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Elvira Nabiullina's speech at 18th International Banking Forum

17 September 2021 Speech

Good afternoon, colleagues.

I am very happy to finally meet all of you in person. This is a great opportunity for us, the large central Bank team, to exchange views with you. Nothing can replace face-to-face contact, and even the weather here in Sochi is good for working in.

Let me start with a discussion of the issues we view as the top items on our agenda as regulator.

This forum seems to me the right place to discuss the future of the banking sector. The pandemic crisis, at least its acute phase, is behind us. The banking sector has fared well enough through this challenging period as you helped your customers, the economy, businesses, and people navigate these difficult times. The sector overall performed well.

For all the importance of the Government and the Bank of Russia's pandemic response, it was the accumulated capital reserves and stability margin that enabled banks to expand lending at a time of acute stress. These reserves made it possible for banks to support borrowers and enabled a faster economic recovery. It is true that the economy has been recovering very quickly, contrary to many expectations, and the banking system has indeed made a valuable contribution towards that rapid economic recovery.

Not only were banks able to avoid the massive losses associated with such crises or a deterioration in the quality of loan portfolios (and the Government's measures to support borrowers helped in that), but they also showed a profit. We are expecting record high profit this year as business growth continues and the cost of reserves is low.

However, this year's achievements are not guaranteed in the future. In the long term, the success of the banking business depends on the efficiency of banks' business models in an ever-changing environment.

Currently, the economy is on track to return to pre-pandemic performance, that is, it is approaching the point where it would have been but for the pandemic. This year's high growth rates are set to give way to a more even recovery.

At the same time, Russia, like other countries, has faced a surge in inflation, fuelled by rapidly recovering demand and persistent supply-side restrictions related to the pandemic. In addition, there are one-off drivers behind the accelerating inflation, such as, for example, this year's harvest of many crops being worse than expected.

The rise in prices for everyday goods has fuelled a spike in inflation expectations, while low deposit and loan rates have propelled people to spend more. We may see the emergence of an inflationary spiral should we fail to respond to the rise in inflation and inflation expectations. That is why, a week ago, the Bank of Russia again raised its policy interest rate — the key rate.

We will be watching how things unfold. Again, it is clear that the full impact of our July move to raise the rate by one percentage point has yet to be seen. A further rate increase, or several increases, may therefore be warranted. That will be decided at upcoming Board meetings. At some point, the rate will certainly return to the neutral level, but that will happen only once we can be sure that there has been a sustained slowdown in inflation.

We can start lowering the rate only when inflation expectations are down and the propensity to save is up. It is unlikely that this will happen before people are satisfied with deposit rates.

Importantly, bank rates, primarily on deposits, are just starting to rise. It might be foolish to expect that banks could afford to ignore the increase in the key rate and leave their rates unchanged, waiting for the key rate to drop again. The key rate and bank rates are integral components of the monetary policy transmission mechanism. One component sets the others in motion. Until such time as the effect of the change in the key rate (including through trends in market rates) sets in, which is necessary to ensure inflation returns to target, no reverse movement of the key rate is possible.

This holds true for both deposits and loans. Inflation has accelerated on the back of the rapid growth of unsecured consumer lending. And furthermore, those growth rates concern us from the social and financial stability perspectives.

Many banks could say: I have a good retail portfolio, and all metrics of retail loans are very good. Why not expand consumer lending further? My business model is changing, and such loans are lucrative. Let me answer. The problem here is that when the growth of loans overtakes the growth of household incomes, it leads to the emergence of systemic risks which may be invisible at the level of an individual bank. In a negative scenario, portfolio quality will deteriorate across the whole sector.

Therefore, we cannot turn a blind eye to the ongoing rapid growth of consumer loans. We resorted to raising macroprudential add-ons from 1 July. The next move is scheduled for 1 October, and we are ready to raise the add-ons further. Having said that, we are sure that direct quantitative restrictions would be a fairer and more efficient tool, given the uneven distribution of capital in the banking system. Such restrictions would alleviate some pressure on banks' capital, enabling them to direct more capital to corporate lending, including loans to SMEs, or mortgage loans.

