FSB FINANCIAL STABILITY BOARD

Peer Review of Russia

Review Report

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Foreword

Financial Stability Board (FSB) member jurisdictions have committed, under the FSB Charter and in the *FSB Framework for Strengthening Adherence to International Standards*[1], to undergo periodic peer reviews. To fulfil this responsibility, the FSB has established a regular programme of country and thematic peer reviews of its member jurisdictions.

Country reviews focus on the implementation and effectiveness of regulatory, supervisory or other financial sector standards and policies agreed within the FSB, as well as their effectiveness in achieving desired outcomes. They examine the steps taken or planned by national authorities to address International Monetary Fund (IMF)–World Bank Financial Sector Assessment Program (FSAP) and Reports on the Observance of Standards and Codes (ROSCs) recommendations on financial regulation and supervision as well as on institutional and market infrastructure that are deemed most important and relevant to the FSB's core mandate of promoting financial stability. Country reviews can also focus on regulatory, supervisory or other financial sector policy issues not covered in the FSAP that are timely and topical for the jurisdiction itself and for the broader FSB membership. Unlike the FSAP, a peer review does not comprehensively analyse a jurisdiction's financial system structure or policies, or its compliance with international financial standards.

FSB jurisdictions have committed to undergo an FSAP assessment every 5 years. Peer reviews taking place 2-3 years following an FSAP will complement that cycle. As part of this commitment, Russia volunteered to undergo a peer review in 2014.

This report describes the findings and conclusions of the Russia peer review, including the key elements of the discussion in the FSB's Standing Committee on Standards Implementation (SCSI) on 1 December 2014. It is the thirteenth country peer review conducted by the FSB and the second using the revised objectives and guidelines for the conduct of peer reviews set forth in the January 2014 *Handbook for FSB Peer Reviews*.[2]

The analysis and conclusions of this peer review are based on the Russian financial authorities' responses to a questionnaire and reflect information on the progress of relevant reforms as of September 2014. The review has also benefited from dialogue with the Russian authorities and private sector representatives as well as discussion in the FSB SCSI.

The draft report for discussion was prepared by a team chaired by Anne Le Lorier (Deputy Governor, Banque de France) and comprising Mehmet Onay (Central Bank of the Republic of Turkey), Danilo Palermo (Central Bank of Brazil) and Rekha G. Warriar (Reserve Bank of India). Jason George, Costas Stephanou and Ruth Walters (all FSB Secretariat) provided support to the team and contributed to the preparation of the peer review report.

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1 See http://www.financialstabilityboard.org/wp-content/uploads/r_100109a.pdf.

2 See http://www.financialstabilityboard.org/wp-content/uploads/r_140106.pdf.

Abbreviations

BCBS	Basel Committee on Banking Supervision
BCP	Basel Core Principles
CBR	Central Bank of Russia
DIA	Deposit Insurance Agency
D-SIBs	Domestic Systemically Important Banks
FMI	Financial market infrastructures
FSAP	Financial Sector Assessment Program
FSB	Financial Stability Board
FSC	National Council on Ensuring Financial Stability
FSCom	Financial Stability Committee (CBR)
FSD	Financial Stability Department (CBR)
FSFM	Federal Service for Financial Markets
FSR	Financial Stability Report
GDP	Gross domestic product
IMF	International Monetary Fund
Inter-agency WG	Working Group to Monitor Financial Market Conditions
IOSCO	International Organisation of Securities Commissions
LTV	Loan-to-value
MFO	Microfinance organisation
MoF	Ministry of Finance
NFB	National Financial Board
NPFs	Non-state pension funds
ROSC	Report on the Observance of Standards and Codes
RUB	Russian Rouble
SCSI	Standing Committee on Standards Implementation
SIFIs	Systemically Important Financial Institutions
USD	United States Dollar

Executive summary

Background and objectives

The main purpose of this peer review is to examine two topics that are relevant for financial stability and important for Russia: the macroprudential policy framework and tools and the bank resolution framework. Both topics were included in the key FSAP recommendations and are topical for the broader FSB membership. The peer review focuses on the steps taken to date by the Russian authorities to implement reforms in these areas, including by following up on relevant FSAP recommendations.

Main findings

Good progress has been made in addressing the FSAP recommendations on both topics, but there is additional work to be done. On the macroprudential side, the Russian authorities will need to clarify the mandate of the recently-formed National Council on Ensuring Financial Stability (FSC) and flesh out the Central Bank of Russia's (CBR) macroprudential policy framework. On the resolution side, they need to further strengthen the prompt remedial action framework, expand the range of resolution tools at their disposal, and review the process for rehabilitating failing systemic banks to further enhance its efficiency and effectiveness.

Macroprudential policy framework and tools

The authorities have made good progress in strengthening the institutional framework for financial stability, which is a necessary prerequisite to address the FSAP recommendation for effective macroprudential policy oversight. The CBR has been given an explicit financial stability mandate and is actively working to enhance its systemic risk monitoring capacity and to expand the range of macroprudential tools at its disposal. Those tools have been deployed in recent years, in an innovative manner, to stem the rapid growth in unsecured consumer lending that had given rise to financial stability concerns. In November 2014, the CBR established a high-level internal Financial Stability Committee (FSCom), chaired by the Governor, to formalise and further strengthen macroprudential policy decision making. An inter-agency FSC has also been established as an advisory body on financial stability issues, and the authorities note that it has served as a useful platform for discussions on these issues.

In spite of these accomplishments, the macroprudential policy framework agenda remains unfinished. The authorities are aware that further steps to flesh out and operationalise the framework are necessary and, in this context, it would be useful to focus their efforts on:

- ***Role and responsibilities of the FSC***: At present, the CBR has an explicit financial stability mandate provided in legislation, while the FSC (established by Government Decree) serves as an advisory body for inter-agency discussions on financial stability matters. It is not clear how the FSC discharges its mandate or whether it (as currently constituted) has the capacity to undertake the tasks required to fulfil this mandate. In particular, some of the FSC's mandated objectives seem to duplicate those of the CBR such as, for example, the review of methodologies for identifying and assessing systemic risks or the development of proposals on measures to restore financial

stability. The participation in the FSC of representatives from various parts of the government points to a broader and more developmental role, which could be beneficial in balancing the objectives of growth and financial stability and in providing a macroeconomic perspective to the CBR's efforts to ensure the stable functioning of the financial system. In order to do so, however, the FSC's mandate may need to be reviewed so that it can better add value to and support the CBR's financial stability mandate without impinging on its independence. This could include, for example, providing input to the CBR on systemic risk assessments, advising on possible policy measures to address emerging financial stability risks (particularly from a macroeconomic perspective), and evaluating the broader economic effects of the macroprudential measures adopted by the CBR.

- ***Institutional and operating arrangements of the FSC***: The FSC is chaired by the Minister of Finance and has broad and diverse membership (17 members), most of whom are government officials. Membership is not based upon designated positions or levels of seniority within the respective institutions. The FSC has no permanent committee structures and Secretariat support on administrative matters is provided by the Ministry of Finance (MoF). Furthermore, the FSC's deliberations are based on consensus and, given the absence of a formal requirement to 'act or explain', its recommendations to official bodies are non-binding. The authorities are currently considering amendments to the Decree that established the FSC. In that context, it may be desirable to adopt some of the good practices and features of similar bodies in other countries. These would include ensuring the participation of individuals with adequate seniority within their respective institutions in its deliberations; introducing a formal 'comply or explain' mechanism for public sector authorities that are the subject of its recommendations; developing organisational structures to carry out tasks (e.g. a standing Secretariat or working group); and adopting majority voting to ensure the timely adoption of any decisions. Moreover, in recognition of the explicit financial stability mandate given to the CBR and its technical expertise on prudential matters, consideration should be given to upgrading the central bank's role within the FSC. This may involve, for example, expanding the CBR's participation in the Council (and linking its membership to official positions), enhancing its voting rights (particularly on financial stability matters), or assigning it sole responsibility of proposing warnings and recommendations (or the power to veto them). Finally, the FSC could explore options to publish information on its activities given that public communication, as a form of 'soft' intervention, is a critical part of the toolkit of macroprudential bodies and forms an important part of their accountability.
- ***Macroprudential function within CBR***: The CBR has a dedicated department that assesses financial stability risks with input from other departments. The recent creation of the FSCom is a useful step in arriving at a collective institutional view of these risks and how to address them. It is important that the Governor is chairing this Committee given the fact that prudential tools come under the responsibility of various departments and given the links between monetary and macroprudential policies. Drawing on good practices in other countries, the FSCom's mandate could be expanded to include coordination with relevant departments and committees within CBR on policy measures for domestic systemically important banks (D-SIBs) and

non-bank financial institutions, and the development of proposals on the use of tools for macroprudential purposes (e.g. countercyclical capital buffer).

- ***Analytics***: The CBR has continued to improve the range and quality of information it receives for systemic risk analysis. Data flow and analytics are critical to systemic risk identification, and the efforts initiated by CBR in recent years evidence the technical competence of its staff. The Financial Stability Report (FSR) has done a good job describing this work, detailing the results of stress tests, identified vulnerabilities and measures taken to address them. Going forward, it would be useful for systemic risk analysis to become even more policy-oriented so that it can support decision-making by the CBR for macroprudential purposes. Drawing on experience from the IMF and central banks in other countries, this may include *inter alia* the establishment of a 'heat map' prioritising systemic risks in terms of their significance or immediacy; the creation of a set of standardised financial market indicators ('dashboard'); and the inclusion of suggestions for possible action. It may also be useful for the CBR to develop a framework for monitoring and assessing the effectiveness of macroprudential policies. The creation of the FSCom provides a good opportunity for the CBR to further expand its work in this area and to enhance the coverage of the FSR by incorporating some of these analyses.
- ***Macroprudential tools***: The CBR has used a range of tools for macroprudential purposes in recent years. Some of these tools, which are mostly microprudential in nature, have been innovative and tailored to the Russian financial system. The most notable among these is the use of differential risk weights based on the level of interest rates of consumer loans. Thus far, the CBR has deployed these tools by imaginatively tweaking its existing regulatory toolkit and requesting legislative authority when the tool does not exist. However, a framework that requires legal amendments or fresh legislation to authorise the use of necessary tools or measures may hamper prompt action during a crisis. The new chapter on Financial Stability in the CBR Law does not mention any specific tools. While some macroprudential measures may involve the use of microprudential tools for which CBR has adequate powers derived from the CBR Law, any new tool (e.g. countercyclical capital buffer, loan-to-value (LTV) and debt-to-income ratios etc.) needs specific legislation. The CBR is considering whether to request these powers. As experience in the use of the tools grows, it might be appropriate to develop a comprehensive macroprudential toolkit on an *ex-ante* basis with the necessary legal foundation to ensure the timely application of tools when necessary.

Bank resolution framework

A number of steps have been undertaken to upgrade the bank resolution framework in Russia, several of which were under development during the period of this peer review and adopted after the analysis and discussions with the authorities took place. Importantly, the resolution framework has helped maintain financial stability in recent years: banking licenses for a large number of small banks were revoked without major adverse confidence effects, while the temporary regime that was created in 2008 has enabled the CBR and the Deposit Insurance

Agency (DIA) to deal effectively with problems affecting systemic banks (as noted in the FSAP).[3] The authorities have encouraged the largest Russian banks to develop recovery plans and, following the peer review discussions, have revised the legislative framework to include a statutory provision for recovery and resolution planning for D-SIBs and to enable the CBR to share information in recovery plans with foreign resolution authorities.

Further reform was adopted at end-2014 in a new Law (Federal Law No 432-FZ) that revokes and replaces the General Bank Insolvency Law and the 2008 Temporary Law into a single instrument and extends the powers of the CBR. That Law was still in draft during the period of peer review analysis, and is therefore referred to as the 'Draft Law'.[4] The relatively cursory examination of the Draft Law in the peer review indicates that it makes notable improvements in some areas, such as a broader role for the DIA in evaluating failing institutions so as to better assess the most cost-effective alternatives; a framework for more timely exchange of information between the DIA and the CBR for failing banks; the mandatory imposition of losses on the shareholders of a failing institution prior to the use of public funds in rehabilitation; provisions to allow the transfer of assets and liabilities from a failing bank to a sound institution and for the conversion of certain subordinated liabilities to equity; and greater powers to sanction managers of the failing institution.

In spite of these accomplishments, however, further work is still needed to enhance the bank resolution framework and to fully address the FSAP recommendations.

- ***Adoption of legislative changes:*** It is not clear how far the Draft Law will meet the FSAP recommendation for a single set of triggers for all banks. In addition, a number of the tools contemplated in the FSB's *Key Attributes of Effective Resolution Regimes* are missing from this law. For example, the Draft Law does not provide for resolution powers in relation to holding companies or powers to use a bridge bank or to write down and convert all unsecured uninsured liabilities (bail-in) other than those with express contractual provisions; powers to require firms to adopt changes to improve their resolvability; or mechanisms for the recovery of public funds used in resolution from the financial industry. These tools would expand the options in dealing with failing banks in a timely and cost-effective manner, provide more clarity to market participants, and allow the authorities to resolve these firms in an orderly manner.
- ***Prompt remedial action framework:*** Useful steps are being taken by the authorities to facilitate prompt remedial action, including revisions to CBR guidance on early supervisory intervention and provisions in the Draft Law for early notification to the DIA of problems in a bank and for collaboration between the CBR and the DIA in planning the measures to be taken. However, it is unclear whether the conditions for intervention to impose bankruptcy prevention measures under the Draft Law in non-systemic cases will differ substantively from the regime in place at the time of the

[3] The 2008 Temporary Law had introduced a number of tools to enable the CBR and the DIA to intervene in order to prevent the failure of those banks that may pose a threat to financial stability. This law was initially set to expire at end-2011, but it was extended to 31 December 2014. Failing banks that were not deemed to be systemic were not covered by the 2008 Temporary Law and continued to be subject to the General Bank Insolvency Law, which did not permit the use of DIA or other government financial support to assist them.

[4] The authorities indicate that no major changes were made to the Draft Law during the approval process.

peer review analysis. These conditions, which apply only at a relatively late stage when the institution is already insolvent or close to it, may need to be revised to implement the FSAP recommendation and to increase the flexibility to take appropriate and timely measures for failing banks.

- ***Revision of rehabilitation process for systemic banks:*** The rehabilitation process for failing systemic banks relies substantially on the use of public funds in the form of loans from the CBR to the DIA, which are on-lent to private sector acquirers of those banks at heavily subsidised rates. This risks creating moral hazard, both because the contribution of private sector investors to funding rehabilitation is small in proportion to the loans that they receive and because the way in which such loans are provided may not create strong incentives for effective and rapid conclusion of the rehabilitation. The authorities indicate that the Draft Law addresses this risk by requiring that, prior to the use of any public funds, existing shareholders are wiped out and any subordinated liabilities with contractual conversion terms held by those shareholders are converted to equity or written off. This represents progress compared to the regime in place at the time of the peer review analysis, although the authorities might also consider adopting measures that enable a portion of the costs of resolution to be recovered from a wider set of creditors of the failing bank and, in appropriate cases, from the industry more broadly. In addition, it may be useful to review and potentially revise the rehabilitation process for systemic banks to enhance its efficiency and reduce the use of public funds. This would include: writing down the failing bank's assets to fair value at the point of intervention based on the results of the joint CBR-DIA inspection (so as to avoid delayed recognition of impaired assets); providing more information upfront to prospective investors on the failing bank (so as to improve the outcome of the tender and minimise the need to provide guarantees for investors); and creating incentives for those investors to work out the impaired assets (so as to improve recoveries and contribute to new productive lending).

Recommendations

In response to the aforementioned findings and issues, the peer review has identified the following recommendations for consideration by the Russian authorities:

Macroprudential policy framework and tools

- The authorities should clarify the role and responsibilities of the FSC in the macroprudential policy framework in order to eliminate potential overlaps in mandates and responsibilities with the CBR.
- In order to enhance the effectiveness of the FSC, the authorities should consider: (1) upgrading the role of the CBR in the FSC, given its financial stability mandate and technical expertise on prudential matters; (2) developing formal structures to carry out its mandated tasks; (3) providing the FSC with the power to issue recommendations to public sector authorities on a comply-or-explain basis; (4) adopting a majority voting system for its decisions; and (5) exploring options to publicly communicate its deliberations and decisions.

- The CBR should review the mandate of its Financial Stability Committee to ensure that it addresses all aspects of macroprudential policy decision making, including coordination on policy measures for systemically important financial institutions and the development of proposals on the use of tools for macroprudential purposes.
- The CBR should enhance its systemic risk analysis to identify and prioritise risks so that it becomes more policy-oriented and can support decision-making for macroprudential purposes.
- The authorities should consider amending the CBR Law to provide an adequate legal foundation for the development and use of a comprehensive macroprudential toolkit on an *ex-ante* basis.

Bank resolution framework

- The authorities should consider extending the options available under the current resolution regime by incorporating additional features of the FSB's *Key Attributes*.
- The authorities should revise the triggers to enable the timely adoption of resolution measures for non-systemic banks before the firm is balance sheet insolvent.
- The authorities should review and potentially revise the rehabilitation process for failing systemic banks in order to further enhance its efficiency and effectiveness.

1. Introduction

Russia underwent an assessment under the FSAP in 2011.[5] The FSAP included a targeted assessment of the Basel Committee on Banking Supervision's (BCBS) *Core Principles for Effective Banking Supervision* (BCP) and an assessment of the International Organisation of Securities Commissions' (IOSCO) *Principles and Objectives of Securities Regulation*.[6]

The FSAP found that a decisive and broad-based policy response enabled the Russian authorities to maintain financial stability in the face of a major global shock and despite a sharp contraction in domestic output. However, the crisis had set back progress toward a more competitive banking system, as concentration had risen and moral hazard increased. The FSAP reported that the system continued to suffer from weak governance, including sometimes non-transparent ownership structures and deficiencies in reporting. Despite progress achieved in previous years, the regulatory and supervisory framework still had gaps and weaknesses; the unification of the supervision of nonbank financial institutions was an opportunity for strengthened oversight. The FSAP also noted that the authorities had solid experience with bank resolution and an effective deposit insurance scheme, although a more structured corrective action regime and a unified administration regime for all banks would help strengthen the system further.

