

# The Main Directions of the Bank of Russia's Activity in the System of Integrated Financial Regulation

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**Abstract: Actuality:** The transition to integrated financial regulation brought the issue on the central banks' role in the new configuration of financial supervision; on the necessity of resistance to financial crises and systemic risks; on overcoming of sectoral fragmentation in the area of regulation and supervisory activities' standardization based on best supervisory practices.

**Novelty:** The regulatory and supervisory function has evolved into a critical factor in management of the financial system stability. Rethinking of the essence of the financial integral regulation has allowed distinguishing three separate directions: ensuring of financial stability, macroprudential oversight and regulation of moral hazard risk in the banking sector, financial institutions' business behavior and limitation of the intention to establish the regulatory arbitrage.

**Practical Value:** In countries, that have adopted the integral regulation of the financial market, in relation to all its sectors, the authors propose to develop and apply standards of the moral hazard risk regulation in the banking sphere and the business behavior of financial institutions; universal standards and technologies of regulation and supervision in order to limit the establishment of regulatory arbitrage; leveling of systemic risks of financially-credit sphere.

**Keywords:** Megaregulator, banking system, financial system, non-credit financial organizations, microfinancial organizations, the role of the Bank of Russia.

## 1. THE NECESSITY TO ESTABLISH A MEGA-REGULATOR IN RUSSIAN FINANCIAL MARKET

Financial market is among those sectors of economy that are kept under strong government regulation and control, since the financial intermediaries' activity makes its own effects upon socio-economic position of the country population. For this reason, the issues on limitation of risks assumed by market actors, ensuring liquidity for depository institutions; and also solvency for the national payment system; prevention of bankruptcy and protection of the rights of financial service consumers are gaining a special importance.

This calls for establishment of a mega-regulator and search for effective methods on financial sphere regulation, namely: ensuring of financial stability; systemic risks' determination, leveling and regulation together with moral hazard risks of financial institution in the financial sphere.

Economic basis for establishment of a single regulatory authority at the financial market is a highly integrated and combined functions and operations at this market, accompanied by the tendency on financial institutions' universalization. Therefore, it is of vital importance for the government to be able to manage

financial risks within financial activity and make organizations from this market segment to observe the laws and rules regulating their activity and to reduce the amount of damage which they will suffer should the potential risks be realized.

Among major factor stimulating transition to the system on financial-market mega-regulation, the following may be emphasized: the mutual ingress of various directions of financial business as the result of new financial tools that have emerged in conditions when the combined financial servicing becomes the dominant tendency; increase of the role played by the off-bank financial institutions and their more significant cooperation with the banking sector, resulting in common features in procedures of licensing, supervision and regulation for various financial companies; change of qualitative and quantitative parameters of risks assumed at the financial markets; consolidation of business via merger and acquisition and establishment on this basis of mega-bank and mega-financial structures.

Thus, the most important indicator of necessity to establish a mega-regulator is the increasingly multiplicity of products and services offered by one and the same financial organizations. As we know, the more sophisticated products and services are, the more difficult it is to assess them for specialized regulators. In developed countries, many banks offer an integrated package, including loans, securities and insurance policies.

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Upon establishment of the mega-regulator realized may be the model on integrated (or cross-sectoral) regulation. This means that the process started on gradual abandonment of the “per-segment” financial-market regulation in favor of transition to “cross-sectoral” regulation.

“Cross-sectoral” regulation requires to take into consideration the specific features of sectors on financial intermediation (stock market institutions, microfinancial organizations and banks) in order to prevent any potential conflict of their interests. Cross-sectoral model on regulation and supervision in financial sector is based on the complete or partial integration of functions on supervision in one or two departments.

Both on International and at the domestic level, people are still debating which supervision system is more advantageous: the mega-regulator system or traditional system involving several competent authorities which imply that the supervision functions will be entrusted to several authorities.

The selection of the mega-regulator model by a country depends on a country’s level and direction of development, distribution of assets owned by the financial sector per types of activity (e.g. banking, insurance or investment activity), existence or absence of appropriate governmental financial institutions and structure of client bases that financial institutions have.