Now, on to longer-term trends.

The global environment is changing irreversibly under the influence of various factors, which are all evident: technological factors, climatic factors, and social factors. These are new challenges for our economy and the financial system, and they call for an active response.

To minimise future risks and ensure the best adaptation to these global changes, we must act proactively. You know of the recent discussions of the EU's carbon tax and its implications for Russia. However, it is important to understand that this is not an isolated example, but a global trend. Thankfully, humankind is increasingly changing its attitude towards nature to ensure that future generations have not only bank accounts and operating factories, but an environment fit for life.

Economic modernisation and technological and environmental transformation are no longer issues that can be put on the back burner. We cannot assume that we can tackle them later as long as current business models are working. We need to act now. The key source of financing for the Russian financial market, the banking sector, should play a leading role here.

We at the Bank of Russia are ready to review our regulatory approach to deliver the necessary structural changes in the economy and in lending patterns. We want to make regulation more risk-based and more flexible in some areas, even if that comes with a moderate increase in risk to the banking system, to a degree that is controllable.

Conversely, bank activities that do not promote long-term economic growth and well-being, such as lending to debt-laden borrowers, will be subject to more stringent regulation.

Our approach will be based on comprehensive analysis of the market and the changes it is undergoing (using stress testing and scenario analysis), and that implies more than just following previously established rules. As the world is changing rapidly, what worked yesterday might no longer work today — we are well aware of that, and we need to adjust the rules in time. We are ready to do so.

What does that mean for banks? In our view, banks should be more involved in projects that foster long-term economic growth, enhance productivity and develop human capital.

In the new reality, banks should do business off the beaten track. Working capital financing for major corporations, essentially lombard loans for real estate buys, financing mergers and acquisitions, or issuing consumer loans to debt-laden borrowers, are, as I have said, no longer enough to address the challenges we face today. These challenges include fostering overall sustainable development and enabling energy transition, promoting steady growth of small and medium-sized enterprises, and improving the financial performance of investments in the overall economy.

One might wonder why banks should be concerned about this. Why is sustainable economic growth their objective? I do not in any way mean to urge you to act against the interests of your own businesses. Quite the contrary. As I have said, the economy is returning to its pre-pandemic levels. However, these levels — and their potential growth rates — are rather low and are set to remain such unless we work to ramp up our economic capabilities. In addition, let us remember advances in technology: it all means that banking margins are on course for stagnation and decline if future business models are ruled by inertia. In that sense, the future of the real sector is the future of banks.

The Bank of Russia is ready to work to adjust regulatory requirements where it is required for structural changes in the economy. Here we would like to join forces with the Association and work in an ongoing dialogue with banks. New regulatory regimes may indeed work out, but — let me say it again — the associated risks must be controlled. While such regulatory regimes should deliver in terms of creating public good, they must also be based on an appropriate assessment of banking risks and must allow for financial stability.

That is how we should approach, for example, the drive to reduce climate risks and assist in energy transition. It is an utterly ambitious agenda given the high energy intensity of the Russian economy. We are well aware that it will take the joint effort of all, including the Government, as well as a proactive and responsible stance from businesses and banks. The focus of our efforts should now be on the green transformation of brown companies.

First, companies themselves should be convinced of the need for restructuring, and the difficulty here is that companies will have to raise costs now, while the positive effect — the avoidance of those costs — will only come later, when the ESG risks have fully materialised. We are in fact talking about strategic investment in the future, investment in a highly uncertain environment.

At the same time, given their limited resources, companies wonder about the source of funding. Banks could provide funds, but it is important that banks maintain a balance of risk and return. The Government is working to develop energy transition incentives to mitigate such risks. At the same time, we at the Bank of Russia are currently studying how to take climate risks into account, and not only climate risks, but also corporate strategies to mitigate climate risks for companies themselves and how to adjust our regulation to them. On the one hand, we seek to provide incentives for lending to green and transformation projects, and, on the other hand, we want to ensure that risks for brown companies are appropriately assessed, aiming to eliminate the risks of so-called greenwashing and avert the emergence of a bubble in the green finance market.