The main purpose of the peer review report is to examine two topics that are relevant for financial stability and important for Russia: its macroprudential policy framework and tools, and its bank resolution framework. Both topics were included in the key FSAP recommendations and are topical for the broader FSB membership. The peer review focuses on the steps taken to date by the authorities to implement reforms in these areas, including by following up on relevant FSAP recommendations. In particular, the review evaluates progress with the reforms in order to draw conclusions and policy implications as well as identify remaining impediments and lessons that could be of benefit to Russia and its FSB peers.

The report has two main sections, corresponding to the two topics being reviewed. Section 2 focuses on the development and implementation of a macroprudential policy framework and tools, while Section 3 analyses progress made to formalise arrangements for a permanent bank resolution regime. In addition to these sections, Annex 1 provides background information on the structure of the Russian financial system and on recent regulatory developments, while Annex 2 presents the follow-up actions reported by the authorities to other key FSAP recommendations; these actions have not been analysed as part of the FSB peer review and are presented solely for purposes of transparency and completeness.

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[5] See "Russia: Financial System Stability Assessment" (September 2011, IMF Country Report No. 11/291, available at http://www.imf.org/external/pubs/ft/scr/2011/cr11291.pdf).

[6] The targeted BCP and IOSCO assessments have been published and are available on the IMF website (http://www.imf.org/external/np/fsap/fsap.aspx).

2. Macroprudential policy framework and tools

Background

In December 2010, a Working Group to Monitor Financial Market Conditions (Inter-agency WG), operating under the Presidential Council, was established by the Russian authorities to identify systemic risks in the financial system. The Inter-agency WG was mandated to monitor the stability of financial markets, systemically important financial institutions (SIFIs), the largest financial groups, the level of indebtedness of Russian state-owned companies and banks which received government support. It was also responsible for developing and proposing necessary legislation for the conduct of such monitoring, preparation of reports, and proposals for market development. Meanwhile, in February 2011 the CBR created a Financial Stability Department (FSD) to undertake systemic risk analysis and develop possible measures to address these risks.

The FSAP welcomed the steps taken by the authorities to develop institutional mechanisms for systemic risk monitoring and management, noting the importance of ensuring close cooperation and information exchange between all supervisory agencies, the government and the DIA. It also indicated that the CBR should assume a leading role in the design and implementation of macroprudential policy, and recommended that the authorities pursue efforts to ensure effective macroprudential policy oversight.

Although the establishment of the Inter-agency WG enhanced coordination of macroprudential policies, certain weaknesses in its functioning, stemming from the membership structure and lack of focus,[7] prompted the government to disband it in 2012. In its place, the Russian Government issued a decree in July 2013 creating the FSC. In the same month, a comprehensive amendment[8] to the CBR Law merged the Federal Service for Financial Markets (FSFM), which had been the authority responsible for the regulation and supervision of non-bank financial institutions, into the CBR. This amendment, which made the CBR the single financial market regulator in Russia, also gave it an explicit financial stability mandate; previously, financial stability was an implicit objective of both the CBR and the FSFM. In particular, the revised CBR Law provides it with powers to monitor the financial system, identify risks to financial stability, and develop measures to address them.

This section examines the institutional arrangements underpinning the macroprudential policy framework, as well as the selection and use of specific tools by the authorities to address risks to financial stability emanating from rapid consumer lending growth.

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[7] In particular, the mandate of some of its member institutions was only very indirectly related to financial stability issues (e.g. RosFinMonitoring that was responsible for money laundering and fraud issues, and the Federal Anti-Monopoly Service for competition issues), while meetings of the Inter-agency WG were held infrequently and the discussions of issues were quite general.

[8] Federal Law No. 251-FZ of 23 July 2013 amended the Federal Law 86-FZ of 10 July 2002 "On the Central Bank of the Russian Federation (Bank of Russia)".

Steps taken and actions planned

Institutional arrangements: The two bodies involved in macroprudential policy in Russia are the CBR and the FSC. In terms of their respective roles and responsibilities, the CBR has the legal mandate and most of the tools required for safeguarding financial stability, while the FSC is an inter-agency body with solely an advisory role, established to create a formal platform for exchanging views and ensuring effective coordination among different authorities that have stakes in financial stability.

According to the revised CBR Law, which includes a chapter entitled "Development of Russian Financial Market and Ensuring its Stability", the CBR is required to:

- elaborate and pursue, in collaboration with the government, the policy of developing and ensuring the stable functioning of the Russian financial market;
- publish at least twice a year the Financial Stability Report (FSR);
- monitor the Russian financial market, including for the purpose of detecting situations endangering financial stability; and
- elaborate measures aimed at reducing threats to financial stability.

The CBR exercises its financial stability mandate by continuously analysing systemic risks and developing measures to address them. Within the CBR, most of this work is carried out by the FSD[9] with input from various other departments, including the Banking Supervision Department, the Systemically Important Banks Supervision Department[10] and the Non-credit Financial Institutions' Statements Collection and Processing Department. The Director of the FSD is a permanent member of the specialised committees (Banking Supervision, Monetary Policy, Financial Supervision) of the CBR. In order to further develop the macroprudential policy function, the CBR created in November 2014 a high-level internal Financial Stability Committee (FSCom). Its responsibilities include: (1) assessment and analysis of systemic risks and the stability of the financial system; (2) assessment and analysis of the financial sustainability of systemically important financial market infrastructures (FMI); (3) assessment and analysis of the financial soundness of the largest non-financial institutions, their financial risks and the impact of these risks on the banking system and financial markets; and (4) review of the draft FSR.

The FSCom, which will meet at least on a quarterly basis, is chaired by the CBR Governor and will comprise First Deputy Governors and other senior officials responsible for monetary policy, financial stability, banking supervision and financial market supervision. It will take decisions on financial stability matters and make recommendations to the Board of Directors (including on the introduction and calibration of macroprudential tools) and to the specialised

[9] There are 4 divisions within the FSD: Macroprudential Analysis Division, Macroprudential Policy Division, Methodology of Regulation and Supervision of Systematically Important Financial Market Infrastructures Division and the Analysis of Systemic Risks of Non-credit Financial Institutions Division.

[10] The Systemically Important Banks Supervision Department was established in October 2013 and is responsible for direct supervision of the largest Russian banks and banking groups.

committees of the CBR. Its decisions will be based on a simple majority vote, with the Chair exercising the casting vote. Technical assistance to the FSCom will be provided by the FSD.

In terms of accountability, the CBR is legally independent[11] but accountable to the lower house of the Russian Parliament (State Duma).[12] Moreover, the CBR's activities are reviewed regularly by the National Financial Board (NFB),[13] a collegiate body of the CBR.

According to the 2013 Government Decree[14] that created the FSC, its objectives are to:

- assess the condition of the global economy and the respective risks;
- analyse conditions and assess systemic risks of financial and commodities markets;
- assess CBR proposals on the methodology for identification of SIFIs and their list;
- review methodologies for identification and assessment of systemic risks;
- assess the level of systemic risks and threats to financial stability; and
- develop proposals on measures to restore financial stability.

The FSC has the authority to provide the CBR and other official bodies with recommendations concerning financial stability monitoring and measures to address risks as well as to request information on issues related to its objectives. The composition of the FSC is approved by the government and appointments are not linked to official positions. It is chaired by the Minister of Finance and, as of September 2014, was comprised of seventeen members, as follows: four representatives (in addition to the Minister) from the MoF; three from the CBR;[15] four from the Ministry of Economic Development; one from the Executive Office of the President; two from the Central Office of the Government; one from the DIA; and one from the Federation Council (upper house of the Russian Parliament). At the discretion of the FSC chairman, representatives from non-member institutions attend FSC meetings on an *ad-hoc* basis.

There are no permanent committee structures under the FSC, although temporary working groups can be established as needed (none have been established thus far). The FSC also does not have a permanent Secretariat to support and oversee work; administrative support to the FSC is provided by the MoF.

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[11] Article 1 of the CBR Law states that "The Bank of Russia shall fulfil the functions and exercise the powers stipulated by the Constitution of the Russian Federation and this Federal Law independently from other federal bodies of state power, the bodies of state power of the constituent entities of the Russian Federation and local self-government bodies."

[12] Article 5 of the CBR Law states that "The Bank of Russia shall be accountable to the State Duma of the Federal Assembly of the Russian Federation."

[13] The NFB is comprised of twelve members: two from the Council of the Federation, three from the State Duma, three appointed by the President and three by the Government and the Governor of the CBR.

[14] Government Decree of 5 July 2013 No. 571 "About National Council on Ensuring Financial Stability".

[15] The CBR is represented by the first deputy governors responsible for monetary policy, financial stability, and regulation and supervision of banks and non-bank financial institutions. The CBR Governor does not have a seat in the FSC.

The FSC is required to meet at least twice a year, although, since its inception, it has met on a quarterly basis. The agenda of the meetings is determined through input from member agencies and can cover both specific issues (e.g. systemic risks stemming from the debt burden of the corporate sector and potential policy measures) and more general issues (e.g. financial stability concerns in the face of worsening external conditions). In each meeting the CBR representatives make a presentation on the current state of the financial system and systemic risks, while the government representatives make presentations on the evolution of macroeconomic and fiscal variables. Decisions of the FSC are taken by consensus and are recorded in protocols signed by members. These protocols are not publicly communicated and, the FSC does not report to any authority, although the regulation governing its activities and its membership structure is determined by the government.

As an advisory body, the FSC can make recommendations to its member institutions. However, these recommendations, which can relate to the use of certain macroprudential instruments, are not subject to any comply-or-explain mechanism. Despite their non-binding nature, FSC recommendations were acted upon by members on several occasions in the past. For example, on the advice of the FSC, the CBR enhanced the monitoring of risks from external debt financing of the corporate sector by launching a regular survey of the 50 largest companies in Russia.

To improve the efficiency of the FSC, amendments to the decree establishing it are being considered. These include the possibility of providing the CBR and the Ministry of Economic Development with additional seats, and improving the decision making process by moving from consensus to majority voting while at the same time recording the opinions of dissenting members in the final protocols. The authorities have not provided a timeline for the amendments, but state that any change in the voting procedures will be accompanied by adjustments to the membership structure to ensure effective decision making.

Communication: The FSC does not publish any information related to its activities, meetings or recommendations. The authorities are of the view that disclosing information about discussions within the FSC may negatively impact market sentiment and affect the credibility of member institutions, particularly if there are differing views on particular policies.

The semi-annual FSR is the CBR's main communication tool for financial stability and macroprudential policy.[16] It presents information on global economic and financial developments and their impact on the Russian financial system; financial conditions in the real sector; risks in the banking sector; and the financial condition of non-bank financial entities.

In addition to the FSR, all macroprudential policy measures are communicated to the public via press releases and are published in a CBR magazine entitled "Vestnik Banka Rossii" (Reporter of the Bank of Russia). The CBR's annual report also contains information on measures taken to maintain financial stability, while the Money Market Review provides information on systemic risk developments.

[16] See http://www.cbr.ru/Eng/publ/?PrtId=stability_e.

Systemic risk monitoring: The CBR is authorised to collect a comprehensive set of data from financial institutions; however, it lacks formal powers to collect information from non-financial firms. The integration of the FSMS into the CBR has improved data availability for systemic risk surveillance by enabling the CBR to obtain data directly from non-bank financial institutions through mandatory reporting forms and voluntary surveys. Reporting forms are updated and expanded as necessary.[17] Regular data flow is supplemented by surveys[18] conducted on both a regular and *ad-hoc* basis. In order to further improve the CBR's ability to conduct systemic risk analysis, a new law that will be effective from March 2015 will allow the CBR to gain access to more granular information of borrowers' credit histories, including their total indebtedness and historical performance.

The FSC is not involved in any data collection efforts and there are currently no formal arrangements for data sharing between the CBR and other members of the FSC.

Using the data at its disposal, the CBR monitors and analyses systemic risks of the banking sector, non-credit financial organisations and the corporate sector. It monitors various indicators (and their forecasts) to capture the time dimension of systemic risk.[19] As for the structural dimension, the CBR monitors linkages between financial institutions on a daily basis by applying network analysis to data obtained from banks on their money market operations. It also measures probabilities of distress of financial institutions using market information, such as equity prices and credit default swap spreads. However, the use of such data is limited since only a few banks have tradable securities and their liquidity is often insufficient. The CBR also uses market-based indicators (albeit limited to a narrow range of instruments) to measure financial institutions' individual contributions to systemic risk and to identify structural shifts in domestic market volatility and overall levels of systemic risk.

The CBR carries out annual stress tests of the banking sector using both top-down and bottom-up approaches. In the former, a CBR model is used to assess the impact of macroeconomic parameters (e.g. economic growth, exchange rate, inflation, real household income etc.) on the performance of the banking sector. As regards the bottom-up approach, the impact on individual banks' solvency of specific shocks and scenarios is estimated using data from large banks and certain lending segments (e.g. mortgage market). When selecting scenarios for stress tests, the CBR considers two main parameters: (i) annual average oil price during the stress period; and (ii) GDP growth rate. The scenarios chosen as final are those that contain parameters which lie in the tails of the probability distribution. The results of these stress tests are used as an input for macroprudential policy proposals.

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[17] For example, to monitor the implementation of new macroprudential measures to curb the growth of high-interest consumer lending, a special section was added in 2013 to banks' reporting forms.

[18] Surveys are sent to credit institutions, non-bank financial institutions (microfinance and insurance companies) and the largest non-financial firms.

[19] These include credit growth rates (both to the corporate and household sectors), credit-to-gross domestic product (GDP) gap, property prices, household debt to GDP/income ratios, non-performing loan ratios, commodity prices and effective interest rates on loans by sectors and maturities.

The analysis and results of the CBR's systemic risk analysis are presented in the FSR and the Banking Supervision Report. They are also shared with the FSC through presentations for discussion during the meetings.

Macroprudential instruments: Most of the instruments at the disposal of the CBR for macroprudential purposes are microprudential in nature. Among other measures, the CBR has applied differentiated risk weights for certain asset classes, adjusted loan loss provisioning requirements for bank loans and increased reserve requirements. To address the structural dimension of systemic risk, the CBR recently adopted a framework to identify D-SIBs[20] and, subject to a transition period, will apply to those firms[21] a systemic capital surcharge (in the form of an extended capital conservation buffer) starting from 1 January 2016.

Currently, the CBR does not have the legal power to impose LTV or debt-to-income limits on banks' lending activities. In spite of this, the CBR has recently used these ratios as a basis for applying different loan loss provisioning requirements and risk weights on various types of loans (see below). The CBR also considers the countercyclical capital buffer in Basel III as another important macroprudential instrument, and legislative work is underway to authorise its use by the CBR.

In calibrating and deploying macroprudential instruments, the CBR uses a discretionary approach with no formal triggers or explicit rules for their activation. Decisions to employ a particular tool are taken on a case-by-case basis and are driven to a large extent by scenario analyses indicating expected losses that a lack of action may cause on the financial system. Depending on the measure and instrument being considered, the Banking Supervision Committee, Monetary Policy Committee or Financial Supervision Committee would present a proposal to the CBR's Board of Directors which then makes a final decision; in some cases, the proposal may be prepared or reviewed by the FSD. Currently, the process for assessing the likely impact of a new policy measure is informal. However, a regulation is being developed that prescribes the methodology to assess the potential impact of a proposed policy measure prior to it being adopted. Once implemented, the effectiveness of the tool will be assessed by the CBR on a quarterly basis.

Application of instruments for macroprudential purposes: The CBR employed a number of tools for macroprudential purposes even prior to the global financial crisis and without a formal financial stability mandate or macroprudential framework. The measures taken before and during the crisis were predominantly intended to contain external vulnerabilities and to stem the risks of destabilising capital flows, while most of the measures taken following the crisis have been aimed at mitigating systemic risks (see Table 1).

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[20] CBR Direction No. 3174-U of 16 January 2014 describes the identification methodology for D-SIBs. The methodology is based on the quantitative indicators of the BCBS's D-SIB framework (size, interconnectedness, volume of household deposits) and supervisory judgment.

[21] The CBR announced in September 2014 that 19 banks had been designated as D-SIBs; the list of these institutions has not yet been published.

