditors, that the bank is unable to regain stability because it is facing capital shortages.

If we fail to revoke the licence from such a bank, it will continue to produce falsified statements and take money from depositors – openly stealing from them and diverting their assets – or lend to inefficient projects of parties affiliated with the bank, etc. In short, such a bank will continue to mismanage and misuse other people's money.

What implications does this have for the competitive environment? There are banks on the market which operate fairly, comply with regulations, do not accumulate risks, act prudently, and develop business with the target of long-term sustainability. This is the principle governing what they offer to their customers.

At the same time, nothing restricts a fraudulent bank unconcerned about risk management, instead simply 'hoovering up' depositors' money. Certainly, to customers looking in from the outside it will seem like the bank with the most appealing offer. If we fail to expose such banks and withdraw them from the market promptly, decent and fair banks will continue to lose in terms of competitiveness.

Therefore, I find it strange that the ARB consistently urges the Bank of Russia not to revoke licences. We believe it to be totally against the interests of responsible banks, which - I am convinced - constitute the majority in the Association and in this room.

We are very much concerned that the ARB, though emphasising the importance of competition, nevertheless tolerates misreporting, fraud and the violation of laws. The Association neither condemns dubious operations nor seeks to develop good standards of practice. Furthermore, they demand that we turn a blind eye to problems arising in banks. This is exactly what the ARB means when it insists that we 'not revoke so many licences'. However, we abide by the law and take measures stipulated by the law.

Managers of those banks from whom licences were revoked used to be members of the ARB Board, i.e. in the best case these people were not particularly gifted or responsible bankers, and as a result they triggered the collapse of their credit institutions.

Here we are faced with a question about which objectives and targets the Association can deliver

on. Should it set standards (including ethical ones) for the banking sector; should it be the voice of the banking community in dialogue with the regulator or should it stand up for 'bad' banks?

I would like to place special emphasis on the fact that when the Bank of Russia withdraws unstable or fraudulent credit institutions from the market, it first, protects the interests of depositors and creditors, and only thereafter is interested in protecting the interests of scrupulous banks.

The clearing of the banking sector is yet to be completed, therefore corporate customers will not just choose from banks offering products and services they need, but seek to mitigate the risk of losing money. In particular, it also manifests itself in the authorities' efforts to determine specific criteria for banks, or a list of banks, which can be entrusted with budget funds and the funds of public companies. The ARB raised the point that these criteria restrict competition.

Let me repeat, competition is undermined by fraudulent banks which remain on the market, while attempts to limit risk by means of registers and criteria are just a corollary.

By and large, we would like to avoid a situation in which competition for the benefit of a customer in the form of the state or a public company, is undermined by such lists or unreasonable criteria.

Therefore we suggest a course of action wherein only limited supervisory information is disclosed to a potential customer, with the bank's consent, if that customer is seeking to raise public funds. We believe that this approach may help to ensure a competitive environment for banks of different size. I am certain that banks convinced of their own stability will give us permission for such a disclosure. We suggested this approach to the government for the funding of agricultural companies, among other things, and the Chairman gave the command to do so. Therefore, I hope we will be able to work on this, bearing in mind large customers' concerns about the possibility of money loss. Coming back to the banking resolution, I would like to emphasise that we intend to complete clearing in the upcoming years. We estimate that this process will take two to three years. I hope that a bank's financial fragility leading to the revocation of its licence will have become an extraordinary event by that time.

However, it does not mean that today we should not try to keep a troubled credit institution afloat. If a bank does not conceal difficulties or produce inaccurate reports, we let it remedy the situation. Unfortunately, the ratio between the resolved and withdrawn banks does not favour the first ones, but this situation should be reversed.

We expect that the ongoing reform of supervision in the Bank of Russia will lead to a shift towards consulting supervision, wherein the Bank of Russia will be able to offer banks reasonable measures to remedy a problematic situation at an early stage. Certainly, consulting supervision is feasible only if a commercial bank is honest with the Central Bank and does not try to conceal real problems. Despite the problems I have mentioned, the revocation of licences has affected 4.3% of banks' assets - over the past four years we have revoked more than 300 licences, or one third of all licences. The impact on the banking system at large is clearly able to be seen. On the whole, we estimate that the banking sector experiences no systemic risks, but remains resilient and capable of building up lending.

Now we can say that a new economic cycle has begun: the economic downturn is over, some industries are growing at an outstripping pace, real wages have begun to grow, and demand is recovering.

We believe it to be important that the banking system has now recovered from the shocks of 2014-2015. This is evidenced by return, profit and capital stock figures, as well as other data. Banks are well-positioned to develop their business and build up lending.