Initially, the appearance of integrated supervision models was linked to the necessity to reduce budgetary costs usually spent to keep the supervisory system in operation. Later, development of various financial tools and the increasingly consolidated financial sectors made it popular in early 2000’s. In a number of countries, financial supervisory authorities, self-contained and, often, independent, to a certain extent, from their national governments, had come to existence to supervise all major sectors of financial markets concurrently and play the role of mega-regulators. The mega-regulators began practicing independent, integral regulation in Norway (in 1986), in Iceland, Denmark, Sweden, England, Germany, South Korea, Hungary, Kazakhstan and, approximately, in 50 other countries.

Within such model, supervision over various financial market sectors is maintained by a single service. In such case, the financial market has a single regulator that laid upon itself all functions on regulation

and supervision over all spheres of activity conducted by all financial institutions. In this case, regulation and supervision over banks’ activities are conducted by a central bank or by any other institution, along with supervision over insurance companies, security market participants, investment funds and other providers of financial services. Under such circumstances, competence held by the supervisory authority extends beyond the banking system.

## **2. SPECIFICS FEATURES ON ESTABLISHMENT OF AN INTEGRATED REGULATION AND SUPERVISION MODEL FOR RUSSIAN FINANCIAL MARKET**

In Russia, financial market regulation and supervision were responsibilities divided between several independent authorities. The authority to regulate financial market was entrusted to the lawmaker, the Government, Ministry of Finance, Federal Service for Financial Markets (FSFM) and the Bank of Russia. Regulatory authorities (such as FSFM, as it was in Russia, for example) often applied different approaches to similar types of activity by the subordinated organization, as well as requirements and criteria on assessment of their business performance. This was a large impediment for the process of summarization of any available data and it was also a factor which distorted the general picture on the state of the national financial market. As a result, none of the existing regulators had any holistic idea on the status of the national financial market, and, hence, none of them was able to adequately assess the existing systemic risks or to offer any effective methods to minimize them. All these factors made the forecasting of any prospects on national economic development difficult and also impeded the development of the optimal monetary –credit policy and a policy on development and ensuring stability for the financial markets, which is one of the most important tools for social –economic management of a country.

The need for standard and generalized estimation of financial and economic situation in this country was increasing in line with the financial market development and turning into more complicated structure, with the reinforcement of interrelations between its participants, convergence of their activities; by the growing consolidation of financial-sector companies into groups and holdings, which, as a rule, offer the entire range of financial services. For instance, Savings Bank, Alfa-Bank, VTB and Rosbank are multi-purpose structures incorporating a legal entity involved into banking

activity; a legal entity engaged in security market business; an insurance and investment company. This means that they are exposed to potential risks in all spheres of business. Obviously, without consolidated control and supervision over entire financial group, it is not possible to get a complete picture of the state of affairs of each of its members, to identify the entire range of the existing risks and offer optimal ways of their leveling and elimination.

In September 2013, Federal Law 251-Φ3 dated 23.07.2013, titled: "On Amendments to Individual Legislative Acts of the Russian Federation Due to Transfer, to Russian Central Bank, of Regulation, Control and Supervision Authority in Financial Market Sphere" came into effect [Federal Law (2013)]. Such law delegated to the Bank of Russia (except functions of supervision over commercial banks) functions of control over non-lending financial organizations.