Table 1: Measures taken by the CBR

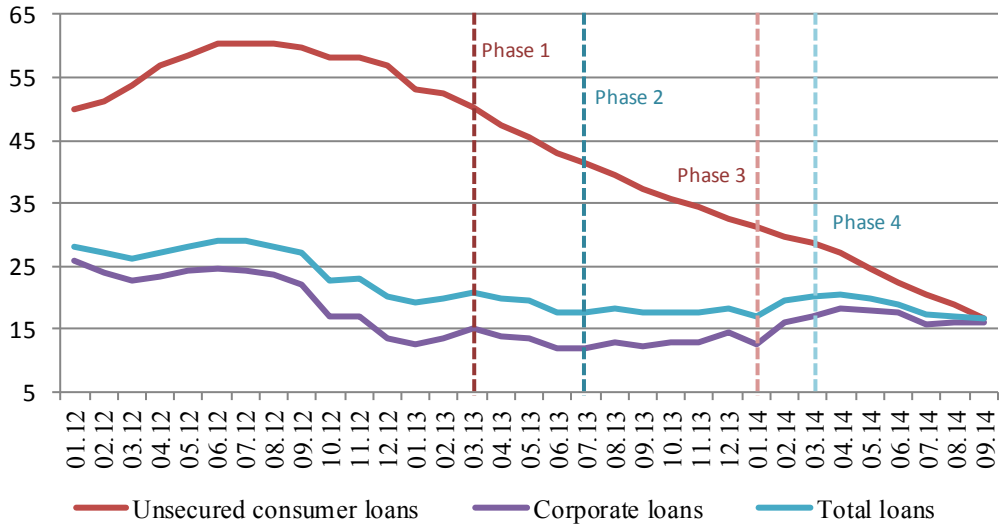
Policy instrument	When?	What?	Objective
Reserve requirements	Mid-2007	Increase in reserve requirements for liabilities to non-residents	To mitigate risks arising from increasing foreign liabilities of banks and growth in foreign currency loans obtained by unhedged borrowers.
Interest rates	2008-10	Increase (and subsequently reduction) of refinancing rate	To contain capital flows
Loan loss provisioning requirements	During the crisis (2008-2010)	Relaxation of provisioning requirements	To stimulate lending and support banks' profitability
Collateral rules	During the crisis	Reduction of haircuts on collateral for CBR lending to banks	To mitigate risks arising from systemic liquidity shortage
Loan loss provisioning requirements	2013-14	Higher loan loss provisioning requirements for unsecured consumer loans (depending on loan status and currency)	To mitigate risks arising from rapid growth of unsecured consumer loans
Risk weights	2012-13	Higher risk weights for non-core assets and foreign currency retail loans. Risk weights for loans to unrated banks in low risk countries were also raised in January 2013.	To increase the resiliency of the sector by improving banks' foreign exchange and liquidity risk profiles
Risk weights	2013-14	Higher risk weights on unsecured consumer loans (depending on effective interest rate and currency)	To mitigate risks arising from rapid growth of unsecured consumer loans

The Russian authorities identified risks to financial stability from the rapid growth in unsecured consumer lending that began in 2011. The annual growth rate of such lending exceeded 60% by mid-2012, while effective interest rates in this lending segment were in excess of 50% at a time when inflation was around 7%. While rapid loan growth and high interest rates had a direct impact on the level of credit risk in this sector, there was also a distortionary impact on the housing and corporate loan markets. Banks specialising in these segments found it increasingly difficult to attract deposits to finance their low-margin lending activities in the face of fierce competition from banks specialising in high-margin unsecured consumer lending. In this environment and with the knowledge that monetary tightening would not be effective in cooling the consumer lending segment due to the insensitive nature of any rate hikes, the CBR begun taking policy measures in 2013. As a first step, loan loss provisioning requirements for unsecured consumer loans were raised in April 2013. Then, in July 2013, risk weights on these loans were differentiated based on the effective interest rate and currency; these measures were further strengthened in 2014. Finally, with the adoption of a new law in December 2013,[22] caps were imposed on the effective interest rate of various

[22] Federal Law No. 353-FZ of 21 December 2013 on Consumer Credit (Loan).

consumer loan products, with the CBR responsible for calculating the relevant market average rates upon which the caps are based and being granted authority to temporarily suspend these caps.[23] The CBR notes that measures to slow consumer loan growth were based on the results of quantitative impact studies and in light of the pace of banking sector asset growth. As a result of the measures taken, the annual growth rate of unsecured consumer loans decreased from 60% in June 2012 to 17% in September 2014 (see Figure 1).

Figure 1: Evolution of unsecured consumer loan growth rates and timing of measures taken (annual growth rate in percent)



Phase 1: Introduction of higher provisioning requirements for unsecured consumer loans (March 2013)
Phase 2: Introduction of higher risk weights for loans differentiated by currency and effective interest rates (July 2013)
Phase 3: Further increase of minimum provisioning requirements for unsecured consumer loans (January 2014)
Phase 4: Further increase of risk weights for loans with effective interest rates above 45% (March 2014)

Lessons learned and issues to be addressed

The Russian authorities have made good progress in strengthening the institutional framework for financial stability, which is a necessary prerequisite to address the FSAP recommendation for effective macroprudential policy oversight. The CBR has been given an explicit financial stability mandate and is actively working to enhance its systemic risk monitoring capacity and to expand the range of macroprudential tools at its disposal. Those tools have been deployed, in an innovative manner, to stem the rapid growth in unsecured consumer lending in recent years, which had given rise to financial stability concerns. In November 2014, the CBR established an internal Financial Stability Committee (FSCom), chaired by the Governor, to formalise and further strengthen macroprudential policy decision making. An inter-agency FSC has also been established as an advisory body on financial

[23] The caps will set a ceiling on the maximum amount by which an effective loan rate can exceed the average for that particular loan type.

stability issues, and the authorities note that it has served as a useful platform for discussions on these issues.

In spite of these accomplishments, the macroprudential policy framework agenda remains unfinished. The authorities are aware that further steps to flesh out and operationalise the framework are necessary and, in this context, it would be useful to focus their efforts on the following issues: strengthening and clarifying institutional arrangements; enhancing communication by the FSC; strengthening the analytics underpinning systemic risk assessments; and expanding the macroprudential policy toolkit.

Roles and responsibilities of the FSC: It would be useful to further clarify the institutional set-up for macroprudential policy, in particular the role and responsibilities of the FSC. At present, the CBR has an explicit financial stability mandate provided in legislation, while the FSC (established by Government Decree) serves as an advisory body for inter-agency discussions on financial stability matters. It is not clear how the FSC discharges its mandate or whether it (as currently constituted) has the capacity to undertake the tasks required to fulfil this mandate. In particular, some of the FSC's mandated objectives seem to duplicate those of the CBR; for example, the review of methodologies for identifying and assessing systemic risks or the development of proposals on measures to restore financial stability. The participation in the FSC of representatives from the Ministry of Economic Development and other parts of the government points to a broader and more developmental role, which could be beneficial in balancing the objectives of growth and financial stability and in providing a macroeconomic perspective to the CBR's efforts to ensure the stable functioning of the financial system. In order to do so, however, the FSC's mandate may need to be reviewed so that it can better add value to and support the CBR's financial stability mandate without impinging on its independence. This could include, for example, providing input to the CBR on systemic risk assessments, advising on possible policy measures to address emerging financial stability risks (particularly from a macroeconomic perspective), and evaluating the broader economic effects of the macroprudential measures adopted by the CBR.

- ***<u>Recommendation 1</u>: The authorities should clarify the role and responsibilities of the FSC in the macroprudential policy framework in order to eliminate potential overlaps in mandates and responsibilities with the CBR.***

Institutional and operating arrangements of the FSC: The functioning of the FSC could also be strengthened to enhance its effectiveness. The FSC is chaired by the Minister of Finance and has broad and diverse membership (17 members), most of whom are government officials. Membership is not based upon designated positions or levels of seniority within the respective institutions. The FSC has no permanent committee structures and Secretariat support on administrative matters is provided by the MoF. Furthermore, the FSC's deliberations are based on consensus and, given the absence of a formal requirement to 'act or explain', its recommendations to official bodies are non-binding.

The authorities are currently considering amendments to the Decree that established the FSC. In that context, it may be desirable to adopt some of the good practices and features of similar

bodies in other countries.[24] These would include ensuring the participation of individuals with adequate seniority within their respective institutions in its deliberations; introducing a formal 'comply or explain' mechanism for institutions that are the subject of its recommendations; developing organisational structures to carry out tasks (e.g. a standing Secretariat or working group); and adopting majority voting to ensure the timely adoption of any decisions. Moreover, consistent with the aforementioned objectives of the FSC and in recognition of the CBR's explicit financial stability mandate and its technical expertise on prudential matters, consideration should be given to upgrading the central bank's role within the FSC. This may involve, for example, expanding the CBR's participation in the Council (and linking its membership to official positions), enhancing its voting rights (particularly on matters that relate to the CBR's financial stability mandate), or assigning to it the sole responsibility of proposing warnings and recommendations (or the power to veto them).

Communication on issues relating to financial stability emanate only from the CBR at present. By contrast, the FSC does not have a separate communication policy and a summary of its discussions and any decisions (including warnings or recommendations) are not published. There are good reasons for keeping the deliberations confidential and avoid publishing information that may cause adverse market effects. On the other hand, public communication, as a form of 'soft' intervention, is a critical part of the toolkit of macroprudential bodies (in terms of providing signals to financial market participants) and forms an important part of their accountability – particularly since the FSC does not report to any authority. This becomes even more important if the FSC is given formal comply-or-explain recommendation powers. The FSC could therefore explore options to publish its activities, such as: publishing minutes of its discussions with a time lag; issuing a press release with a summary of the topics discussed and decisions reached (without recording individual member views); or publishing an annual report summarising its activities, recommendations and their follow-up by member institutions.

- ***Recommendation 2*: In order to enhance the effectiveness of the FSC, the authorities should consider: (1) upgrading the role of the CBR in the FSC, given its financial stability mandate and technical expertise on prudential matters; (2) developing formal structures to carry out its mandated tasks; (3) providing the FSC with the power to issue recommendations to public sector authorities on a comply-or-explain basis; (4) adopting a majority voting system for its decisions; and (5) exploring options to publicly communicate its deliberations and decisions.**

Macroprudential function within CBR: As previously mentioned, the CBR has a dedicated department (FSD) responsible for assessing – with input from other departments – financial stability risks. The recent creation of the FSCom is a useful step in arriving at a collective institutional view of these risks and how to address them. It is important that the Governor is chairing this Committee given the fact that prudential tools come under the responsibility of

[24] See, for example, the section on macroprudential policy frameworks in the FSB peer reviews of Germany (http://www.financialstabilityboard.org/wp-content/uploads/r_140409.pdf), Netherlands (http://www.financialstabilityboard.org/wp-content/uploads/Netherlands-peer-review-report.pdf), the UK (http://www.financialstabilityboard.org/wp-content/uploads/r_130910.pdf) and the US (http://www.financialstabilityboard.org/wp-content/uploads/r_130827.pdf).

various departments and given the links between monetary and macroprudential policies. The FSCom's current mandate is the assessment and analysis of systemic risks, the financial sustainability of systemically important FMI, the financial soundness and risks of large non-financial institutions, and review of the draft FSR. Drawing on good practices in other countries, the FSCom may usefully serve as a mechanism to develop and oversee the systemic risk framework, assess financial stability risks (by combining the micro and macroprudential perspectives) and coordinate macroprudential policies. To this end, its mandate could be expanded to include consultation with relevant departments and committees within CBR on policy measures for domestic systemically important banks (D-SIBs) and non-bank financial institutions, and the development of proposals on the use of tools for macroprudential purposes (e.g. countercyclical capital buffer).

- ***Recommendation 3*: The CBR should review the mandate of its Financial Stability Committee to ensure that it addresses all aspects of macroprudential policy decision making, including coordination on policy measures for systemically important financial institutions and the development of proposals on the use of tools for macroprudential purposes.**

***Analytics*:** The CBR has continued to improve the range and quality of the information it receives for systemic risk analysis. Data flow and analytics are critical to systemic risk identification, and the efforts initiated by CBR in recent years evidence the technical competence of its staff. The FSRs have done a good job describing this work, detailing the results of stress tests, identified vulnerabilities and measures taken to address them. The coverage has become more analytical and the use of advanced tools (e.g. network analysis to assess interconnectedness) has improved the quality and usefulness of the content.

Going forward, it would be useful for systemic risk analysis to become even more policy-oriented so that it can support decision-making by the CBR for macroprudential purposes. Drawing on experience from the IMF and central banks in other countries, this may include the incorporation of market intelligence and risk assessments in the design of stress test scenarios; the establishment of a 'heat map' prioritising systemic risks in terms of their significance (i.e. likelihood and impact on the financial system/economy) or immediacy; the identification and analysis of transmission channels via which identified risks may be propagated to the financial system and economy at-large; the identification of other potentially systemically important risks to monitor; the creation of a comprehensive set of standardised financial market indicators ('dashboard'); and the inclusion of suggestions for possible action (whether in terms of further analysis/data collection or policy measures). It may also be useful for the CBR to develop a framework for monitoring and assessing the effectiveness of macroprudential policy responses. The creation of the FSCom provides a good opportunity for the CBR to further expand its work in this area[25] and to enhance the coverage of the FSR by incorporating some of these analyses.

[25] Before the establishment of the FSCom, the FSD regularly presented a report to the Banking Supervision Committee that contained information on risk transmission channels, prioritisation of risks and the effectiveness of measures undertaken by the CBR. This report will now be submitted to the FSCom.

- ***Recommendation 4*: The CBR should enhance its systemic risk analysis to identify and prioritise risks so that it becomes more policy-oriented and can support decision-making for macroprudential purposes.**

Macroprudential tools: The CBR has used a range of tools for macroprudential purposes in recent years. Some of these tools, which are mostly microprudential in nature, have been innovative and tailored to the Russian financial system. The most notable among these is the use of differential risk weights based on the level of interest rates of consumer loans. This was based on the CBR's assessment that consumer credit rates had ballooned and because banks involved in such lending were not sensitive to policy rates, monetary measures would not have quelled the rise in rates or the growth in credit to this segment. The measure succeeded in reducing the growth in consumer credit and also limiting interest rates charged on such loans.

Thus far, the CBR has deployed these tools by imaginatively tweaking its existing regulatory toolkit and requesting legislative authority when the tool does not exist, as in the case of countercyclical buffers and LTV limits. However, a framework that requires legal amendments or fresh legislation to authorise the use of necessary tools or measures may hamper prompt action during a crisis. The CBR Law lists the instruments and tools for monetary policy and supervision and regulation in the respective chapters. The new chapter on Financial Stability in the Law does not mention any specific tools. While some macroprudential measures may involve the use of microprudential tools for which CBR has adequate powers derived from the CBR Law, any new tool (e.g. countercyclical capital buffer, LTV ratio etc.) needs specific legislation. The CBR is considering whether to request these powers. As experience in the use of the tools grows, it might be appropriate to develop a comprehensive macroprudential toolkit on an *ex-ante* basis with the necessary legal foundation to ensure the timely application of tools when necessary.

- ***Recommendation 5*: The authorities should consider amending the CBR Law to provide an adequate legal foundation for the development and use of a comprehensive macroprudential toolkit on an ex-ante basis.**

3. Bank resolution framework

Background

The Russian regime for managing failing banks was reformed during the financial crisis. Federal Law Nº 175-FZ of 27 October 2008 introduced a number of tools to enable the CBR and the DIA to intervene in order to prevent the failure of those banks that may pose a threat to financial stability (hereafter referred to as 'systemic banks'). Where there was evidence of the unstable financial position of a systemic bank, this law empowered the DIA, at the request of the CBR, to take control of the bank as official administrator and to use funds to recapitalise it, assist third party acquisitions, purchase assets from the bank or provide open

bank assistance to restore normal operations.[26] This law was temporary ('2008 Temporary Law'): while initially set to expire at end-2011, it was extended to 31 December 2014.

Other banks were not covered by the 2008 Temporary Law and continued to be subject to the regime under Federal Law Nº 40-FZ of 25 February 1999 ('General Bank Insolvency Law'). The General Bank Insolvency Law did not permit the use of DIA or other government financial support in order to assist the rehabilitation of non-systemic failing banks and, according to the FSAP, only allowed the CBR to intervene and require (or impose) insolvency prevention measures at a late stage in the financial deterioration of a bank.

The FSAP noted that despite the absence of formalised arrangements, the Russian authorities had cooperated effectively in their response to the crisis. The FSAP also found, however, that while the resolution framework functioned well during the crisis, it risked exacerbating moral hazard as it provided for a limited set of resolution tools with late triggers for non-systemic banks and a wide range of tools with early triggers for systemic banks. It recommended that, instead of making the 2008 Temporary Law permanent, the authorities should design a new permanent bank resolution law with a unified administration regime for all banks (systemic or otherwise). That regime should be based on a prompt remedial action framework that would allow the CBR to appoint the DIA at an early stage as official administrator to all banks, with a broad authority to assume all powers of decision-making bodies of the bank and override the preemption rights of existing shareholders. To mitigate moral hazard, it also recommended that open-bank assistance tools – such as loans to investors, recapitalisation using public funds and nationalisation – should be restricted to systemic situations and their use should be subject to a decision by the government.

This section reviews the progress made by the authorities to address those FSAP recommendations drawing on available international guidance in this area, particularly the FSB *Key Attributes of Effective Resolution Regimes for Financial Institutions* (*Key Attributes*).[27] It also examines the funding of resolution, information sharing and cooperation between relevant agencies, and recovery and resolution planning requirements. The section does not analyse other elements of the crisis management framework, such as the design of the deposit insurance scheme or systemic liquidity arrangements.

Steps taken and actions planned

Reforms to the resolution regime: A new draft federal law Nº 612004-6 ('Draft Law') was sent to the State Duma in September 2014. That Law was still in draft during the period of peer review analysis, and is therefore referred to below as the 'Draft Law'.[28] The Draft Law

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[26] According to the FSAP, the DIA and the CBR used these powers to successfully resolve 18 banks between October 2008 and April 2011.

[27] See http://www.financialstabilityboard.org/wp-content/uploads/r_141015.pdf.

[28] Subsequent to the peer review analysis and discussions with the authorities, the Draft Law was adopted by the State Duma and signed by the President of the Russian Federation as Federal Law Nº 432-FZ of 22 December 2014 "On Amendments to Certain Legislative Acts of the Russian Federation and Repeal of Certain Legislative Acts (Provisions of Legislative Acts) of the Russian Federation". It is available at http://publication.pravo.gov.ru/Document/View/0001201412230059?index=2&rangeSize=1&filterid=225698f1-cfbc-4e42-9caa-32f9f7403211&back=False.

revokes and replaces the 1999 General Bank Insolvency Law and the 2008 Temporary Law, and it consolidates the provisions applicable to financial institutions contained in Federal Law Nº 127-FZ of 26 October 2002 ('General Bankruptcy Law'). The review team discussed the contents of the Draft Law only at a general level with the CBR and the MoF.[29] Observations on some of its features are included below.

Under the framework examined by the peer review (see Box 1), different sets of powers under different laws are available to deal with a failing bank, depending on whether the failure of that bank is determined to have a systemic impact. That determination is made by the CBR at the time when intervention is being contemplated based on the provisions of the 2008 Temporary Law; namely, if the bank's unstable financial situation is deemed to threaten the stability of the banking system and the interests of bank depositors and creditors.