The aggregate capital adequacy ratio sits at a comfortable level slightly above 13% (the minimum

value is 8%). We estimate that current capital stock is worth 1.8 trillion rubles, which is sufficient to boost lending. Banks' nominal profits have recovered to the pre-crisis level of roughly one trillion rubles, though real profits are still below the pre-crisis readings. In relation to 2013 prices, profits are still 30% lower.

We expect banks to use their profits to boost growth in the banking business, and to step up lending. To do so, they should convert the bulk of their profits into capital. Currently, financial statements suggest that 88% of profits will be converted into capital.

I hope that the final figure, after profit allocation between shareholders has occurred, will not differ greatly. Furthermore, banks' profits increased by 212 billion rubles in the first two months of 2017, a growth rate 2.5 times that of the same period of the previous year.

Despite the fact that the current situation in the banking system is quite good, we believe that changes are brewing, which will allow the banking system to more efficiently meet citizens' demand and economic development objectives.

Both bills which we consider to be pivotal - the proportional banking regulation bill and the new resolution mechanism bill - have passed the first reading at the State Duma. We have already discussed these in detail on many occasions, therefore today I will dwell only on the amendments introduced to the bills to be considered by the State Duma in the second reading.

As regards proportional regulation, I would like to return to the promotion of competition. When we first proposed the concept, many small banks voiced concerns that they might face tougher competition. We took this concern very seriously and have held many discussions on the matter. However, we do not think that the three-tier system disrupts competition. Instead, it will boost the stability of banks - irrespective of their size - and result in more realistic business models in the future. In addition, the system not only imposes restrictions on operations, but also considerably eases regulatory burden for banks holding basic licences.

Banks holding basic licences will have to comply with only five required ratios and will not have to meet new highly technical standards. Along with two capital adequacy ratios, one current liquidity ratio and two credit concentration ratios will be applied.

The current version of the bill, though aiming to focus small banks on servicing small businesses and individuals, provides a more flexible mechanism and allows lending to larger borrowers if they comply with both a more strictly concentrated ratio of credit risk per borrower and the related party risk ratio. We took these comments into account after the dialogue and discussion with the banking community. We believe that the niche we are establishing for banking will be popular among investors. This will make possible clearer, more transparent and, consequently, more interesting banking business for new private investors. No less important is the fact that we are creating a system which will help banks chose their development strategy as to how to turn a small banking business into a large one, while avoiding risks to its stability.

A few words about the development of a new resolution mechanism.

The existing credit resolution mechanism is not only more expensive and time-consuming than that which has been proposed, but it also hampers the competitive environment. Today, a bank operating under this resolution may not comply with the ratios, but nevertheless carry out the same operations as a normally operating bank, meanwhile a turnaround manager obtains access to almost free benefits. Turnaround managers fiercely competed for this credit resource exactly because it gave them a considerable competitive advantage. We do not think that the new mechanism will trigger significant growth in resolutions. Resolution means that the state takes up losses incurred by previous bank owners, thus this mechanism should be applied with caution.

We call the new instrument the Banking Sector Consolidation Fund, because we expect that banks under resolution will be able to be united into banks with larger capital, which will then attract more investors. We consider it important to encourage growth in the number of banks with large capital to avoid excessive concentration in any one level of the banking system.

Finally, I would like to draw your attention to another topic. It concerns the future, - the development of financial technologies - and it is a topic today being discussed widely. The development of financial technologies has become a point of regular discussion in the partnership of financial institutions and banks with the regulator. We are aware that growth of such technologies allows banks and other financial institutions to improve their efficiency, enter new market segments, and develop customer products and services. However, there is another reason to take a closer look at fintech - for it is these technologies that may rapidly alter the banking environment and all of you need to take it into account that new technologies are developing very quickly and may impact on your business. We should be prepared for such an alteration. Otherwise new actors may oust conventional banks from the market.

We are interested in developing financial technologies because they are convenient for people and for businesses, but at the same time we do not want the explosive growth in technologies to result in an increase in cyberattacks and cyberfraud. The Bank of Russia is focused on this issue. We have established both a centre for the development of financial technology and a centre for monitoring and response to cyberattacks in the financial sector. We believe that this work should be continued in cooperation with the banking community and businesses so that such shifts in the market become predictable and smooth and everybody is able to reap benefits from innovation and technology.

In conclusion I would like to emphasise once again that we hope the Central Bank and the banking community will continue to cooperate constructively. We are open to dialogue and the exchanging of views. Although banks may sometimes be sensitive to our measures we do our best for healthy, responsible and fair banks to retain stability, develop their business and meet the economy's demand.