There are many complicated issues here. Undoubtedly, we need to find the right interaction formula together, which will not only solve the energy transition problem but will also create a new point of growth for banks and the overall economy.

Another important area in the development of the banking sector is another subject that I would like to focus on today. It is the behavioural reboot of the banking sector, that is, a pivot to responsible business that is free of deception. This principle is essential to maintaining confidence in the financial market.

First of all, I am talking about consumer trust, primarily retail customers' trust. This is a much-talked-about matter, but, unfortunately, I have to talk about it even more.

Banks should stop misleading borrowers or concealing information about product terms, the real total cost of loans. They should stop attaching additional conditions and promoting sophisticated solutions to unqualified audiences. Unfortunately, we are still unsatisfied with how banks behave. Not all of them, I admit. There are banks that behave honestly. And we would not like for them to lose out in competition, because the competition is unfair.

I would like to draw particular attention to the fact that the current crackdown against unfair market practices is no less important than the effort to clear the banking system of weak and dubious players we undertook a few years ago. This is the same priority level. We are sure to take action here.

Let me cite a few examples to substantiate my points. I think you will have seen such cases in practice. Your clients certainly have.

Incidentally, I saw an ad from a well-known bank yesterday offering loans to individuals at 5% per annum. We are well aware that that is nothing but deception: one cannot get a loan at such a low rate, it simply cannot be a mass-market product. When you read the fine print, you realise that this rate is only effective if you buy insurance, which significantly ups the cost of the loan.

Importantly, this is much more than just a one-off example, with many large banks using this ploy. All it takes is a look at the omnipresent ads. It is nothing but a ploy, and that word fits best here. In general, it is a common practice to impose voluntary insurance, including double and triple insurance, with the aim of circumventing the requirements related to the total cost of a loan and high add-ons. Retail interest rates are rather high, and if you calculate all the related fees and payments, in some cases — actually, in many cases — borrowers end up paying up to 30% per annum.

Or another example: A bank advertises a credit card with a long grace period and low total cost. However, the customer is in fact offered an agreement for a card without a grace period. The grace period is provided for in an additional agreement. It looks OK, but the interest rate in this additional agreement is a lot higher.

Consumers still trust banks some and sign such agreements without a second glance. Yet, this erodes consumer trust in banks: while the main agreement does offer a market rate, the product becomes much more expensive beyond the grace period.

The same trick is played with point-of-sale loans, when credit cards are forced on consumers instead of consumer loans per se. Instead of loans at 14% interest, consumers are offered credit cards with a 25% total cost of revolving credit. We ask the banks: 'Was that credit line ever resumed?' 'No, but it is possible,' the banks answer. Clearly, the consumers mean to take out loans specifically to buy particular products, not credit cards. However, they get confused by the lengthy agreements and extensive explanations from the managers, and they agree and overpay.

Sadly, the examples I am citing are not single instances, and we are concerned about that. Let me stress: conduct supervision and a behavioural reboot are our top priority for the near future. We will respond to these and other unfair practices, and we will stop them. Meanwhile, client-oriented banks that pursue responsible policies will benefit from a market that is free of such malpractice.

We place high emphasis on conduct supervision, given that the border between what is good and what is bad in the Russian banking sector remains very blurred. In this respect, the self-regulatory organisations have fallen short of expectations. This issue has been looked into on many occasions, and I hope we will continue to discuss it. Therefore, unfortunately, all standards for sales of financial products and the associated requirements are external to banks. They are established by the regulator, rather than the banking community. We view this as a certain sign of the immaturity of the financial community. This is a very challenging problem, and a problem for us to discuss at this forum, I think, given its implications for long-term development.