Guidance on the circumstances in which the CBR might make this determination is set out in a 2008 CBR Direction.[30] In applying that guidance, the CBR takes into account the significance of the failing bank to the Russian Federation or the economic and social development of a certain region, its overall deposit market share and extent to which it is involved in financing the real economy, and the likelihood of attracting investors (other than the DIA) to participate in these measures. In practice, the CBR has great flexibility in this determination and can base its decision on a range of considerations relating to the general context, reasons for the failure (e.g. solvency or compliance problems) and its likely impact. Banks that are similar in size may therefore be subject to a different determination about the systemic impact of their failure.[31] In the discussion below, banks whose failure is determined to have a systemic impact are referred to as 'systemic banks'; and banks whose failure is not determined as systemic are referred to as 'non-systemic banks'.

Before a determination is made, representatives of the CBR and DIA carry out a joint inspection of the bank in which the assets, liabilities and financial shortfall are evaluated. Where the CBR assesses that the instability of a bank constitutes a threat to financial stability, it may propose that the DIA participate in a 'bankruptcy prevention measure' under the 2008 Temporary Law. The DIA has the right to refuse to participate. If the DIA agrees, the decision regarding the measures that will be adopted is made jointly by the CBR and the DIA on the basis of the examination that they have conducted.[32] For systemic banks, the CBR and DIA may use a wide range of rehabilitation tools available under the 2008 Temporary Law,

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[29] The authorities indicate that no major changes were made to the Draft Law during the approval process.

[30] CBR Direction of 29.10.2008 No 2106-U "On the procedure for the Bank of Russia to take decisions on sending a proposal to the State Corporation 'Deposit Insurance Agency' for participation in preventing the bankruptcy of a bank and approval (endorsement) of a plan for the participation of the Deposit Insurance Agency in preventing the bankruptcy of a bank".

[31] The determination that a bank is systemic for resolution purposes is not the same as the identification of a bank by the CBR as a D-SIB, based on the BCBS framework, for purposes of higher loss absorbency and intensified supervision. For example, a bank with a substantial presence in a single region of the Russian Federation may not be a D-SIB but, since its failure could have a significant impact on the regional economy, it may be considered 'systemic' for purposes of permitting the CBR and DIA to apply the range of resolution tools under the 2008 Temporary Law.

[32] The DIA's Board of Directors, which makes this decision, comprises 13 members as follows: 5 representatives of the CBR, 7 representatives of the government and the chief officer of the DIA.

including the provision of financial assistance either to the bank itself (coupled with the acquisition by the DIA of a controlling equity interest) or to another entity that acquires the bank, or all or part of its assets and liabilities (see Box 1). The measures to be adopted are set out in a rehabilitation plan that is drawn up by the DIA and approved by the CBR.

Where the preferred rehabilitation approach involves a private sector purchaser, the DIA conducts a tender during which potential investors submit proposals for acquiring some or all of the failing bank's assets and liabilities or of a controlling ownership stake. Typically, such a proposal entails a loan from the DIA – financed by CBR – to the acquirer or to the failing bank (see below). Where more than one applicant participates in a tender, the investor that requires the least amount of funds from the DIA under its proposal (given a fixed interest rate and a pre-set term for repayment) is generally chosen.

For non-systemic banks, only the measures under the General Bank Insolvency Law are available. These are limited to the appointment of a provisional administrator or a requirement that the management take measures to rehabilitate the bank or reorganise it through merger with or takeover by another institution.[33]

Box 1: Main Features of the Russian Resolution Regime[34]

Systemic banks

Where a bank is considered to be systemic, the bankruptcy prevention tools under the 2008 Temporary Law are available. These allow the DIA to:

- acquire a controlling equity interest in and provide financial assistance to the troubled bank;
- conduct purchase and assumption transactions, and provide financial assistance to other banks or third party investors that acquire shares or assets and liabilities of the failing bank;
- organise a tender for the sale of assets given as guarantee for the bank's obligations; and
- sell all or part of the bank's assets and liabilities, regardless of the consent from creditors.

In addition, the CBR has the power to:

- appoint the DIA as temporary administrator;
- impose losses on the shareholders by reducing the bank's capital to reflect its net worth or, if the net worth is negative, to one rouble; and
- impose a moratorium of up to three months on the enforcement of creditors' claims against the bank.

The measures taken will be based on a rehabilitation plan for the bank that is approved by the CBR, and regular reports will be submitted to the CBR on its implementation. As temporary administrator, the DIA has extensive powers, including powers to reorganise the bank, reduce or increase its capital, transfer assets and liabilities, purchase bank assets, repudiate contracts and take a decision to liquidate the bank.

Participation by the DIA in bankruptcy prevention measures under the 2008 Temporary Law is contingent on its assessment that:

- the amount of the assistance needed falls within the limits specified in the DIA's regulations; and
- the bank's total unencumbered assets are worth more than its retail deposits.

If these conditions are not met, the DIA may refuse to participate in the bankruptcy prevention measures under the 2008 Temporary Law, and the bank will be dealt with under the General Bank Insolvency Law.

[33] Those categories of measures may include: recapitalisation by existing shareholders or new investors; restructuring of assets and liabilities; and changes to the organisational structure. The CBR has the power to require the management to take such measures if they are not adopted by a bank at its own initiative.

[34] The resolution regime described here is the one that was in place at the time of the peer review analysis, which was carried out before the adoption of the 'Draft Law'.

Non-systemic banks

Failing non-systemic banks are dealt with under the General Bank Insolvency Law. This Law covers both bankruptcy prevention measures and the conduct of insolvency and liquidation proceedings in the event that bankruptcy cannot be prevented. Prior to withdrawing the licence of a non-systemic bank, the CBR must take one of the following bankruptcy prevention measures:

- require the bank's management to take one or more financial rehabilitation measures (such as raising equity or other funds to restore capital, disposing of assets or reducing liabilities);
- appoint a special management body, headed by a CBR employee, to undertake the provisional administration of the bank with a remit to take financial rehabilitation measures; or
- require the bank's management to reorganise the bank through a merger or takeover.

If such measures fail or are not taken by the bank's management, the CBR will withdraw the banking license and petition the court for its insolvency. The DIA is appointed as administrator, and in that capacity will take the necessary measures to liquidate the bank, including the transfer of assets and liabilities to other institutions and pay-out of insured depositors. Since 2014, the DIA has been able to conduct purchase-and-assumption transactions for bank assets and liabilities before the CBR petitions for bankruptcy.

Alignment with the *Key Attributes*

As noted in the FSB's 2013 peer review report on resolution regimes,[35] the Russian regime lacks a number of elements specified in the *Key Attributes*. These include: resolution powers in relation to holding companies; powers to bridge institutions and to write down and convert unsecured liabilities (bail-in); powers, when imposing losses in resolution, to depart from equal treatment of creditors of the same class and an associated safeguard that creditors should not suffer greater losses in resolution than in liquidation; mechanisms for recovering public funds used in resolution from the firm, its creditors or the wider financial industry; requirements for recovery and resolution planning for all financial firms that could be systemic in failure; and powers to require firms to adopt changes to improve their resolvability.

Table 2: Use of bank revocation and rehabilitation processes in Russia (2011-14)

	2011	2012	2013	2014 (as of 1 September)
Number of banks whose license was revoked	18	22	32	55
Number of rehabilitated banks (under 2008 Temporary Law)				
- banks which started rehabilitation process in that year	1	0	2	7*
- banks which finished rehabilitation process in that year	5	1	2	3*
- banks which continued rehabilitation process in that year	7	6	6	10
Sources of financing for bank rehabilitation in that year (RUB billion):				
- CBR loans to DIA	295	0	9	184
- Property contribution	0	0	0	19
- Investors' own funds	0	0	0	3
- DIA fund	0	0	0	0

Source: CBR and DIA.

* *Includes one bank that underwent a purchase-and-assumption transaction.*

[35] See http://www.financialstabilityboard.org/wp-content/uploads/r_130411a.pdf.

The CBR and DIA have been extensively involved in bank revocation and rehabilitation processes in recent years (see Table 2). Between 2011 and August 2014, the CBR revoked 127 banking licenses. Bankruptcy prevention measures over this period were taken in connection with 10 banks (in only one of which a purchase-and-assumption transaction was used), and several of them are still undergoing rehabilitation. In the majority of cases, these banks were acquired by other (investor) banks with financing provided by the DIA.[36]

Over the last few years Russia has experienced a reduction in the number of banks as a result of the CBR's actions to revoke the licenses of banks that were financially weak or engaged in dubious operations. The large number of banks that have been subject to intervention reflects the current structure of the Russian banking system (see Box 2 and Annex 1). The system is highly concentrated, with state-owned banks controlling the majority of the relevant market. At the same time, however, there is a large number of small banks (the average asset size of banks whose licenses were revoked in 2013-14 was around RUB 5-10 billion).[37]

Box 2: Structure of the Russian Banking System

The Russian banking system accounted for 91% of total financial system assets (corresponding to 86% of GDP) at the end of 2013. Four of the five largest banks are state-owned, while the market share of state-owned banks (excluding banks that are indirectly controlled by the government) at the end of 2013 was 51.4%. The number of banks has been declining consistently over the past few years. As of January 2011, Russia had 1,012 banks, whereas in June 2014 that number had fallen to 888. As a result, concentration has increased, with the market share of the 5 largest banks rising from 47.7% (January 2011) to 53.8% (June 2014).

The table below shows how the market shares of banking system assets have evolved since 2012:

	January 1, 2012	January 1, 2014
State-owned banks:	50.2%	51.4%
Banks with foreign participation:	16.9%	15.3%
Largest private banks:[38]	27.5%	28.8%
Small banks:	5.4%	4.5%

Increased market concentration in recent years has been driven *inter alia* by the challenging economic environment and the CBR's ongoing process of consolidation and clean-up. The extensive coverage of personal deposits by the DIA, which covers 99% of retail deposits by number and 70% by value, has provided an important confidence backstop, and pay-outs to insured depositors have proceeded within a period of two weeks. The fact that state-owned banks have relatively cheap access to funding through household deposits and access to CBR liquidity lines may have put them in a better position to face the challenges faced by the banking system.[39]

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[36] In a few cases, other non-bank institutions were the investors in rehabilitated banks. Two banks are currently controlled directly by the DIA since no third-party investors were interested in acquiring them.

[37] By contrast, the average asset size of banks that were rehabilitated in 2013 and 2014 (until September) amounted to RUB 22 billion and 60 billion respectively.

[38] Of the 200 largest banks by total assets.

[39] See the July 2014 Article IV report (IMF Country Report No. 14/175, available at http://www.imf.org/external/pubs/ft/scr/2014/cr14175.pdf).

Prompt remedial action framework: Although steps have been taken to ensure early involvement by the DIA in decisions about how to manage a failing bank, the Draft Law does not fully address the FSAP recommendation for the creation of a prompt remedial action framework. The *Key Attributes* state that resolution regimes should provide for timely and early entry into resolution before a firm is balance-sheet insolvent and before all equity has been fully wiped out. The provisions in the 2008 Temporary Law appear to permit intervention at a sufficiently early stage, as envisaged by the *Key Attributes*. By contrast, the conditions for the adoption of bankruptcy prevention measures for non-systemic banks under the General Bank Insolvency Law are linked to solvency or liquidity conditions that are associated with insolvency or near insolvency.[40] By the time those conditions are met, the financial situation of the bank is likely to have deteriorated to such an extent that the chances of a successful rehabilitation may be diminished and the costs are likely to be higher. The conditions for intervention in non-systemic cases under the Draft Law do not appear to differ substantively from the regime in place at the time of the peer review analysis.

However, the Russian authorities also indicate that a new version of the CBR Instruction covering early supervisory intervention[41] is currently being prepared to give effect to the FSAP recommendation on prompt remedial action.

***Funding of rehabilitation measures*:** The FSAP highlighted concerns about the substantial reliance of the Russian resolution framework for systemic banks on taxpayer funds and the associated risks of moral hazard.

There is no statutory limit on the amount of funding that the DIA can provide to support measures under the 2008 Temporary Law. Rather, the amount is decided case-by-case by the CBR and the DIA based on a range of considerations including: the amount of losses incurred by the failing bank, as assessed by the DIA and the CBR during their joint inspection prior to intervention; the amount that the investor(s) chosen through the DIA tender procedure to participate in the rehabilitation would require to carry out the rehabilitation; and the analysis conducted by the CBR and the DIA to assess the cost effectiveness of the chosen rehabilitation strategy compared to other options.

The funding of a rehabilitation measure would typically entail the write-down or significant dilution of existing shareholders and a large loan from the DIA to the potential acquirer or to the failing institution for a period of up to 10 years at a rate (currently around 0.5%) that is significantly below the market rate. The loan is collateralised by the assets of the failing bank or other guarantees provided by investors. The intention is that, by the end of the term of the loan, the DIA is repaid and the acquired bank is fully recapitalised and sufficiently sound and viable to continue its operations.

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[40] Those conditions are: (i) repeated failure, over the preceding six months, to meet creditors' claims or make any other payments; (ii) failure to pay any obligations within three days from their due date owing to the unavailability or lack of funds; (iii) inability to prevent a capital reduction of more than 20% in relation to the highest capital amount of the preceding 12 months, together with a breach of any capital requirements imposed by the CBR; (iv) breach of CBR capital requirements; (v) breach by more than 10% of the CBR liquidity ratio; or (vi) reduction of capital to amounts lower than the minimum specified in the bank's constitution.

[41] CBR Instruction of 31.03.1997 No.59 on "Application of intervention measures in respect of banks".

In order to fund such a measure, the DIA may either: borrow funds from the CBR without collateral; use assets contributed from the federal budget;[42] or use its own funds contributed by way of deposit insurance premiums. As a rule, the DIA cannot use the latter option unless the cost of the measure would be less than the DIA would incur if the bank were liquidated and pay-outs made from the fund to insured depositors and the soundness of the deposit insurance fund would not be compromised.[43] As can be seen from Table 2, the majority of the DIA's financing for rehabilitation transactions since 2011 has been provided by the CBR in the form of loans. A small part of those transactions was financed using the asset contribution from the federal government, while private investors taking over failed banks contributed an even smaller amount. The DIA fund has not contributed to these transactions.

The Draft Law does not fundamentally change this mechanism of funding rehabilitation measures. The authorities believe that the current mechanism is efficient in terms of the costs to the public sector. They note, in particular, that prior to granting any loans the CBR and the DIA conduct a study regarding the cost-effectiveness of the rehabilitation measures that are to be funded and that the tender conducted by the DIA provides incentives to prospective investors to bid for the lowest loan amount in DIA funding.

The authorities also indicate that the risks of moral hazard are addressed in the Draft Law by making the use of public funds in rehabilitation measures conditional on the write-off of all claims held by shareholders against the failing bank. This includes both the write-down of existing equity and the write-off of debt claims that existing shareholders may have against the bank. The Draft Law also limits the severance pay for dismissed management and reinforces the powers of the DIA to pursue sanctions against management responsible for the failure. Furthermore, the authorities note that the cost of rehabilitation would be further reduced by adjusting the framework for early supervisory intervention in failing institutions (see above) and by providing incentives to banks to avoid excessive risk-taking through the introduction of risk-based deposit insurance premiums. This latter provision is included in a legislative proposal to amend the DIA and CBR Laws by introducing differentiated deposit insurance contributions depending on the size of the deposit rate and, starting from 1 January 2015, on the assessment of the bank's financial resilience.[44]

***Cooperation and information sharing*:** The FSAP recognised that the Russian authorities cooperated effectively during the financial crisis, even though at that time the CBR did not have legal powers to share information protected by banking secrecy laws with foreign authorities. According to the authorities, this issue has been dealt with by 2013 amendments to the Federal Law on the Central Bank of the Russian Federation[45] that authorise the CBR to

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[42] The DIA founding law (Federal Law Nº 177-FZ of 23 December 2003), as amended in 2013, provides for the Russian Federation to contribute RUB 3 billion to the DIA's assets, of which RUB 2 billion is allocated to deposit insurance and RUB 1 billion is earmarked to fund the measures taken by the DIA in connection with the Bank Insolvency Law and the 2008 Temporary Law.

[43] The mandatory deposit insurance fund amounted to around RUB 100 billion as of 1 October 2014.

[44] Subsequent to the peer review analysis and discussions with the authorities, this legislative proposal was incorporated in the Draft Law that was adopted by the State Duma and signed by the President of the Russian Federation as Federal Law No 432-FZ of 22 December 2014.

[45] See http://www.cbr.ru/Eng/today/status_functions/law_cb_eng.pdf. The amendments were made by Federal Law Nº 251-FZ of 23 July 2013.

exchange information with "foreign market regulators" based on memoranda of understanding signed by the CBR and foreign authorities or international treaties to which Russia is a signatory, provided that the authority receiving such information treats it with the same level of confidentiality as the Russian authorities and that the information does not constitute a state secret. Moreover, the CBR noted that a legislative proposal had been made to further amend the CBR Law so as to explicitly empower the CBR to exchange information contained in financial recovery plans (except state secrets) with foreign resolution authorities.[46]

The FSAP also recommended that the DIA should be given earlier notice by the CBR of a failing bank and powers to conduct an audit of problem banks jointly with the CBR. The statutory framework for the Russian deposit insurance system requires the CBR to supply the DIA with a broad range of information regarding Russian banks and the CBR notifies the DIA of all banks that are subject to sanctions, such as temporary administration or restrictions on accepting new deposits.[47] However, under the framework in place at the time of the peer review analysis, bank failures were communicated to the DIA only after the conditions for intervention were met, meaning that the DIA had only a very short period to examine the assets and liabilities of the failed bank and propose possible solutions. This increased the risk of misjudgement, which could make resolution more expensive as potential investors could require guarantees to cover unanticipated losses. The Draft Law addresses this issue by requiring that when the CBR identifies problems with a bank that threaten its financial soundness, the interests of creditors or the stability of the banking system, it must inform the DIA and a joint inspection should take place with access to all the premises, documents and information systems of the bank. The inspection team would then have 45 days to prepare a report, which would be used to determine the measures to be taken with respect to the specific institution. In addition, the aforementioned amendment introducing risk-based premiums for the deposit insurance fund requires the CBR to classify banks in accordance with their financial soundness for the purposes of determining their required contributions, and the DIA will be notified of that classification.

