

## Elvira Nabiullina: Establishing a mega regulator for the Russian financial sector

Speech by Ms Elvira Nabiullina, Governor of the Bank of Russia, at the Federation Council, Moscow, 15 February 2017.

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Good afternoon, esteemed colleagues, ladies and gentlemen

Today I will speak on the progress to date as regards our efforts to establish a megaregulator and develop the industries which fall into our remit.

Let me begin with a brief summary of the past economic background for the makings of the megaregulator.

It would be fair to say that three years ago all the hardships the Russian banking sector and the overall economy were set to go through were the very last thing expected. Oil prices were high and steady then, while the negative impact from the nascent geopolitical developments was yet to take its toll. As the Russian economy faced the sharp decline in the price of oil in the second half of 2014, alongside financial sanctions, the Bank of Russia focused on the need to secure both financial and price stability, as well as financial security. The Central Bank had to take tough steps to address the impact from the turbulence on financial institutes and their clients. With the Bank of Russia having by then become the sole regulator of the financial market, we could approach the overall financial sector in a holistic manner.

The switchover to a floating exchange rate regime, our moderately tight monetary policy stance and consistent action to cleanse the market of chronically unstable or even criminal financial institutions helped the financial system quickly adjust to the new environment and stabilise the situation.

Between late 2014 and early 2015, at the acute stage of the crisis, key impact was expected from our monetary policy and the programme to support a stable operation of the banking sector and the financial market overall.

The floating ruble exchange rate the Bank of Russia implemented in late 2014, came to be seen as an inbuilt stabiliser enabling to reduce, at the time of stress, the influence from external shocks on the economy, while also providing an overall balancing effect on exporters' and importers' interests.

Although the scale and duration of the oil price slump, further complicated by sanctions, were more severe than in 2008–2009, the rate of economic decline was more than twice lower and unemployment rose only slightly. The key rate rise to 17% at the end of 2014, with its subsequent gradual reduction, was central to countering a surge in inflation, inevitably triggered by the oil slump-caused drop in the ruble exchange rate.

As you are aware, inflation for 2016 was record low at 5.4%, while annualised inflation for January slowed down to 5%. Our plans envision for inflation to reach, in late 2017 and on schedule, our 4% target. Steadily low inflation is a major factor enabling households and businesses to make long-term plans; it lays the groundwork for transition to an investment-type economic development based not only on oil exports, but also on domestic investment. Low inflation is a means of protection for our citizens against the depreciation of their incomes and savings.

Incidentally, the rise in the key rate made bank deposits fairly attractive, so in the very challenging environment of the year 2015 banks showed a record growth in deposits (25%). The banking

system managed to retain its resources and credibility.

At the time our actions included some nonstandard approaches. To name just a few, we implemented some easing in the regulation of the banking sector and provided foreign currency refinancing facilities to help companies meet their external debt liabilities when such payments peaked, given that external financial markets were inaccessible.

Through its cleansing programme for the banking sector the Bank of Russia meant to do away with weak and unscrupulous players, as well as to stave off the domino effect, when financial difficulties of individual banks will trigger repercussions in the overall banking system.

The current banking system indicators are almost back to their pre-crisis readings. Banking sector profit is rising, and so is banking capital stock; growing bad debt is no longer a risk factor. Banks were able to build up appropriate reserves against bad loans. The rates of lending to the economy are consistent with the overall economic trends and on course to reach 4–7% in 2017. Although lending rates are still high, they are beginning to decline and are set to decline further as inflation recedes.

Let me proceed to report on our efforts to build a megaregulator and the progress to date.

Our efforts were centred on the development of institutes, instruments and infrastructure of the Russian financial market. While we remain committed to the global financial system as its full-fledged participant, we seek to create conditions for the domestic financial market to be able to operate regardless of external political developments.

The financial market can be viewed as a whole through the lens of a megaregulator, so that grey zones or regulatory arbitrage can be avoided; the megaregulator concept facilitates improvements in the quality of supervision, enabling a transition to consolidated supervision, preventing, at the same time, problems at an early stage in financial groups and holding companies (given that these hold a lion's share of financial system assets).

In 2013, the disbanded Federal Financial Markets Service's functions were transferred to the Bank of Russia. We assumed responsibility for the regulation of insurance and pension markets, professional security market participants, investment funds, actuary activities, rating agencies, microfinance organisations, as well as for the development of financial market infrastructure and instruments, etc. As a result, the Bank of Russia's remit extended to more than 20 thousand supervised entities. The list was later further expanded to include pawn-shops and forex dealers.

Over these three years, the Bank of Russia has conducted policies to cleanse and enable financial recovery of market participants; these efforts are almost complete as regards *non-credit financial institutions*. The cleansing *in the banking sector* is however set to take a few more years.

Beyond this agenda, the challenging geopolitical environment spells the need for the megaregulator to provide financial security and lower the Russian financial market's reliance on external factors. Hence the need to build a fully-fledged domestic financial market infrastructure, especially in the sectors previously fully reliant on the global market. This is why we set up the National Payment Card System, re-launched the rating industry, established a national reinsurance company and advanced a SWIFT-equivalent tool for the domestic market.

The national system of payment cards currently handles all Russian domestic bank card transactions. The scheme was put in place in spring 2014; Mir, the national payment card, has been in circulation since late 2015. Since then, as many as 2.5 million cards have been issued, which can be used in almost 80% of points of sale accepting banking cards. Mir is also used for cash withdrawal (approx. 98% ATMs accept Mir) or online shopping. In the next two years Mir will be the system to handle payments to all public sector employees, pensioners, students and

other budget payment recipients.