**Table 1: Major Directions of Activity of the Bank of Russia in its Status of the Mega-Regulator**

Chapter/Article	Direction of activity
Article 4	Regulatory functions relevant to the mega-regulator's responsibilities
Item 1.1 dd. 23.07.2013, N 251-Φ3	To develop and implement, together with the Russian Government, the policies of developing and ensuring stability for financial market in Russian Federation;
Item 4.1 dd. 27.06.2011, N 162- Φ3	To supervise and monitor the national payment system;
Item 8	State registration of lending organizations; banking transactions; issue, suspension and revocation of banking licenses.
Item 8.1 dd. 28.12.2013, N 410- Φ3	State registration of non-governmental pension funds.
Item 9	Supervision over lending organizations and banking groups
Item 9.1 dd. 23.07.2013, N 251- Φ3	Regulation, control and supervision over non-lending financial organizations.
Item 10.1 dd. 23.07.2013, N 251-FZ	Control and supervision over issuers' compliance with Russian laws on joint stock companies and securities;
Item 10.2 dd. 23.07.2013, N 251- Φ3	Regulation, control and supervision over corporate relationships within joint stock companies;
Item 18 dd. 23.07.2013, N 251- Φ3	Analyzing and forecasting of economic situation in the Russian Federation; publication of the relevant materials and statistical data;
Item 18.3 dd. 23.07.2013, N 251- Φ3	Control over compliance with Russian laws on counteracting the illegal use of insider information and manipulation of market;
Item 18.4 dd. 23.07.2013, N 251- Φ3	Protection of rights and lawful interests of shareholders and investors at financial markets and by insuring parties, insured parties and beneficiaries.
Chapter 3, Article 18, Item 9 dd. 07.03.2018, N 53-FZ.	Bank of Russia's Board of Directors determines the size of extra risk-ratio premium rates to be applied in order to reduce any hazards to Russian financial stability, as per individual asset types.
Chapter 7.1 dd. 23.07.2013, N 251- Φ3	Developing and implementing (by Bank of Russia together with Russian Government), the policies on development and providing stability for operation of Russian financial market
Chapter X.2 01.05.2017, N 84- Φ3	Banking Sector Consolidation Fund Managing Company
Article 76.10.	Bank of Russia may, in order to take specific steps towards financial rehabilitation of any lending organizations, establish Limited Liability Company "Banking Sector Consolidation Fund Managing Company", while acting as its sole Member. On behalf of Bank of Russia, the Fund shall participate in process on prevention of lending organizations' bankruptcy and use any money, which make Banking Sector Consolidation Fund.
Chapter XI dd. 23.07.2013, N 251- Φ3	Relationship between Bank of Russia and lending organizations, non-lending financial organizations, their associations and unions, and also with self-regulated entities made up of non-lending financial organizations.
Chapter 12.1 dd. 27.06.2011, N 162- Φ3	Providing stability and development for the national payment system

Reference: Federal Law dated 10.07.2002, N 86- Φ3 Z (version of 07.03.2018), titled: "On Russian Central Bank (Bank of Russia)" (as amended, effective since 18.03.2018).

Amendments to the laws on main directions of activities conducted by the Bank of Russia as the sole independent mega-regulator are listed in Table 1.

In the result of the activity aiming at the establishment of the sole mega-regulator on the Basis of the Bank of Russia, its authorities had been increased, i.e. it laid upon itself the responsibilities on supervision and regulation of non-lending financial organizations, and also functions to ensure financial and pricing stability and financial markets' development.

For the purpose of regulation, control and supervision by the Bank of Russia, Financial Supervision Department (within the Bank of Russia) shall be established which will be responsible for state registration, licensing and accreditation of non-lending financial organizations.

All powers of the sole mega-regulator in micro- and macroprudential supervision over lending organizations, non-lending financial organizations and institutional investors were concentrated in the same hands, allowing to simplify and consolidate the complicated structure as it exists in many countries, and combine functions on regulation, supervision and protection of consumer rights.

### 3. THE CENTRAL BANK'S ROLE IN THE NEW CONFIGURATION ON FINANCIAL REGULATION AND SUPERVISION

The transition to the mega-regulator highlighted the issue of the Central Bank's new role in the economic system.

The principal function of the financial system is redistribution of capital, while lending and non-lending financial organizations, who are acting as intermediaries in the financial markets, are reducing transaction costs related to capital flow between them. The Central Bank's role is in regulation of the financial market using tools of monetary and macroprudential policies and via creation of conditions allowing to increase attractiveness of investment for the benefit of economic growth.

The result of the mega-regulator's activity at the financial market can be seen by how efficiently it re-distributes the monetary capital for the purpose of macroeconomic equilibrium, financial stability and a higher economic growth.

The mega-regulator's tasks at the financial market are presented in Table 2.