***Recovery and resolution planning*:** At the time of the peer review analysis, Russian law did not require financial institutions that may be systemic at the point of failure to prepare recovery plans in accordance with the *Key Attributes*; there was also no provision for the development of resolution plans. However, Russian banks were subject to a 2012 CBR recommendation[48] to develop 'self-rehabilitation' (recovery) plans in accordance with guidance provided by the CBR and the standards and guidance set out in the *Key Attributes.* As of July 2014, all D-SIBs were reported to be developing such plans, eight had already sent their plans for CBR approval; and one plan had already been approved, while the others had

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[46] Subsequent to the peer review analysis and discussions with the authorities, this legislative proposal was incorporated in the Draft Law that was adopted by the State Duma and signed by the President of the Russian Federation as Federal Law No 432-FZ of 22 December 2014.

[47] See Federal Law Nº 177-FZ of 2003, which sets out the principles and operation of the Russian deposit insurance system.

[48] The recommendation is made in Letter 193-T of 29 December 2012 "On Methodical Recommendations for the Development of Financial Recovery Plans".

been sent back for adjustments. A few other banks that are not D-SIBs had also opted to submit recovery plans to the CBR.

According to the authorities, a legislative proposal provides a statutory basis for recovery planning by requiring all D-SIBs to maintain recovery plans and giving the CBR the power to require them for other banks.[49] The plans must be submitted to the CBR for review and approval, and the CBR will develop resolution plans on the basis of the recovery plans.

Lessons learned and issues to be addressed

A number of steps have been undertaken to upgrade the bank resolution framework in Russia, several of which were under development during the period of this peer review and adopted after the analysis and discussions with the authorities took place. Importantly, the resolution framework has helped maintain financial stability in recent years: banking licenses for a large number of small banks were revoked without major adverse confidence effects, while the temporary regime that was created in 2008 has enabled the CBR and DIA to deal effectively with problems affecting systemic banks (as noted in the FSAP).[50] The authorities have encouraged the largest Russian banks to develop recovery plans and, following the peer discussions, have revised the legislative framework to include a statutory provision for recovery and resolution planning for D-SIBs (which can be extended to other banks, at the request of the CBR) and to enable the CBR to share information in recovery plans with foreign resolution authorities.[51]

Further reform was adopted at end-2014 in a new Law (Federal Law No 432-FZ) that revokes and replaces the General Bank Insolvency Law and the 2008 Temporary Law into a single instrument and extends the powers of the CBR. The relatively cursory examination of this law in the peer review indicates that it makes notable improvements in some areas, such as a broader role for the DIA in evaluating failing institutions so as to better assess the most cost-effective alternatives; a framework for more timely exchange of information between the DIA and the CBR for failing banks; the mandatory imposition of losses on the shareholders of a failing institution prior to the use of public funds in rehabilitation; provisions to allow the transfer of assets and liabilities from a failing bank to a sound institution and for the conversion of certain subordinated liabilities to equity; and greater powers to sanction managers of the failing institution.

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[49] Subsequent to the peer review analysis and discussions with the authorities, this legislative proposal was incorporated in the Draft Law that was adopted by the State Duma and signed by the President of the Russian Federation as Federal Law No 432-FZ of 22 December 2014.

[50] More recently, Federal Law No 451-FZ of 29 December 2014 was published (available at http://publication.pravo.gov.ru/Document/View/0001201412290001?filterid=225698f1-cfbc-4e42-9caa-32f9f7403211) that increases the deposit insurance coverage from 700,000 roubles to 1.4 million roubles. In order to stabilize the financial system, the law also gives powers to the CBR to provide subordinated loans to Sberbank, and to the DIA to use property contributions of the Russian Federation (in the form of government bonds) to recapitalise banks using subordinated loans with several conditions.

[51] As noted in footnotes 46 and 49, these provisions have now been adopted in law. However, it is not clear whether the CBR's expanded information-sharing powers cover all the information that foreign resolution may potentially require. It may also be desirable to provide for a formal role for the DIA in resolution planning given the nature of its involvement in rehabilitation measures.

In spite of these accomplishments, however, further work is still needed to enhance the bank resolution framework and to fully address the FSAP recommendations. This involves incorporating additional features of the *Key Attributes* in the resolution framework; enhancing the prompt remedial action framework; and revising the rehabilitation process for systemic banks to align incentives and reduce the use of public funds.

Adoption of legislative changes: The Draft Law that consolidates the existing laws on bank insolvency and rehabilitation is a significant step forward in addressing the FSAP recommendation of unifying Russia's resolution regimes and expanding the powers available to the CBR. However, it is not clear how far that consolidation will meet the FSAP recommendation for a single set of triggers for all banks. In addition, a number of the tools contemplated in the *Key Attributes* are missing from this law. For example, the Draft Law does not provide for resolution powers in relation to holding companies or powers to use a bridge bank or to write down and convert all unsecured uninsured liabilities (bail-in) other than those with express contractual provisions. Moreover, it does not include powers to require firms to adopt changes to improve their resolvability or any mechanism for the recovery of public funds used in resolution from the financial industry. These tools would expand the range of options for the authorities in dealing with failing banks in a timely and cost-effective manner, provide more clarity to market participants, and allow the authorities to resolve these firms in an orderly manner.

As regards a full bail-in power, the authorities note that it was not included in the Draft Law because of concerns that it could trigger a lack of confidence by depositors in the banking system, given the experience with the 1999 banking crisis in which many depositors lost their savings. This could have the unintended effect of accelerating the concentration of the system, particularly given current market conditions and the ongoing consolidation process that involves the closure of weak banks. While these concerns are valid, they might be addressed through the careful design of the tool in terms of scope and timing of application.[52]

- ***<u>Recommendation 6:</u> The authorities should consider extending the options available under the current resolution regime by incorporating additional features of the FSB's Key Attributes.***

Prompt remedial action framework: The FSAP noted the need for a more structured, transparent and consolidated corrective action regime to enable a consistent approach in the treatment of different banks and enhance public confidence. It also highlighted concerns that the triggers under the General Bank Insolvency Law require non-systemic banks to take recovery measures and the authorities to impose bankruptcy prevention measures[53] only at a relatively late stage when the institution is already insolvent or close to it. The FSAP recommended that the CBR and DIA should be able to intervene at a sufficiently early stage in all banks and not just those cases that are determined to be systemic. Late intervention may

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[52] For example, deposits could be explicitly excluded from the scope of the bail-in or implementation could be delayed for a few years while the current process of consolidation within the banking sector is completed.

[53] These involve financial rehabilitation; the appointment of provisional administration to manage the institution; and reorganisation through merger or takeover by another institution. The CBR has the power to require the management to take such measures if they are not adopted by a bank at its own initiative.

increase the costs of resolution, limit the available options and reduce the chances that it will be successful.

Useful steps are being taken by the authorities to facilitate prompt remedial action, including revisions to CBR guidance on early supervisory intervention and provisions in the Draft Law for early notification to the DIA of problems in a bank and for collaboration between the CBR and the DIA in planning the measures to be taken. The CBR also points out that, in its role as bank regulator and supervisor, it has a wide range of powers to act promptly in response to identified violations and to take precautionary and enforcement measures for those institutions. However, it is unclear whether the conditions for intervention to impose bankruptcy prevention measures under the Draft Law in non-systemic cases will differ substantively from the regime in place at the time of the peer review analysis. These conditions may need to be revised to implement the FSAP recommendation and to increase the flexibility to take appropriate and timely measures in relation to failing banks.

- ***<u>Recommendation 7:</u> The authorities should revise the triggers to enable the timely adoption of resolution measures for non-systemic banks before the firm is balance sheet insolvent.***

Revision of rehabilitation process for systemic banks: The rehabilitation process for systemic banks relies substantially on the use of public funds in the form of loans from the CBR to the DIA. This risks creating moral hazard, both because the contribution of private sector investors to funding rehabilitation is small in proportion to the loans that they receive and because the way in which such loans are provided may not create strong incentives for effective and rapid conclusion of the rehabilitation.

The authorities indicate that the Draft Law addresses the risk of moral hazard by requiring that, prior to the use of any public funds, existing shareholders are wiped out and any subordinated liabilities with contractual conversion terms held by those shareholders are converted to equity or written off. This represents progress compared to the regime in place at the time of the peer review analysis, although the authorities might also consider adopting measures that enable a portion of the costs of resolution to be recovered from the private sector – that is, from a wider set of creditors of the failing bank (through bail-in) and, in appropriate cases, from the industry more broadly in the form of additional DIA contributions or other levies.

In addition, it may be useful to review and potentially revise the rehabilitation process for systemic banks to enhance its efficiency and reduce the use of public funds. Under a typical rehabilitation plan, a private investor contributes a very small sum of money ('skin in the game') for the purchase of the failing bank. The loan is provided for a period of up to 10 years at a rate that is significantly below market rates. The amount of such a loan is calculated so that the acquirer can benefit from the spread between market rates and the subsidised rate to recoup any losses arising from impaired assets (which are only recognised over time). As a result, the size of the loan typically exceeds the estimated gap between the assets and liabilities of the institution, and the CBR essentially indemnifies the investor for the full value of impaired assets. The contract also requires early repayment by the investor of the value of any assets that are realised or recovered, so the incentive to actively work out impaired assets or conclude the rehabilitation in advance of the term of the loan is unclear.

This process may therefore provide little incentive for investors to recover impaired assets in a timely manner, which represents a deadweight loss on the financial system and economy.

The CBR notes that failure to repay the loans is unlikely since the arrangements between the DIA and investors stipulate a timeframe for repayment and the loans are secured against the assets of the investor and/or third parties. It is of the view that the process meets its intended objective because the loans have been repaid in full (although their duration has been extended in some cases) and the tender ensures an effective pricing mechanism for the rehabilitation of the failing bank. It also notes that the rehabilitation plan involves regular monitoring by the CBR and DIA; funds that are used inappropriately must be returned in advance of the agreed schedule for repayment; and that the plan includes specific targets for recovering impaired assets depending on their characteristics and based on the valuation procedure that preceded the intervention.

Notwithstanding the positive aspects of the current rehabilitation process, there may be ways to further enhance its efficiency and effectiveness by reducing the amount and improving the terms of DIA loans (funded by CBR) that are provided to private investors and strengthening the incentives for workouts of impaired loans. These would include: writing down the failing bank's assets to fair value at the point of intervention based on the results of the joint CBR-DIA inspection (so as to avoid the delayed recognition of impaired assets); providing more information upfront to prospective investors on the failing bank (so as to improve the outcome of the tender and minimise the need to provide guarantees for investors); and creating incentives for those investors to work out the impaired assets (so as to improve recoveries and contribute to new productive lending).

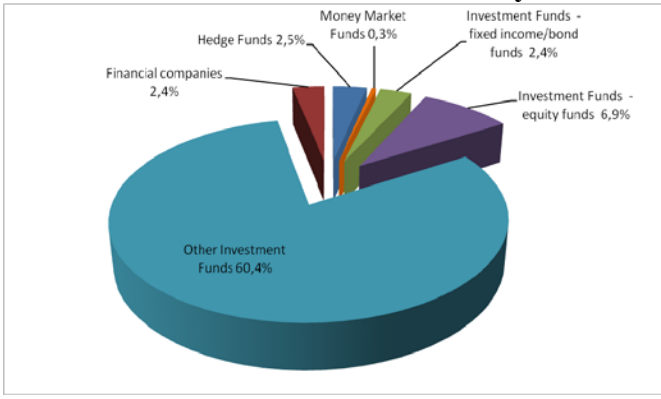
- ***<u>Recommendation 8:</u> The authorities should review and potentially revise the rehabilitation process for failing systemic banks in order to further enhance its efficiency and effectiveness.***

Annex 1: Structure of the financial system and recent developments[54]

Structure of the Russian financial system

The Russian financial sector is dominated by banks, which accounted for 91% of the total assets as at the end of 2013. Assets of insurance companies and pension funds amounted to approximately 5% of total system assets, while the assets of other financial institutions amounted to 4% (Figure 1). The asset structure of the financial system has remained relatively stable since 2011. In 2013 the banking sector exhibited higher annual growth rate of assets (16%) than insurance companies and pension funds (approximately 11%).

Figure 1: Composition of other financial institutions by asset size (as of end-2013)



Banking sector: The banking sector growth has been tempered by the slowdown in the Russian economy in recent years: assets of credit institutions grew by 16% in 2013 compared to 23% in 2011. However, the banking sector is growing faster than the economy as a whole, resulting in an increase in the ratio of banking sector assets to GDP from 73% in 2010 to 86.0% in 2013. In 2013, the ratio of banking sector capital to GDP rose to 10.6% (Figure 2).

Figure 2: Dynamics of assets and capital of the banking sector to GDP

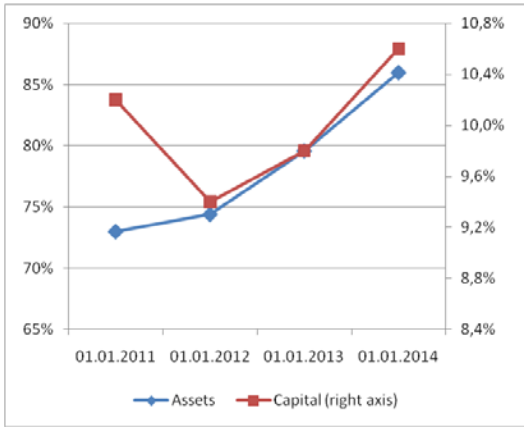
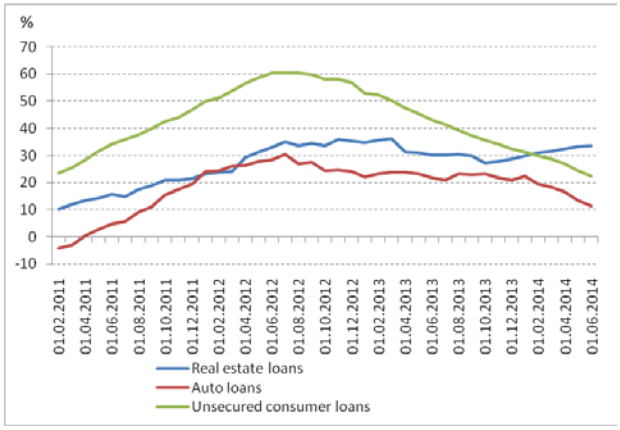


Figure 3: Dynamics of the annual growth rate for retail lending segments



[54] Based on information provided by the Russian authorities as of September 2014.

The banking sector asset structure largely comprises loans to non-financial firms and individuals (56.5% at end-2013). Retail loans as a proportion of total lending has been increasing steadily: from 19.3% at end- 2011 to 24.6% at end-2013. In 2011-2012 in Russia there was a substantial growth in consumer lending (Figure 3), driven mainly by the increase in unsecured retail loans. As of June 2014, the annual growth rate of this segment amounted to 22% while the growth rate of banks' assets was 19%.

The main source of bank funding is deposits, with the share of these deposits amounting to 61% of the liabilities of the banking sector at the end of 2013. The share of interbank loans as a proportion of banking sector liabilities decreased from 11% at end-2011 to 8.4% in 2013. Issuance of external debt by banks has been limited in recent years, with the share of foreign borrowings representing almost 11% of banking sector liabilities in May 2014. This is driven both by difficult access to external markets but also by more prudential risk management policies of banks, which have reduced their dependence on external creditors.

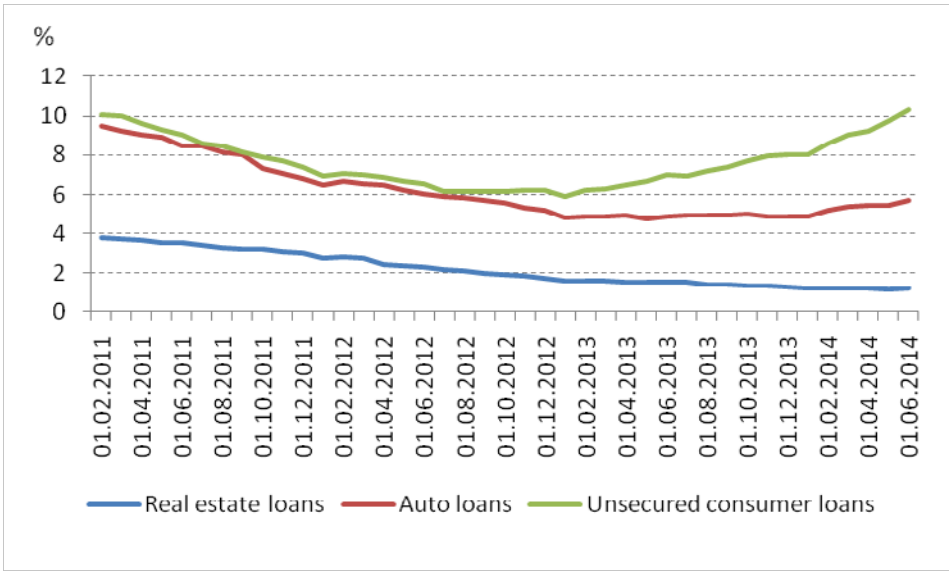
The capital adequacy ratio of the banking sector has continued to decline over the past few years. As of June 2014, the ratio amounted to 12.9% compared to 14.7% in January 2012. The decline was mainly due to rapid growth in risk-weighted assets of banks and the stricter capital requirements of Basel III.[55]

After record results in 2012 (USD 32.5 billion), earnings before tax of the Russian banking sector dropped in 2013 owing to the economic slowdown. The return on asset and return on equity figures declined in subsequent years, reaching 1.9% and 15.2% respectively in 2013. By contrast, the share of non-performing loans decreased from 4.7% in 2011 to 3.5% in 2013, mainly due to the slowdown in the growth rate of overdue debt on loans granted to firms.

The quality of retail lending differs by segment. Mortgage lending is characterized by the lowest share of non-performing loans (1% as of June 2014), while the share of non-performing unsecured consumer lending reached in excess of 10% as of June 2014 (Figure 4). Due to deterioration of loan portfolio quality in this segment, banks formed additional loan loss provisions that adversely impacted their profitability.