The State Duma is currently crafting a draft law to specify the timeline when all budget payments will pass over to Mir. Our intention is to ensure that this transition is as trouble-free to clients as possible and to give banks sufficient time for preparations, with a compressed time frame though. The national system of payment cards has also covered the Republic of Crimea, with its banking system having integrated into the Russian financial system and penetration levels approaching Russia's average.

Furthermore, in 2016 the Central Bank established a national reinsurance company (NPK), which is supposed to accept a wide range of risks for reinsurance including, among other things, those related to home insurance and government contracts. NPK will also provide insurance protection to companies under international sanctions. The creation of NPK will be instrumental in enhancing capacities of the Russian reinsurance market, still underdeveloped, with a view to turn around the situation where most risks are reinsured overseas.

Let me now proceed to comment on the issues of regulation and development of key financial market sectors.

The Bank of Russia has also been actively targeting the insurance market, seeking to get rid of weak and unscrupulous players by strengthening requirements for the sustainability of market participants. Upon obtaining the respective mandate, the Bank of Russia launched a thorough analysis of insurers' assets. As a result of the above measures, by 1 February, 183 insurance companies (roughly 40% of the total insurance market) had exited the market. A big portion of these companies did not have sufficient real assets. Formal compliance with requirements as of a reporting date is not the only concern of ours. Any insurers should possess real assets in their balance sheets – to be able to fulfil their obligations at any moment. We view it as a priority for our supervisory policy. Insurance companies should be able to pay out insurance indemnities.

The Bank of Russia intends to further strengthen requirements for the quality of assets in which insurers invest their own funds and insurance reserves. At present, we are transitioning to risk-oriented supervision in the insurance sector and introducing the institute for curatorial practice.

A reform in the actuarial industry has been conducted to enhance the quality and status of actuarial reports used in insurance business. We want to thank you parliamentarians for passing the respective law.

OSAGO seems to be the most challenging and also the most socially sensitive type of insurance. Problems in the OSAGO market, where rates have remained unchanged for a decade, have been piling up for quite a long time. In some regions, OSAGO has turned unprofitable. The deterioration in the OSAGO market was caused by rising prices for spare parts following the ruble appreciation. This objective economic factor raised OSAGO rates. At the same time, the market situation was adversely influenced by non-market factors, such as the activities of traffic lawyers which have virtually distorted the market in several regions. We definitely regard consumers' interests as our priority. Therefore, we have applied various measures to insurers in order to restore the accessibility of OSAGO in distressed regions, given the overall profitability of this type of insurance. These measures include the launch of OSAGO policy sales through a single agent and mandatory sales of electronic OSAGO policies starting this year.

It is now time to put an end to the practice pursued by traffic lawyers who tap insurers for money. The true aim of such lawyers is to obtain maximum penalties levied on insurers by court orders, rather than to restore the violated rights of offended parties.

Work is now underway to prepare a bill on the priority of in-kind loss resolution. The bill is being discussed rather thoroughly and heatedly. We believe that all this will eventually make OSAGO

less attractive for unscrupulous lawyers-intermediaries, and this is the initiative where I count on your support.

#### Pension savings market

Efforts were also made to streamline and strengthen non-governmental pension funds. They had to be turned into joint-stock companies. As a result, as many as 41 non-governmental pension funds are currently operating in the mandatory pension insurance system (out of 89 non-governmental pension funds which dealt with mandatory pension savings in 2014).

We introduced a system of guaranteed pension savings. It serves as reliable protection for the interests of pension fund customers. However, the situation calls for further improvements in the pension system and its funded component. Therefore, the Central Bank jointly with the Ministry of Finance have put forward their concept which is currently being discussed in the government. In our opinion, this concept enables citizens to make a new and beneficial choice, providing good protection for their rights and making it possible to accumulate more pension funds (in addition to the state insurance pension).

The operation of microfinance organisations is another highly sensitive social issue. Microloans are very popular among households. Should legal lenders, capable of issuing express loans in small amounts and for short terms, disappear, while household demand remains unchanged, microfinance organisations may be replaced by shadow lenders. Borrowers will be left absolutely unprotected against tough debt collectors and exaggerated interest charged on their loans. This market remains flawed, with loud cases surfacing from time to time, when individuals become suddenly aware that they owe microfinance organisations outrageous amounts in interest, absolutely inconsistent with the amount of the principle.

Jointly with the parliament, we have carried out considerable work to enhance the protection for borrowers. The Federation Council initiated this work in order to massively limit the amount of potential debt for households and to lower lending rates.

We seek to thoroughly clean up this sector. As a result, roughly 4,000 organisations have been struck off from registers.

Alongside the above efforts, we also initiated a programme to record microfinance organisations, to rectify the situation where they operated as totally invisible organisations without any official records in the register.

We sought to either include them in the register or to strike them off from the register, if required by supervisory findings.

This brings me to the end of my speech. I would like to conclude by saying that we will continue with our efforts to develop the megaregulator, along key functionalities of the financial market. I refer to the document that has been drafted for the first time and formulates our strategy for three years ahead across all areas of financial market development. We have forwarded this document to the parliament for consideration, and we plan to continue our joint work on it.

Thank you for time.