Bank of Russia's purposes as of the financial market mega-regulator: to provide sustainable

**Table 2: Mega-Regulator's Major Tasks in the Financial Market**

Tasks	Solutions
Overcoming sectoral fragmentation in regulation and supervision	The task is set forth to maintain supervision on the consolidated basis, especially within banking supervision system, which makes it possible to analyze activity conducted by banks as members of larger entities, more complex in terms of management and economy – that is, banking groups and banking holdings
Creation of a macroprudential regulation system	Identification and prevention of systemic risks; implementation of macroprudential supervision
Solving the issue of regulatory arbitration, i.e., problem arising out of regulation by dissimilar authorities of the same relationship types	Establishment of an effective consolidated supervision system; exclusion of any regulatory arbitration; improvement of the existing supervision culture and implementation of the best non-banking supervision practices (including application of professional judgment); transition to risk-oriented supervision in relation to non-lending financial organizations.
Standardization of supervision based on best supervisory practices.	Transition to the system of risk-oriented supervision over all financial market participants.
Resistance to financial crises and systemic risks.	Financial cycle effacement: "soap bubbles" prevention at financial asset markets, if they are, potentially threat to financial system's stability. Prevention of financial market crises; responding in due time to any crises, irrespectively of specific sectors they arise in. Possibility for liquidity for financial market stabilization; transparent central bank's policies and overcoming of panics among investors and creditors.
Provision of macroeconomic equilibrium	Independency in monetary policies, in order to provide price stability.
Applying a specific set of tools	Macroprudential standards should be counter-cyclical (dynamic) in order to counteract "soap bubbles" and imbalances at financial asset markets.

development for Russian financial market; effective management of risks arising in financial markets, rapid identification and resisting to crises; protection of rights and lawful interests of financial market investors, insuring and insured parties and beneficiaries, and also parties insured under compulsory pension insurance schemes, depositors and participants of any non-governmental pension funds, for non-governmental retirement benefit purposes, and any other financial service consumers (other than banking service consumers).

The Bank of Russia's present day activities as tools, serve its essential economic purpose as the mega-regulator:

1. Creation of a prudential and macroprudential supervisory system, the principal purpose of which is to maintain macroeconomic equilibrium and financial stability; regulation of risks and systemic risks with focus on, first, preventive supervision and prevention of law infringements but not on administrative measures.
  2. Creation of a macroprudential regulation system for systemically important financial organizations and direct control to be maintained by the mega-regulator over banking sector, which is backbone sector important for financial market.
  3. The development of transparent policies and creation of a single financial-market documentation center responsible for monitoring of market situation.
  4. The development of a flexible system of supervision, control and regulation of financial market entities for identifying and counteracting crisis situations, such as regulatory arbitration, for trying to profit from differences in the regulation of different jurisdictions where the same physical or legal person can act in different regulatory spaces and choose - where is the best. An example in modern Russia can be the situation where an organization can choose whether to call it a pawnshop and fall under the relevant law and under the regulation of the Bank of Russia or be called a commission shop, perform the same operations as a pawnshop, but do not fall under the regulation of the Bank of Russia.
- For credit institutions and non-credit financial organizations, the development, optimization and implementation of standards of proportional regulation, self-regulation and basic standards for risk management.
5. The development of a competitive environment in financial market; identification of any crises and counteracting them.
  6. Minimization of moral hazard risk; regulation of business behavior of financial institutions and financial market actors. In such a case, institution or banks, financial intermediaries (first, banks with a government share), do not assume full responsibility for their actions and put it on the state. Such situations occur as the result of asymmetric data in financial market, when some of contracting parties have significant data not available to other parties of the same transaction.
  7. Design and implementation of the policy on attaining and securing stability of Russian financial market (in collaboration with the Government); maintenance of stability in Russian banking system and protection of the depositors/ creditors interests.
  8. Supervision and monitoring of the national payment system.
  9. Control and supervision over issuers 'compliance with the Russian laws on joint stock companies and securities.
  10. Regulation, control and supervision over corporate relationships within joint stock companies.
  11. Protection of rights and lawful interests of shareholders and investors at financial markets and of insuring/insured parties and beneficiaries, who are recognized as such under the insurance laws, and also of parties insured under compulsory pension insurance schemes, depositors and participants of any non-governmental pension funds for non-governmental retirement benefit purposes.
  12. Analyzing banking holdings' activities, for purposes of banking supervision over lending organizations and banking groups incorporated into banking holdings. Continuous supervision over compliance with the laws by lending organizations and banking groups norms and

standards set up by Bank of Russia; compulsory standards set up by them and/or individual maximal and minimal rates for compulsory standards set up by Bank of Russia. Control over compliance with Russian laws when it concerns the illegal use of insider data and manipulation of the market.