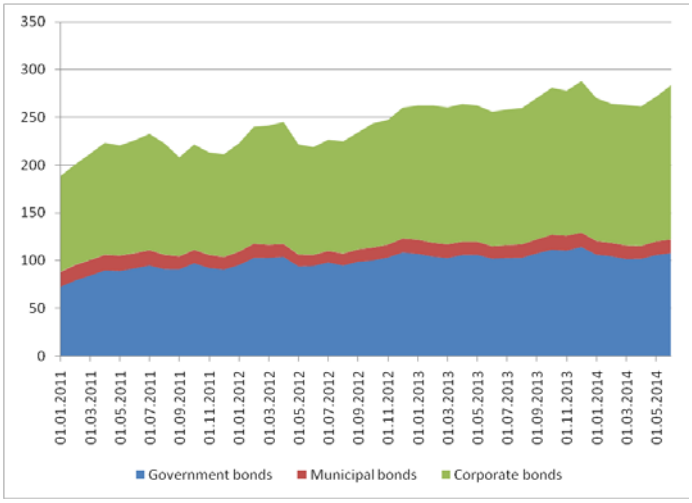
[55] In 2013 the CBR published Regulation No. 395-P "On the Methodology of Calculating the Capital Value and Assessment of Capital Adequacy of Credit Institutions (Basel III)", which included the methodology for determining capital adequacy ratios in accordance with Basel III requirements. In Russia the standards came into force on 1 January 2014.

Figure 4: Evolution of non-performing loan ratio (90 days past due) for consumer lending segments



Debt securities market: The capacity of the banking sector to attract the CBR's refinancing through repurchase operations is largely limited to the Russian securities market and is based on the quality of the issued securities. Debt instruments traditionally prevail in the structure of the securities portfolio of the Russian credit institutions. The volume of the Russian debt market has been growing steadily in recent years (Figure 5).

Figure 5: Volume of the domestic bond market (billions of USD)



Other financial sector reforms

Liberalization of access to the Russian bond market: A positive factor for the development of the domestic debt market was the opening by the Russian Central Depository of nominee accounts for international settlement and clearing organizations (Clearstream and Euroclear) in the beginning of 2013, which resulted in a significant inflow of foreign investments to the domestic public debt market. Moreover, in the first quarter of 2014 international depository clearing systems were granted the possibility to open nominee accounts for the Russian

corporate and municipal bonds in the Russian Central Depository. Foreign investments in the Russian sovereign bond market increased significantly after this opening, with the share of non-residents increasing from 3% in 2012 to 28% in May 2013.

Laws to strengthen financial resilience and transparency of non-credit financial institutions, especially microfinance organisations (MFOs) and non-state pension funds (NPFs): In order to slow down the accumulation of excessive household debt and to improve the regulation and supervision of the microfinance sector, the CBR has introduced the following changes:

- Requirements to loan loss provisioning depending on overdue period, categories of borrowers and collateral;
- Mandatory provisioning to alleviate the volatility of the returns on equity and improve the competitive environment for market participants;
- Disclosure requirements and limits on effective interest rates to control the amount of loans to households with high debt servicing cost, decrease the debt burden of households and increase the resilience of microfinance sector in the long term;
- New rules for funding, broadening the scope of allowed funding sources (which will let MFOs diversify their funding base) but also introducing stricter and more detailed conditions for attracting funds of unqualified individual investors (such funds cannot be lower than RUB 1.5 million roubles as of 1 July 2014 over the contract duration);
- Mandatory filing of information to credit bureau in order to increase transparency of borrowers' obligations and reduce credit risk of MFOs; and
- Maximum amount of charges on overdue loans and limits to any extra services (fees, insurance etc.) in order to contribute to more objective pricing policies in the sector.

Besides strengthening the regulatory regime, the CBR also has the objective of increasing the transparency of the MFO sector, the quality of financial management and its operational efficiency. Several amendments have been drafted to allow the submission of reports in electronic form and the verification of reported data in order to improve the quality of reports.[56] In order to standardise and unify the activities of MFOs, it is planned to introduce mandatory membership in self-regulating organisations. Moreover, starting from 1 January 2014, MFOs cannot use a simplified tax system. In the medium term, as a result of the strengthened requirements, it is expected that the number of officially registered MFOs will decline but that the resilience and public confidence in the microfinance market will improve as a result of the exit of non-compliant MFOs from the market.

New regulations concerning NPFs also came into force. These include mandatory corporatization of all NPFs, i.e. all NPFs that provide mandatory pension insurance services must become joint-stock companies before 1 January 2016 and all remaining NPFs before January 2019. This is expected to improve the investment climate in the sector and increase financial resilience, transparency and efficiency of the NPF market.

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[56] In addition, according to Federal Law of 21.12.2013 No. 375-FZ "On Amending Certain Legislative Acts of the Russian Federation", MFOs can be excluded from the relevant state register in case of multiple violations of loan extension rules during one calendar year or in case of filing false information.

It is expected that after all NPFs providing mandatory pension insurance services become joint-stock companies, they will join a pension guarantee system – the analogue to a bank deposit insurance system. NPFs will need to comply with qualitative and quantitative requirements in order to participate in the system (at the end of 2013, only 64 out of 120 NPFs met the requirement).

In order to address the conflict of interest in investment activities, the CBR is examining the relationship of NPFs and their asset management companies. This is due to increasing NPFs' dependence on captive asset managers: during 2013, the share of the biggest asset managers in NPFs' portfolios rose from 68% to 72% on average.

Another requirement is disclosure of information on activities and ownership structure of NPFs. It is likely that big incorporated NPFs not willing to disclose information on their owners will create a separate mandatory pension system fund, which will be owned by a fund for non-state pension provisioning (such framework will be eligible till 2019).

The ongoing pension reform that could reduce or even permanently eliminate the funded component of the Russian pension system constitutes an important constraint for NPF development in the medium term.

Planned reforms to insurance sector: The CBR is planning to improve the regulation and supervision of insurance companies, in particular to strengthen the control over asset quality of such companies, including the appointment of authorized representatives of the CBR.

Consumer loans: According to Federal Law of 21.12.2013 No. 353-FZ "On Consumer Credit (Loan)", the amount of potentially risky loans with high interest rates that can be provided to households will be limited. The effective interest rate (including all non-interest payments) should not exceed the average market value by more than one-third. The average market value will be calculated by the CBR quarterly on the basis of information received from 100 biggest lenders or one-third of all lenders that provide the relevant loans. The CBR Direction No. 3249-U of 29.04.2014 "On the Procedure of Defining by the Bank of Russia Categories of Consumer Credits (Loans) and on the Procedure of Calculation and Publication of Average Market Effective Interest Rate on a Quarterly Basis" was registered in the Ministry of Justice of the Russian Federation on 1 July 2014.

In order to carry out high quality analysis of potential borrowers, banks need to have reliable information on their income and debt burden. An expert group has been set up in the CBR, which is developing a framework that will allow lenders to access information on income and financial obligations of borrowers, including from the Pension Fund of the Russian Federation, tax authorities, and the Federal Bailiff Service.

Mega-regulator: In September 2013, the regulatory functions previously performed by the Federal Service for Financial Markets (FSFM) were transferred to the CBR. The "mega-regulator" created through this merger is now responsible for the supervision of both banks and non-banking financial entities.

Annex 2: Follow-up of other key FSAP recommendations

This Annex presents the follow-up actions reported by the Russian authorities to key FSAP recommendations that are not covered in sections 2 and 3. The actions mentioned below have not been evaluated as part of the peer review and are presented solely for purposes of transparency and completeness.

No.	Recommendations	*Steps taken to date and actions planned (including timeframes)*
1	Empower the CBR to use professional judgment in interpreting laws and regulations, issuing enforceable risk management guidance, and applying it to individual banks.	According to Federal Law of 10.07.2002 "On the Central Bank of the Russia Federation (Bank of Russia)" (hereinafter – Federal Law No. 86-FZ) the CBR is empowered to use professional judgment in its supervisory activities (Article 57.2, part 4 of Article 72, part 3 of Article 72.1 – introduced by Federal Law of 02.07.2013 No. 146-FZ) *Article 57.2. The Bank of Russia shall assess in accordance with the procedure established by the Bank of Russia regulation the quality of the risk and capital management and internal control systems of a credit institution, banking group, capital adequacy and liquidity of a credit institution (banking group), their conformity to the nature and the scope of operations performed by a credit institution (in a banking group), the level and combination of risks assumed, including determining the volume and structure of operations as the criteria for such an assessment. Should an assessment reveal non-conformity of the risk and capital management and internal control systems, capital adequacy and liquidity of a credit institution (banking group) to the requirements set by the Bank of Russia and (or) the nature and scope of operations performed by a credit institution (in a banking group), the level and combination of risks assumed, the Bank of Russia shall be obliged in compliance with the procedure prescribed by it to send the credit institution (parent credit institution of the banking group) a direction on bringing their risk and capital management and internal control systems into conformity with the Bank of Russia requirements, the nature and scope of operations performed by the credit institution (in the banking group), the level and combination of risks assumed and (or) on establishing individual required ratio limits for the credit institution (banking group).* *(Article 57.2 was introduced by Federal Law No. 146-FZ, dated July 2, 2013)* *Article 72. The Bank of Russia shall establish the methods for calculating capital and required ratios of a credit institution (banking group), taking into account international standards and consultations with credit institutions and banking associations and unions.* *(part first in the wording of Federal Law No. 146-FZ, dated July 2, 2013)* *The Bank of Russia shall be entitled to establish different ratios and methods for calculating them for various credit institutions.* *The Bank of Russia shall officially announce any forthcoming change in ratios and methods for calculating them no later than one month before introducing them.* *To calculate the capital of a credit institution and a banking group, the Bank of Russia shall evaluate their assets and liabilities, using the evaluation methods established by Bank of Russia regulations. The credit institution and the banking group shall indicate the amount of their own capital, established by the Bank of Russia, in their accounting and other reports.* *(part four in the wording of Federal Law No. 146-FZ, dated July 2, 2013)* *Should the amount of capital of a credit institution prove smaller than its authorised capital, indicated in its founding documents, the Bank of Russia shall demand that this credit institution match its capital with its authorised capital. The credit institution shall comply with the Bank of Russia prescription in accordance with the procedure, within the terms and on the conditions established by Federal Law "On the Insolvency (Bankruptcy) of Credit Institutions".* *The Bank of Russia shall establish the conditions for including subordinated credit (deposits, loans and bond issues) into the sources of capital of a credit institution and the*

		conditions for excluding subordinated credit (deposits, loans and bond issues) from the sources of capital of a credit institution. The sum of subordinated credit (deposit, loan or bond issue) may be excluded from the calculation of capital of a credit institution after prior agreement with the Bank of Russia reached according to the procedure established by the Bank of Russia regulation, if the subordinated credit (deposit or loan) agreement is terminated before the expiry of its term or if bonds are redeemed ahead of schedule on the initiative of the borrower credit institution. *(part six was introduced by Federal Law No. 247-FZ, dated December 29, 2006)* *The Bank of Russia shall be entitled to suspend payment of the principal amount of the debt and (or) interest under a subordinated credit (deposit or loan) agreement or bonds according to the procedure set by the Bank of Russia regulations if the suspension of payments is provided for by the subordinated credit (deposit or loan) agreement or the registered terms of bond issue and the effectuation of scheduled payments to creditors creates the grounds for implementing bankruptcy-prevention measures stipulated by Federal Law "On the Insolvency (Bankruptcy) of Credit Institutions". At the same time, the Bank of Russia shall prohibit credit institutions from taking decisions on the allocation of profit between their founders (members) and the payment (announcement) of dividends to them and from allocating profits between their founders (members), paying them dividends and meeting the demands by the founders (members) of credit institutions for allocating a share (a part of a share) to them or paying its actual value or buying out shares in credit institutions. The suspension of payments under the subordinated credit (deposit or loan) agreement or on bonds and the prohibition for a credit institution to take decisions on the allocation of profit between its founders (members) and the payment (announcement) of dividends to them and from allocating profits between its founders (members), paying them dividends and meeting the demand by the founders (members) of the credit institution for allocating a share (a part of a share) to them or paying its actual value or buying out shares in the credit institution shall be cancelled at the request of the credit institution, made according to the procedure established by the Bank of Russia, if the real threat of the emergence of the grounds for implementing bankruptcy-prevention measures has been removed.* *(part 7 was introduced by Federal Law No. 247-FZ, dated December 29, 2006)* *Article 72.1. The Bank of Russia shall establish requirements for bank risk management methods and quantitative risk assessment models, including for the quality of data used in these models, applied by credit institutions and banking groups for evaluating assets, calculating capital adequacy ratio and other required ratios.* *A credit institution, the parent credit institution of a banking group may assume the duty of applying bank risk management methods and quantitative risk assessment models for calculating required ratios. Bank risk management methods and quantitative risk assessment models shall be applied only on the basis of a permission issued by the Bank of Russia at the request of the credit institution or the parent credit institution of the banking group. The procedure for obtaining the permission for applying bank risk management methods and quantitative risk assessment models shall be established by the Bank of Russia.* *The procedure for evaluating the quality of bank risk management methods and quantitative risk assessment models shall be established by Bank of Russia regulations.* *The Bank of Russia shall refuse to give the permission, if an evaluation of the quality of bank risk management methods and quantitative risk assessment models held by the Bank of Russia finds them inconsistent with Bank of Russia requirements.* *Credit institutions and the parent credit institutions of banking groups must comply with the bank risk management methods and quantitative risk assessment models, the application of which was permitted by the Bank of Russia.* *A material change in bank risk management methods and quantitative risk assessment models applied pursuant to the Bank of Russia permission shall be allowed only on the basis of the permission obtained from the Bank of Russia in accordance with the procedure stipulated by this Article. The criteria of material changes shall be established by the Bank of Russia.* *In the event of a failure to comply with the bank risk management methods and quantitative*

		risk assessment models, the application of which was permitted by the Bank of Russia, the Bank of Russia shall have the right in accordance with its prescribed procedure to require the compliance of the said bank methods and models and (or) establish increased values for risk parameters used for calculating capital adequacy and (or) apply measures stipulated by part one of paragraph three in point 2 and point 6 of part two of Article 74 of this Federal Law. *Should bank risk management methods and quantitative risk assessment models cease to comply with the Bank of Russia requirements, the Bank of Russia shall have the right in accordance with its prescribed procedure to require that the said bank methods and models be brought into compliance with the Bank of Russia requirements and (or) establish increased values for risk parameters used for calculating capital adequacy and (or) apply measures stipulated by part one of paragraph three in point 2 and point 6 of part two of Article 74 of this Federal Law.* *Should grounds be eliminated or changed for establishing increased values for risk parameters, the Bank of Russia shall take a decision on their cancellation and inform a credit institution and the parent credit institution of a banking group thereof in accordance with the procedure prescribed by the Bank of Russia.* *Should a credit institution or the parent credit institution of a banking group fail to comply with the requirements sent by the Bank of Russia in accordance with this Article, the Bank of Russia shall have the right to revoke according to its prescribed procedure the permission for applying bank risk management methods and quantitative risk assessment models for calculating capital adequacy.* *(Article 72.1 was introduced by Federal Law No. 146-FZ, dated July 2, 2013)* The CBR is using professional judgement in the following situations: 1) In order to control risks taken by banks, regional departments of the CBR order banks to include in calculations (or exclude from calculations) of regulatory ratios assets and (or) liabilities on the basis of professional judgement which is made in the process of supervision (documentary analysis and/or inspections) (Item 10.3 of Instruction of the CBR of 03.12.2012 No. 139-I "On regulatory ratios"; 2) In order to asses financial conditions of legal persons – founders (participants) of a credit organization and of legal persons which acquire shares of a credit organization or take actions in order to establish control of shareholders (participants) of a credit organization (Regulation of the CBR of 18.02.2014 No. 415-P – entered into force on 27.06.2014). 3) The CBR, its regional departments and authorized representatives acting in accordance with Article 73 of Federal Law No. 86-FZ assess assets and liabilities of credit organizations in accordance with Article 72 of Federal Law No. 86-FZ, including credit risk on loans, and make professional judgement in respect of classification of loans and the size of provisions made, which are prescribed in Regulation of the CBR of 26.03.2004 No. 254-P "On the Procedure for the Formation by Credit Institutions of Reserves for Possible Losses from Loans, from Loan Debts and Those Equated to Them" Federal Law No. 146-FZ has amended the Law "On the Central Bank of the Russian Federation (Bank of Russia)" (amended version attached) and vested the Bank of Russia with authority to take a decision on acknowledging a person as a person related to a credit institution (being part of a group of persons related to a credit institution) pursuant to an informed judgment. In order to implement its authority the Bank of Russia has drafted regulations establishing the criteria for possible relation of a person (persons) to a credit organization, as well as the procedure for taking a decision by the Banking Supervision Committee on acknowledging a person as a person related to a credit institution (being part of a group of persons related to a credit institution). These regulations will come into force from January 1, 2015. Federal Law No. 146-FZ has also established the definition of "a person related to a credit institution" and has introduced a new required ratio that limits the risk per person related to a credit institution (a group of persons related to a credit institution) to 20% of the own funds (capital) of a credit institution, and has given the right to the Bank of Russia, when taking decisions on acknowledging a person as a person related to a credit institution (being