We call on you not to quarrel with your bread and butter: customer confidence is what the financial system is based on. I urge everyone to revisit the issue of building long-term customer loyalty, something that can only be achieved though fair practices, good faith and top-class customer care. We saw how this attitude towards customers delivered during the pandemic, when banks demonstrated an exemplary responsible approach in a time of stress, taking a close look at customers' problems. It proved to be a winning strategy for both banks and customers. From the perspective of future strategy, the case of the pandemic is a lesson for us all.

To conclude, let me say a few words about technology. The subject is on every agenda for our meetings. We are in a very interesting situation: there are some extremely innovative banks, including small banks and banks turning into the cores of ecosystems. Many banks shun investment in their own digital transformation in view of the costs. They view this investment as a non-essential component of their business, assuming that the digital transformation might be escaped. But here is the question: Are you sure that you will have no regrets in a matter of five years? The regulator's view is that this transformation is inevitable. Here is the reason I am talking about this now: Banking sector profits are going to be big this year. I would like to urge you to consider the option of investing some of these profits in innovations and business transformation with a view to supporting your future business models.

Another issue directly related to advances in technology is stronger competition. I think that all banks feel this way. At the same time, by levelling out the rules of the game, technology increases competition not only between banks, but also between banks and other financial institutions and even non-financial companies. We welcome this and are working to build an infrastructure that will create a level playing field for banks. Even more, we would like banks to be mindful of these new competitors and pursue strategies to meet the challenge. It is within our mandate as regulator to promote competition, drive efficiencies in the cost of services and enhance the benefits to end customers. In this context, we are willing to allow non-financial organisations to offer financial services.

For example, we intend to introduce a so-called non-bank payment service provider category, which will be able to work with both businesses and individuals. This means that it will be extremely difficult to maintain high fees for payment services. This is essential for our economy. As things stand, some payment systems and banks are using their monopoly position or large market share to gain excess profits from standard payment operations, which are becoming much cheaper because of technology, forcing such high costs on businesses. Therefore, we will welcome new business players offering the same quality but cheaper services to consumers and businesses.

Certainly, our policies will be free of regulatory arbitrage. We will not allow scenarios where a non-financial company has an advantage over the financial sector in the payment business. A non-bank agent willing to enter the payment market will have to comply with our requirements for net asset value, management's qualification, business reputation, segregation of client funds, and so on. Ultimately, our regulatory stance has to be aligned with the trends in global competition: what is happening in the world is set happen in our country. That is, competition is set to increase.

Another recent example. There were plans for the new procedure for calculating required reserves to be in effect from October. Yet, bank treasurers convinced us that the new regime was probably suboptimal, and ultimately, we postponed the effective date of the new regime for six months, until 1 April 2022. We have until 1 April to work with banks to adjust the procedure to ensure that it is optimal.

We want the banking business to evolve and work for the economy. We will continue to improve regulation in dialogue with the market, taking into account all these trends and challenges. Our talk of readiness for dialogue with the market is by no means empty words.

Another example is our concept of ecosystem regulation, which we are actively discussing with the market. Let me stress once again: unlike many national regulators, we do not intend to prohibit banks from engaging in new types of business, considering the evident benefits technology offers to banks and their customers. We do, however, want to limit the concentration risk of investments in such activities, to keep them from growing to a point that they pose a threat to depositors or to financial stability.

It is key for us to strike the right balance between two objectives. One is to promote competition, support innovation, and improve inclusion and service quality for consumers. The other is to limit risks to the financial system. I think together we will succeed.

In conclusion, I would like to underline this point again: we have come a long way together, and we have dealt with multiple challenges, but the challenges confronting the banking industry today demand a complete rethinking of the role of banks in the domestic economic agenda. This new role requires another level of initiative, higher standards of professional and social responsibility, and new strategies and business models. I am confident that our joint capabilities will be up to the mark in this changing environment. Several days into the forum, I am sure you must have discussed many of the issues I have raised. My colleagues tell me that you are having very detailed discussions of each point. I am pleased to know that we all realise that the banking system is in need of change consistent with the current stage of economic development. I hope that together we will successfully navigate today's difficulties.