13. Regulation, control and supervision over activity conducted by non-lending financial organizations, in order to maintain stability of the national financial market. Bank of Russia is the authority responsible for financial market regulation, control and supervision over non-

lending financial organizations and the sphere of their activity.

However, the mega-regulator's functions have their own specific risks (organizational, legal and economic).

1. Systemic risk assessment implies identification of risks and systemic risks carriers. In the banking sector, the regulator had strived to resolve this issue long ago, practicing risk-oriented supervision philosophy. For each of all other financial market sectors, it is necessary to develop "its own philosophy", considering specific features of each such sector.

**Table 3: Results Attained by Bank of Russia as the Financial Market Mega-Regulator**

Regulated party	Steps taken by the mega-regulator
Banking sector	Proportional banking-sector regulation law is promulgated Insurance indemnity rate payable, as per individuals' deposits, is increased from 700 thousand Rubles up to 1.4 million Rubles. Transition to Basle 1,2,3 standards is under way Supervision over systemically important banks is tightened
Insurance market	Certain elements of risk-oriented approach are introduced. Compulsory third-party liability car insurance (OSAGO) system is reformed (applicable uniform tariffs reviewed; increased control over application of standard insurance tariffs in Russian constituent entities). A draft version is made for plan of accounts and reports for use by insurers and insurance brokers
System of guarantee support for the rights of insured parties. Non-governmental pension funds (NPF)	Applicable since January 1, 2015. Pension Savings Guarantee Fund has been established in Deposit Insurance Agency, where all retirement funds participating in the guarantee system are required to make annual contributions.
Professional participants of securities market	Capital adequacy standards are developed and made applicable. Document titled: "Unified requirements to brokerage regulations to be applicable to transactions with a broker's client's property" is developed and made applicable. There is no access, for foreign brokers to any transactions in Russian stock exchange markets, any longer
Microfinance organizations (MFO and credit consumer cooperatives (CCC)	Proportional regulation is made applicable at the microfinance market MFO and CCC are included into the credit reference bureau. It became compulsory to shape reserves against loan losses that may arise. Formula applicable to calculation of full loan values for MFO is modified, and the full loan values became compulsory for disclosure. MFO are made entitled to issue bonds
Bank of Russia Expert Council for Debt Instrument Market	May 2015. Collection, analysis and summarization of opinions held by Russian financial-market participants on top-relevant issues of long-term investment market; expertise of legal norms and standards applicable in the Russian Federation and regulating long-term investment market, including preparation of analyses and other support information on matters related to situation prevalent at the long-term investment market.
Expert Council for Financial Asset Securitization	Making recommendations for strategy and policy to be applicable to development and provision of stability for the functioning of financial market.
National Clearing Center (National Payment Cards System, NPCCS)	Joint Stock Company "National Payment Cards System" (NPCS) is MIR National Payment System operator established on July 23, 2014. 100% of JSC "NPCS" shares are held by Russian Central Bank. Provision of sovereignty for national payment space; guarantee for safe and smooth making of banking card-supported intra-Russian transactions.

Reference: compiled basing on: Monetary policy report – Issue No 4 (20) • December 2017; Financial stability overview • Quarter 2-3 of 2017; Major lines of unified governmental monetary policy for 2018 and for 2019-2020; Bank of Russia's annual report for 2016; Report on development of banking sector and banking supervision system in 2016; Findings of monitoring in the national payment system for 2014–2016; Major lines of Russian financial-market development for 2016–2018; [https://elibrary.ru/download/elibrary\\_24341692\\_13968484.pdf](https://elibrary.ru/download/elibrary_24341692_13968484.pdf)

2. Systematically significant banks bear systematic risks within the Russian financial sphere. In their lending policies, systemically significant lending organizations rest, to a large extent, on deposits from individuals and they bear high-rate moral hazards, as being "too big to fail". Therefore, there is a need to insert in compulsory mode the regular assessment of systemically important players not only in banking, but also in the entire financial sector.
3. New market environments required rethinking of the essence of risk-oriented supervision. Up-to-date approach has required to create more homogeneous system of supervision over similar activities conducted by various market participants and, hence, a modified structure of financial regulatory authorities, removal of duplication and reduction of cost for regulation by governmental authorities also.

The Bank of Russia's results attained by it as the financial market mega-regulator are presented in Table 3.

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