		part of a group of persons related to a credit institution), to apply informed judgment based on the criteria of possible relation of a person (persons) to a credit institution (these criteria will be set in the respective regulation of the Bank of Russia). This regulation comes into force from January 1, 2015. In addition, Federal Law No. 146-FZ has empowered the Bank of Russia to establish requirements for risk and capital management systems of a credit institution, including on a consolidated basis. The Bank of Russia has drafted a regulation that sets requirements for internal procedures for the capital adequacy assessment. The indicated regulation is planned to take effect from January 1, 2015.
2	Approve pending amendments to expand CBR supervisory authority over bank holding companies and related parties, and eliminate restrictions on information-sharing with other domestic and foreign supervisors	The Bank of Russia has been empowered, since 1 January 2014, to obtain information on bank holding companies on a consolidated basis, where banking activities are significant in the group, and will be able, from 1 January 2015, to impose limits on exposures to related parties. The Bank of Russia does not supervise bank holding companies on a consolidated basis, since prudential requirements cannot be imposed at that level. In 2015 it is planned to prepare proposals for the Ministry of Finance of the Russian Federation, which has legislative initiative, to amend the federal legislation in order to broaden the powers of the Bank of Russia in respect of bank holding companies, and to include into the scope of consolidated supervision of the Bank of Russia those holding companies, which include at least one organization regulated by the Bank of Russia. Federal Law No. 146-FZ has empowered the Bank of Russia with the right to set the rules for bank holding companies for compiling and presenting to the Bank of Russia the information on the composition and risks of the bank holding company, as well as the procedure for presenting and disclosing consolidated financial reports of a bank holding company. If the parent credit institution of a bank holding group violates Federal Laws "On Banks and Banking Activities" and "On the Central Bank of the Russian Federation (Bank of Russia)" the Bank of Russia is entitled to ban or restrict operations of credit institutions participating in a bank holding company with the parent company of the bank holding company or its participants. For groups where the parent company is a bank or a bank holding company, the Bank of Russia has been given enhanced capacity to cooperate with foreign supervisors, including, since 2 October 2013, the capacity to exchange confidential information on individual clients, subject to some conditions such as equivalent professional secrecy. Federal Law No. 146-FZ significantly strengthens the powers of the Bank of Russia to obtain information on bank holding groups under the Central Bank Law and Banking Law. Federal Law No. 146-FZ defines "bank holding groups", which cover cases where the head organisation is not a credit institution, provided that banking activities represent at least 40% of the assets or revenues of the group. For the "bank holding groups" the law specifies that the Bank of Russia shall conduct an analysis of the activity of bank holding [groups] and use the information received from this analysis for the purposes of banking supervision over credit institutions and banking groups integrated into bank holding [groups]. Under Article 4 of the Banking Law, to sanction a bank holding group, the Bank of Russia may restrict or ban transactions by the individual credit organisations that are part of the bank holding group. Directions of the CBR of 25.10.2013: - No. 3083-U "On the Compiling and Filing of Information of Bank Holding Risks"; - No. 3086-U "On the Method of Determination of the Amount of Assets and Incomes of Credit Organizations - Participants if a Bank Holding and of a Bank Holding"; - No. 3087-U "On the Consolidated Financial Reports Disclosed and Submitted by Bank Holding Companies". Article 51.1 of Federal Law 'On the Central Bank of the Russian Federation (Bank of Russia)'. The Bank of Russia shall be entitled to request a foreign financial market regulator to provide it with information and (or) documents, which may be confidential, including those that contain data constituting bank secrecy. The Bank of Russia shall exchange information

		and (or) documents, which may be confidential, including those that contain data constituting bank secrecy (hereinafter confidential information), with a foreign financial market regulator pursuant to and in compliance with: 1) the Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information of the International Organisation of Securities Commissions; 2) an international treaty of the Russian Federation; 3) a bilateral treaty with a foreign financial market regulator envisaging an exchange of information, if the legislation of the corresponding foreign state stipulates the level of security for information provision at least matching the level of information security envisaged by Russian Federation legislation. As regards confidential information received from a foreign financial market regulator, the Bank of Russia shall be obliged to comply with the requirements for the disclosure of confidential information established by Russian Federation legislation, taking into consideration the procedure stipulated in part two of this Article. Confidential information received by the Bank of Russia from a foreign financial market regulator may be provided to third parties only with the consent of such a regulator, except for the cases when the said confidential information is provided to a court of law pursuant to a court judgement passed in criminal case proceedings. Upon receiving a reasoned inquiry from a foreign financial market regulator in accordance with the procedure stipulated by agreements specified in part two of this Article, the Bank of Russia shall send an order to provide such information (to a financial institution) pursuant to a decision taken by the Financial Supervision Committee. The Bank of Russia order to provide information shall not include the purpose of receiving such information. Pursuant to a decision by the Board of Directors, the Bank of Russia shall be entitled to provide a foreign financial market regulator with confidential information on operations and (or) transactions upon a reasoned inquiry from the foreign financial market regulator in cases stipulated by agreements specified in part two of this Article, and also on persons who performed the said operations and (or) transactions and (or) beneficiaries under these operations and (or) transactions, except for information constituting state secrecy. The Bank of Russia shall provide such confidential information to a foreign financial market regulator on condition that the legislation of the corresponding foreign state stipulates the level of security for information provision at least matching the level of information security envisaged by Russian Federation legislation, and also on condition that the foreign financial market regulator may not provide confidential information to third parties, including law-enforcement agencies, without the Bank of Russia's prior consent, except for the cases when such confidential information is provided to a court of law pursuant to a court judgement passed in criminal case proceedings. For more detailed information please refer to FSB evaluation report on adherence to financial regulatory and supervisory standards on international cooperation and information exchange.
3	Allow the CBR to sanction individual directors and key managers, raise capital requirements on individual institutions, and impose restrictions on transactions between affiliates.	1. Sanctions to individual director and key managers. In accordance with Federal Law No. 86-FZ the Bank of Russia has the right to demand the replacement of individuals, whose positions are listed in Article 60 of Federal Law No. 86-FZ, or the limitation of the size of compensation and (or) incentive payments to such persons for up to three years. The Bank of Russia is also empowered to set for a credit institution (banking group) individual limits of required ratios in cases stipulated by Article 57.2. Federal Law No. 86-FZ. According to Article 74 of Federal Law No. 86-FZ: Should a credit institution fail to fulfil the Bank of Russia order to eliminate the violations discovered in its work or should these violations or banking operations or transactions conducted by a credit institution pose a serious threat to the interests of its creditors (depositors), the Bank of Russia shall be entitled to demand that the credit institution replace the persons included in the list of positions given in Article 60 of this Federal Law or limit the size of compensatory and (or) stimulating payments to the said persons for up to three years.

		According to Article 60 of Federal Law No. 86-FZ: The Bank of Russia shall be entitled to set qualification requirements and requirements for the business reputation of a single executive body and his deputies, members of a collegiate executive body, chief accountant and deputy chief accountant of a credit institution, the head and chief accountant of a credit institution's branch and candidates for these positions, and also the requirements for the business reputation of members of a board of directors (supervisory board) of a credit institution and candidates for these positions, private individuals and legal entities acquiring more than 10 per cent (owning more than 10 per cent) of shares (stakes) of a credit institution or performing a transaction (transactions) aimed at establishing control (or exercising control) over shareholders (members) of a credit institution, a person fulfilling the functions of a single executive body of a legal entity acquiring more than 10 per cent (owning more than 10 per cent) of shares (stakes) of a credit institution, a person fulfilling the functions of a one-man executive body of a legal entity performing a transaction (transactions) aimed at establishing control (or exercising control) over shareholders (members) of a credit institution, in compliance with the criteria defined by Article 16 of Federal Law "On Banks and Banking Activities". The Bank of Russia shall be entitled in accordance with the procedure prescribed by it to assess compliance with the requirements established by Federal Law "On Banks and Banking Activities" for the qualification and business reputation of persons holding the positions of a single executive body and his deputies, members of a collegiate executive body, chief accountant and deputy chief accountants of a credit institution, the head and chief accountant of a credit institution's branch or being candidates for these positions, and also the requirements for the business reputation of members of a board of directors (supervisory board) of a credit institution and candidates for these positions, private individuals and legal entities acquiring more than 10 per cent (owning more than 10 per cent) of shares (stakes) of a credit institution or performing a transaction (transactions) aimed at establishing control (or exercising control) over shareholders (members) of a credit institution, a person fulfilling the functions of a single executive body of a legal entity acquiring more than 10 per cent (owning more than 10 per cent) of shares (stakes) of a credit institution, a person fulfilling the functions of a single executive body of a legal entity performing a transaction (transactions) aimed at establishing control (or exercising control) over shareholders (members) of a credit institution. The Bank of Russia shall have the right to request and receive free of charge information from the federal bodies of executive power and their regional branches and legal entities, permitting to assess compliance with the requirements for the business reputation of persons holding the positions of a single executive body and his deputies, members of a collegiate executive body, chief accountant and deputy chief accountants of a credit institution, the head and chief accountant of a credit institution's branch or being candidates for these positions, and also the requirements for the business reputation of members of a board of directors (supervisory board) of a credit institution and candidates for these positions, private individuals and legal entities acquiring more than 10 per cent (owning more than 10 per cent) of shares (stakes) of a credit institution or performing a transaction (transactions) aimed at establishing control (or exercising control) over shareholders (members) of a credit institution, a person fulfilling the functions of a single executive body of a legal entity acquiring more than 10 per cent (owning more than 10 per cent) of shares (stakes) of a credit institution, a person fulfilling the functions of a single executive body of a legal entity performing a transaction (transactions) aimed at establishing control (or exercising control) over shareholders (members) of a credit institution, and the criteria defined by Article 16 of Federal Law "On Banks and Banking Activities". The Bank of Russia shall have the right to demand the replacement of persons holding the positions specified in parts 4 and 6 of Article 11.1 of Federal Law "On Banks and Banking Activities", in the event of their failure to comply with the qualification requirements and the requirements for business reputation established by Article 16 of Federal Law "On Banks and Banking Activities". According to Article 11.1 of Federal Law of 02.12.1990 No. 395-I "On Banks and Banking Activities" (hereinafter – Federal Law No. 395-I) apart from the general meeting of its founders (stakeholders) the managerial bodies of a credit organisation are the board of directors (supervisory board), single executive body and collegiate executive body. The day-to-day management of the activities of the credit organisation is done by its single

		executive body and collegiate executive body. The single executive body, his/her deputies, members of the collegiate executive body (hereinafter referred to as "the head of the credit organisation"), chief accountant, deputy chief accountants of the credit organisation, the head, chief accountant of a branch of the credit organisation are not entitled to occupy the positions of head or chief accountant in other organisations which are credit, insurance or clearing organisations, professional participants in a securities market, organisers of trade on commodity and/or financial markets and also joint-stock investment companies, the specialised depositaries of investment companies/trusts, non-state pension funds, organisations engaged in the provision of pensions and pension insurance, in the management of investment companies/trusts, joint-stock investment companies, unit investment trusts and non-state pension funds, organisations engaged in leasing or being affiliated entities in respect of a credit organisation, and to pursue entrepreneurial activities without the formation of a legal entity. If credit organisations are a parent and an affiliated economic associations in respect of each other the sole executive body of the affiliated credit organisation is entitled to occupy positions in the collective executive body of the credit organisation being the parent association, save the position of the chairman of that body. The members of the board of directors (supervisory board) of a credit organisation and contenders for said positions shall meet the requirements applicable to business reputation established by Article 16 of the present Federal Law, and also the qualification requirements established in accordance with federal laws. If in respect of a member of the board of directors (supervisory board) of a credit organisation a court's judgement of guilty has become final for the commitment of a deliberate crime or a court's decision ordering an administrative penalty in the form of disqualification has become final, the said member of the board of directors (supervisory board) shall be deemed removed from the board of directors (supervisory board) as of the day on which the relevant court judgement/decision becomes final. The persons mentioned in Part 3 of the present article -- while being considered by the Bank of Russia as nominees, appointed (elected) to a position and also within the entire term of office in the said positions, including temporary execution of the duties of office -- shall meet the qualification and business reputation requirements established by Article 16 of the present Federal Law. For the purpose of securing the consent of the Bank of Russia the credit organisation shall send a petition to the Bank of Russia for approval of nominees to the positions specified in Part 6 of the present article and provide the information and documents envisaged by Item 8 of Part 1 of Article 14 of the present Federal Law. Within one month after receiving the said documents the Bank of Russia shall grant its consent to the appointment (election) or produce a substantiated refusal in writing on the grounds envisaged by Article 16 of the present Federal Law. As this is being done, the due dates set by Paragraphs 5, 8-11, 15 and 16 of Item 1 of Part 1 of Article 16 of the present Federal Law shall be counted in respect of the date of receipt of said documents by the Bank of Russia. The Bank of Russia's refusal to consent to the appointment (election) of a nominee may be appealed against by him/her in court. The credit organisation shall notify in writing the Bank of Russia of the removal from their positions of the persons specified in Part 6 of the present article, not later than on the working day following the date of such decision. The credit organisation shall notify in writing the Bank of Russia of the election (dismissal) of a member of the board of directors (supervisory board) within three days after the date of such decision. New draft version of Regulation of the Bank of Russia of March 31, 1997 No. 59 "On the Application of Sanctions to Credit Institutions" is being developed currently to address the cases of violation by a credit institution of federal laws, as well as regulations and orders of the Bank of Russia issued in accordance with the laws, failure to submit information, presentation of incomplete or inaccurate information, failure to conduct the compulsory audit, failure to disclose information on its activities and the audit report on them, (planned to be published in 2014). 2. Capital requirements on individual credit organizations.

		Necessary amendments entered into force with the adoption of Federal Law No. 146-FZ. According to Article 56 of Federal Law No. 86-FZ the Bank of Russia shall be the body of banking regulation and banking supervision. The Bank of Russia shall exercise ongoing supervision over the compliance by credit institutions and banking groups with Russian legislation, the Bank of Russia regulations, required ratios set by such regulations and (or) individual required ratio limits established by the Bank of Russia. It shall conduct analysis of the activities of bank holding companies and use the information received from this analysis for the purposes of banking supervision over credit institutions and banking groups integrated into the bank holding companies. According to Article 57.2 of Federal Law No. 86-FZ the Bank of Russia shall assess in accordance with the procedure established by the Bank of Russia regulation the quality of the risk and capital management and internal control systems of a credit institution, banking group, capital adequacy and liquidity of a credit institution (banking group), their conformity to the nature and the scope of operations performed by a credit institution (in a banking group), the level and combination of risks assumed, including determining the volume and structure of operations as the criteria for such an assessment. Should an assessment reveal non-conformity of the risk and capital management and internal control systems, capital adequacy and liquidity of a credit institution (banking group) to the requirements set by the Bank of Russia and (or) the nature and scope of operations performed by a credit institution (in a banking group), the level and combination of risks assumed, the Bank of Russia shall be obliged in compliance with the procedure prescribed by it to send the credit institution (parent credit institution of the banking group) a direction on bringing their risk and capital management and internal control systems into conformity with the Bank of Russia requirements, the nature and scope of operations performed by the credit institution (in the banking group), the level and combination of risks assumed and (or) on establishing individual required ratio limits for the credit institution (banking group). According to Article 72.1 of Federal Law No. 86-FZ the Bank of Russia shall establish requirements for bank risk management methods and quantitative risk assessment models, including for the quality of data used in these models, applied by credit institutions and banking groups for evaluating assets, calculating capital adequacy ratio and other required ratios. A credit institution, the parent credit institution of a banking group may assume the duty of applying bank risk management methods and quantitative risk assessment models when calculating required ratios. Bank risk management methods and quantitative risk assessment models shall be applied only on the basis of a permission issued by the Bank of Russia at the request of the credit institution or the parent credit institution of the banking group. The procedure for obtaining the permission for applying bank risk management methods and quantitative risk assessment models shall be established by the Bank of Russia. The procedure for evaluating the quality of bank risk management methods and quantitative risk assessment models shall be established by the Bank of Russia regulations. The Bank of Russia shall refuse to give the permission, if an evaluation of the quality of bank risk management methods and quantitative risk assessment models held by the Bank of Russia finds them inconsistent with the Bank of Russia requirements. Credit institutions and parent credit institutions of banking groups must comply with the bank risk management methods and quantitative risk assessment models, the application of which was permitted by the Bank of Russia. A material change in bank risk management methods and quantitative risk assessment models applied pursuant to the Bank of Russia permission shall be allowed only on the basis of the permission obtained from the Bank of Russia in accordance with the procedure stipulated by this Article. The criteria of material changes shall be established by the Bank of Russia. In the event of a failure to comply with the bank risk management methods and quantitative risk assessment models, the application of which was permitted by the Bank of Russia, the Bank of Russia shall have the right in accordance with its prescribed procedure to require the compliance of the said bank methods and models and (or) establish increased values for risk parameters used for calculating capital adequacy and (or) apply measures stipulated by

		Part 1 of Paragraph 3 in Item 2 and Item 6 of Part 2 of Article 74 of this Federal Law. Should bank risk management methods and quantitative risk assessment models cease to comply with the Bank of Russia requirements, the Bank of Russia shall have the right in accordance with its prescribed procedure to require that the said bank methods and models be brought into compliance with the Bank of Russia requirements and (or) establish increased values for risk parameters used for calculating capital adequacy and (or) apply measures stipulated by part one of paragraph three in point 2 and point 6 of part two of Article 74 of this Federal Law. Should grounds be eliminated or changed for establishing increased values for risk parameters, the Bank of Russia shall take a decision on their cancellation and inform a credit institution and the parent credit institution of a banking group thereof in accordance with the procedure prescribed by the Bank of Russia. Should a credit institution or the parent credit institution of a banking group fail to comply with the requirements sent by the Bank of Russia in accordance with this Article, the Bank of Russia shall have the right to revoke according to its prescribed procedure the permission for applying bank risk management methods and quantitative risk assessment models for calculating capital adequacy. Letter of the CBR of 29.06.2011 No. 96-T on "Methodical recommendations on organization of internal capital adequacy assessment procedures" contained minimum requirements for organization by credit organizations of internal capital adequacy assessment procedures required for coverage of risks taken, potential risks and capital planning. As part of implementation process of Pillar 2 "Supervisory Review Process" the CBR has developed draft regulation on approval of internal capital adequacy assessment procedures (ICAAP) used by credit organizations. It is planned, that this regulation will enter into force in 2015 which will be the ground for the CBR to adjust capital requirements on individual credit organizations, taking into account their compliance with the said procedures. 3) Restrictions on transactions between affiliates. The Bank of Russia has the authority to ban or restrict transactions of credit institutions participating in a bank holding company with the parent institution of a bank holding company or with its participants (related persons). Draft Direction of the Bank of Russia "On Amending Instructions of the Bank of Russia of December 3, 2012 No. 139-I "On Required Ratios for Banks" clarifies the methodology for the calculation of the ratio of the maximum risk per borrower or a group of related borrowers (H6) and introduces a new ratio of the maximum risk per person related to a credit institution (a group of persons related to a credit institution) (H25) (planned to be published in 2014). According to Article 74 of Federal Law No. 86-FZ should a credit institution violate federal laws or the Bank of Russia normative acts or orders issued in pursuance of these laws, or fail to provide information or provide incomplete or false information, or fail to conduct a mandatory audit or disclose information on its activity and an auditor's opinion on it, the Bank of Russia shall have the right to require the credit institution to eliminate the violations discovered, charge a penalty of up to 0.1 per cent of the minimum amount of authorised capital or prohibit the credit institution from conducting some banking operations for up to six months, including operations with the parent credit institution of the banking group, the parent organisation of the bank holding company, participants of the banking group, participants of the bank holding company or a person related to the credit institution (persons related to the credit institution). Should a credit institution fail to fulfil the Bank of Russia order to eliminate the violations discovered in its work or should these violations or banking operations or transactions conducted by a credit institution pose a serious threat to the interests of its creditors (depositors), the Bank of Russia shall be entitled to impose a ban on the implementation of some banking operations by the credit institution under its banking licence for a period of up to one year, including operations with the parent credit institution of the banking group, the parent organisation of the bank holding company, participants of the banking group, participants of the bank holding company or a person related to the credit institution

		(persons related to the credit institution), and also prohibit it from opening branches for a period of up to one year. Should a parent credit institution of a banking group violate the requirements of federal laws in connection with its participation in the banking group, or fail to provide information or provide incomplete or false information, or fail to conduct a mandatory audit or disclose consolidated statements and an auditor's opinion on them, the Bank of Russia shall have the right to take measures against the parent credit institution of the banking group, stipulated by Part 1 of this Article. Should the required ratios established by the Bank of Russia for banking groups in pursuance of this Federal Law be violated, the Bank of Russia shall have the right to take measures against the parent credit institution of the banking group, stipulated by Part 1 of this Article. Should a parent credit institution of a banking group fail to fulfil the Bank of Russia order to eliminate the violations connected with its participation in the banking group or should these violations pose a threat to the legitimate interests of creditors (depositors) of the said credit institution or credit institutions that are members of the banking group, the Bank of Russia shall be entitled to impose a ban stipulated by item 3 of Part 2 of this Article.
4	Ensure the unified securities and insurance supervisor (FSFM) has the power to issue secondary regulation to interpret the law, as well as industry-wide binding norms.	Pursuant to Decree of the President of the Russian Federation No. 645, dated 25 July 2013, the FSFM was abolished on 1 September 2013. The FSFM authorities to exercise regulation, control and supervision on financial markets were delegated to the Bank of Russia from 1 September 2013 (Federal Law No. 251-FZ, dated 23 July 2013). According to the Article 76.1 of Federal Law No. 86-FZ the Bank of Russia shall be the body of regulation, control and supervision on financial markets over non-credit financial institutions and (or) the area of their activities in compliance with federal laws. Non-credit financial institutions in accordance with this Federal Law shall mean entities conducting the following types of activities: 1) the activities of professional securities market participants; 2) the activities of the management companies of investment funds, unit investment funds and non-state pension funds; 3) the activities of the specialised depositaries of investment funds, unit investment funds and non-state pension funds; 4) the activities of equity investment funds; 5) clearing activities; 6) the activities related to the performance of the functions of central counterparties; 7) the activities of trade organisers; 8) the activities of central depositaries; 9) the activities of insurers; 10) the activities of non-state pension funds; 11) the activities of microfinance organisations; 12) the activities of consumer credit co-operatives; 13) the activities of housing savings co-operatives; 14) the activities of credit history bureaus; 15) actuarial activities; 16) the activities of rating agencies; 17) the activities of agricultural consumer credit co-operatives; 18) pawn-shops. According to Article 7 of Federal Law No. 86-FZ on issues within its competence under this Federal Law and other federal laws, the Bank of Russia shall issue normative acts in the form of directives, regulations and instructions binding for the federal bodies of state power, the bodies of state power of the constituent entities of the Russian Federation and local self-government bodies and all legal entities and private individuals. At the same time, according to Article 1 of Federal Law of 27.11.1992 No. 4015-1 "On the Organization of Insurance Business in the Russian Federation" (hereinafter – Federal Law

		No. 4015-1): 1) The present Law regulates relationships between persons pursuing activity in the insurance business area or involving the participation of such persons, the relationships in carrying out supervision over the activities of insurance businesses and also other relationships relating to the organisation of the insurance business. 2) Relations mentioned in Item 1 of this Article are also regulated by the federal laws and by the normative acts of the Central Bank of the Russian Federation (hereinafter referred to as the Bank of Russia) and in the cases stipulated by federal laws - by the normative legal acts of the Russian Federation passed in conformity with them (hereinafter referred to as normative legal acts). 3) For the purposes of the present Law the federal laws, other normative legal acts and the normative acts of the Bank of Russia envisaged by Items 1 and 2 of the present article are deemed an integral part of the insurance legislation.
5	Empower the FSFM to require insurers to have in place internal controls and risk management systems commensurate with for the complexity of their business.	According to Federal Law of 23.07.2013 No. 234-FZ "On the Introduction of Amendments into the Law of the Russian Federation on Organising the Insurance Business in the Russian Federation" insurance companies are now obliged to establish internal control systems which will ensure efficiency of insurers' risk management. In order to ensure reliability of internal control systems, assess their effectiveness and inspect the compliance with the law on insurance companies' activities, insurers are also obliged to establish internal audit systems. Currently the CBR is developing recommendations on establishment of internal control and internal audit systems. At the same time, the CBR is analysing the efficiency of implementation of the said systems. The results of the analysis will be used in preparation of necessary recommendations on the organization of internal control systems. Concerning the risk management efficiency the CBR is drafting a regulation which will set capital requirements. This document will be the first step in the implementation of the Solvency-II system. As a next step, the CBR is planning to introduce assessment of solvency depending on total balance, calculations of the capital requirements on the basis of risk common to insurers, fair value management, and calculations of insurance reserves using the best estimate method. According to the Article 76.1 of Federal Law No. 86-FZ the Bank of Russia shall be the body of regulation, control and supervision on financial markets over non-credit financial institutions and (or) the area of their activities in compliance with the federal laws. (See answer to question 4). Requirements for establishing internal control are stipulated in the legislation. According to Article 28.1 of Federal Law No. 4015-1 an insurer is obliged to organise an internal control system that provides achievement of the following goals: 1) effectiveness and performance (including the break-even) of the insurer's financial-economic activity when making insurance and other transactions; 2) effectiveness of the management of assets including securing of their safety, of the own funds (capital), of insurance reserves and of the insurer's other liabilities; 3) effectiveness of the management of the insurer's risks (exposure, estimation of risks, defining the acceptable level of risks assumed by the insurer and taking measures for maintaining their level as not threatening the insurer's financial stability and solvency); 4) authenticity, fullness and objectivity of financial reports, statistical reports and reports by way of supervision and the timeliness of compiling and presenting such reports; 5) observation by the insurer's workers of ethical norms and of the principles of professionalism and competence; 6) counteraction to the legalising (laundering) of incomes derived through crime and to the financing of terrorism in conformity with the legislation of the Russian Federation.

		In conformity with powers defined in the insurer's constituent documents and in the internal organisational and directive documents the internal control is exerted by: 1) insurer's management bodies; 2) insurer's auditing commission; 3) insurer's chief accountant (his deputies); 4) insurer's internal auditor (the internal audit service); 5) special official or structural subdivision responsible for the observation of rules of internal control and for the implementation of programmes for its exertion elaborated in conformity with the legislation of the Russian Federation on counteracting the legalising (laundering) of incomes derived through crime and to the financing of terrorism; 6) actuary; 7) insurer's other workers and structural subdivisions in accordance with powers defined in the insurer's internal organisational-directive documents. According to Article 28.2 of Federal Law No. 4015-1 for the purposes of organising the internal audit the insurer approves the regulations on organising and exerting the internal audit (hereinafter referred to as the regulations on the internal audit) which shall contain: 1) goals and tasks facing the internal audit; 2) objects of the internal audit in conformity with the insurer's risk management models; 3) forms and methods of the internal audit; 4) order of actions of the internal auditor and of the internal audit service if violations and shortcomings are exposed in the insurer's activity; 5) composition of reports on the results of conducted checks, the forms and procedure for their presentation; 6) procedure for the exertion of control (including for conducting repeated checks) over taking measures aimed at eliminating violations and shortcomings in the insurer's activity revealed by the internal auditor or by the internal audit service; 7) procedure for informing the shareholders (partners) of an insurance organisation or members of a mutual insurance company of all violations admitted by the insurer's management bodies in case of their adopting decisions on the issues referred to the competence of the general meeting of the insurance organisation's shareholders (partners) as well as of the general meeting of members of a mutual insurance company; 8) powers, rights and duties of the internal auditor and of the internal audit service; 9) form and procedure for estimating risks and the effectiveness of the risks management; 10) procedure for estimating the expediency and effectiveness of transactions and deals; 11) form and procedure of checking provisions for the preservation of assets; 12) form and procedure for participation in carrying out an analysis of the insurer's financial position; 13) other provisions not contradicting the legislation of the Russian Federation.
6	Apply fit and proper requirements to directors and key management of insurers on an ongoing basis.	Requirements to directors and key management of insurers are stipulated in Federal Law of the Russian Federation No. 4015-1. Extracts from Federal Law No. 4015-1: Article 32.1. Qualification and Other Requirements (extract) 1. The heads (in particular, the single executive body, the head of a collegiate executive body) of an insurance entity being a legal entity and an individual entrepreneur engaged in insurance business shall have a higher education confirmed by a document certifying higher education recognised in the Russian Federation and also work experience for at least two

		years as a head of a subdivision of an insurance entity, other financial organization. 2. The chief accountant of an insurance, reinsurance organisation shall comply with the requirements set by Federal Law No. 402-FZ of December 6, 2011 "On Accounting" and shall have a work experience in accounting at an insurance or a reinsurance organisation for at least two years out of the last five years preceding the appointment to the said post. The chief accountant of an insurance broker shall have a higher education confirmed by the document on a higher education recognised in the Russian Federation and shall have a work experience for at least two years at a subdivision of an insurance entity whose activity is related to accounting or finances. The chief accountant of a mutual insurance company shall have a higher education confirmed by the document on a higher education recognised in the Russian Federation and shall have a professional work experience in economics or at a position requiring the knowledge of accounting of at least two years at an insurance or a reinsurance organisation or at a mutual insurance company and (or) at an organisation of an insurance broker registered on the territory of the Russian Federation. 3.1. An internal auditor, a head of the internal audit service shall have higher education in economics, finance or law confirmed by a document on higher education in economics, finance or law recognised in the Russian Federation and a professional work experience of no less than two years in an insurance, reinsurance, other financial or audit organisation registered in the Russian Federation, as well as in the state financial control authorities of the Russian Federation. If the persons named in this Clause have a different higher education they must confirm the fact of undergoing the professional retraining in economics, finance or law, having submitted a document recognised in the Russian Federation on undergoing the professional retraining and shall have a work experience for at least three years at a subdivision of an insurance entity whose activity is involved with accounting, finance or legal matters. 4. An internal auditor, a head of the internal audit service may not be a person who: 1) fulfilled the functions of a single executive body, chief accountant of the insurer or was a member of a collegiate executive body of the insurer during two years preceding the date of appointment as internal auditor, head of the internal audit service; 2) is a shareholder (equity participant) of the insurer; 3) is related by consanguinity or by affinity (parents, spouses, children, brothers, sisters, as well as brothers, sisters, parents and children of spouses) to shareholders (equity participants) of the insurer or to a person, who is a single executive body of the insurer or a member of the Board of Directors (Supervisory Board) or a collegiate executive body of the insurer, or to a chief accountant of the insurer. 5. The heads (including the single executive body) and the chief accountant of an insurance entity being a legal entity shall permanently reside in the territory of the Russian Federation. 6. Persons indicated in Clauses 1, 2, 3.1 of this Article, as well as members of the Board of Directors (Supervisory Board), members of the collegiate executive body of an insurance entity being a legal entity shall not be: 1) persons who acted as a single executive body in financial organisations at the time when such organisations committed violations resulted in their respective licence cancellation (revocation), or violations resulted in the suspension of the said licences and in the subsequent cancellation (revocation) of these licences following such organisations' failure to correct these violations, if less than three years have elapsed since the moment of such cancellation (revocation). For the purposes of this Law a financial organisation shall mean a professional securities market participant, clearing organisation, management company of an investment fund, unit investment fund and non-state pension fund; a specialised depository of an investment fund, unit investment fund and non-state pension fund; a joint-stock investment fund, credit institution, insurance entity, non-state pension fund, a trade organiser; 2) persons which were disqualified as a result of administrative sanctions, whose

		terms of disqualification have not expired; 3) persons whose criminal records for committed economic crimes or crimes against state have not been removed or expunged. 7. Under the circumstances specified in sub-clauses 1-3 of Clause 6 of this Article an existing member of the Board of Directors (Supervisory Board) shall be deemed as excluded from such bodies as of the date on which a corresponding decision of an authorized body or court comes into force. 12. The insurer is obliged to inform in writing the insurance supervisor on the assignment to a position and on the dismissal of persons referred to in Clauses 1, 2, 3.1 of this Article not later than within ten working days as from the day of taking such decision. Article 28.2. Internal Audit 5. A person appointed as internal auditor, head of the internal audit service, is prohibited from holding more than one office. An internal auditor, a head of the internal audit service may be included in the insurer's auditing committee. An internal auditor, a head and staffers of the internal audit service, who previously held positions in other structural units of the insurer, may take part in checking the activity of these structural units after 12 months from the date of termination of their employment in these structural units.
7	Make home-host notifications and cross-border cooperation in insurance mandatory for the FSFM.	International treaties and bilateral agreements with foreign financial market regulators may stipulate the Bank of Russia's duty to provide foreign insurance supervisors with information pertaining to the activities of parent/subsidiary insurers in the respective countries. – See Article 51.1 of Federal Law 'On the Central Bank of the Russian Federation (Bank of Russia)'. Article 51.1 of Federal Law 'On the Central Bank of the Russian Federation (Bank of Russia)'. «The Bank of Russia shall be entitled to request a foreign financial market regulator to provide it with information and (or) documents, which may be confidential, including those that contain data constituting bank secrecy. The Bank of Russia shall exchange information and (or) documents, which may be confidential, including those that contain data constituting bank secrecy (hereinafter confidential information), with a foreign financial market regulator pursuant to and in compliance with: 1) the Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information of the International Organisation of Securities Commissions; 2) an international treaty of the Russian Federation; 3) a bilateral treaty with a foreign financial market regulator envisaging an exchange of information, if the legislation of the corresponding foreign state stipulates the level of security for information provision at least matching the level of information security envisaged by Russian Federation legislation. As regards confidential information received from a foreign financial market regulator, the Bank of Russia shall be obliged to comply with the requirements for the disclosure of confidential information established by the Russian Federation legislation, taking into consideration the procedure stipulated in Part 2 of this Article. Confidential information received by the Bank of Russia from a foreign financial market regulator may be provided to third parties only with the consent of such a regulator, except for the cases when the said confidential information is provided to a court of law pursuant to a court judgement passed in criminal case proceedings. Upon receiving a reasoned inquiry from a foreign financial market regulator in accordance with the procedure stipulated by agreements specified in Part 2 of this Article, the Bank of Russia shall send an order to provide such information (to a financial institution) pursuant to a decision taken by the Financial Supervision Committee. The Bank of Russia order to provide information shall not include the purpose of receiving such information. Pursuant to a decision by the Board of Directors, the Bank of Russia shall be entitled to provide a foreign financial market regulator with confidential information on operations

		and (or) transactions upon a reasoned inquiry from the foreign financial market regulator in cases stipulated by agreements specified in part two of this Article, and also on persons who performed the said operations and (or) transactions and (or) beneficiaries under these operations and (or) transactions, except for information constituting state secrecy. The Bank of Russia shall provide such confidential information to a foreign financial market regulator on condition that the legislation of the corresponding foreign state stipulates the level of security for information provision at least matching the level of information security envisaged by Russian Federation legislation, and also on condition that the foreign financial market regulator may not provide confidential information to third parties, including law-enforcement agencies, without the Bank of Russia's prior consent, except for the cases when such confidential information is provided to a court of law pursuant to a court judgement passed in criminal case proceedings.
8	Adopt pending legislation that empowers the FSFM to appoint a provisional administrator, freeze assets, and wind down distressed securities firms.	Federal Law of 26.10.2002 No. 127-FZ "On Insolvency (Bankruptcy)" contains articles concerning bankruptcy of financial organisations which stipulate the following possible measures: 1) possible appointment of provisional administration; 2) measures aimed at prevention of bankruptcy of a credit organization, including adjustment of assets and liabilities structure of a financial organization, reorganization of a financial organization. Adjustment of organizaton's assets structure may envisage sale or transfer of financial organization's unprofitable assets, as well as sale or transfer of financial organization's assets, if this will not prevent the credit organization from meeting its license requirements and solvency requirements. 3) Change of organizational structure of a financial organization, which can be implemented by means of: 1. changing the composition and quantity of employees 2. changing the structure (including by terminating structural divisions, branches, representative offices or other separate structural division of an organization). The Bank of Russia is empowered with control functions in case of insolvency (bankruptcy) of a non-credit financial institution and subsequently has the right to appoint provisional administrator.
9	Require government guarantee for all CBR loans that are unsecured or not backed by marketable collateral or guarantees.	Russian legislation does not oblige the CBR to require government guarantees for loans that are unsecured or not backed by marketable collateral. At the same time, the CBR may provide unsecured loans only in case of significant liquidity deficit in the market as was the issue in 2008-2009. Now the CBR does not provide unsecured loans to banks.
10	Require repo transactions to take place using central counterparty clearing. Set limits on concentration of collateral in the repo market.	There is no such requirement in Russian legislation, but economic incentives were created (Instructions of the Bank of Russia of 03.12.2012 No. 139-I): lower ratios for operations with central counterparties. As a result, the share of centrally cleared repo transaction has reached about 30% in the 1st quarter of 2014.