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Credit Risk and Non-Performing Assets in Russian Banking Sector Since 1990's: An Analytical View

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Abstract : Finance and growth goes hand in hand, it is a general phenomenon and thereby it becomes pertinent to have satisfactory and sufficient availability of finance for the economic growth and banks that acts as an intermediary between depositors and borrowers helps in facilitating and smoothing the process of growth. Banks in this process of providing service earns profit in the shape of interest margins and if the borrowers do not repay back (NPL) the principle and interest on time then it affects banks profitability and bank accumulates NPL. Russian banking sector too suffers from the problem of NPLs, hence it is important to manage this issue through proper credit risk management.

Keywords : Credit Risk, Non-Performing, Assets, Russian, Banking, Sector, Since, Analytical, View.

Introduction- The main function of a full bloomed financial intermediary is to enhance domestic savings, efficiently allocate investment resources to enhance the productivity of an economy and enhances the rate of economic growth. Generally, it is considered the main function of financial intermediation in all countries and similar function was also performed by the financial intermediation in Russia since Soviet times as well. But in Soviet economy, banks rather playing an active role usually play a passive role merely collecting household savings and distributing grants to the enterprises and money was used as a tool to avoid difficulties of barter system. Literature available of around the year 2000 depicts that even a decade has been passed for transition, movement from a soviet type banks to market type banks, one can easily witness that incompleteness and uncertainty prevails in the sector. one can easily witness the rise in the number of financial institutions nonetheless domination of state sector still continues with legal and regulatory framework remained incomplete and asymmetric information required for risk management was of low grade and even the response from policymakers and regulators remained slow in acting to improve intermediation services. One cannot ignore the strides made for growth in this sector; nonetheless much has to be accomplished.

History of the Soviet banking system- History of anything helps in understanding past, present and future of any aspect and banks are one such that had played an important role in human-beings society. It is through banking system that people started understanding the significance of savings and the same can be invested further and thereby cats as a catalyst in economic growth multiplier. History of Russian banking system is quite interesting dated back mid of the 18th century during which the first Russian bank "the Gentry Credit bank" and the "Merchants Bank", started in 1754 in St. Petersburg and Moscow that respectively operated in care of the Russian Government, providing credits to landowners and the treasury.(Pepita, 2003) It took almost a century for the saving habits to inculcate in the society in which Emperor Nicholas-I played a significant role by signing the initial charter of savings office in 1841, opened in Moscow and St. Petersburg and from 1842-1860, around forty-five more saving offices started functioning to encourage the spread of concept savings with rural residents and bulk of the population. Year 1861 played a significant role with abolition of serfdom, radical changes were brought in and savings offices started to open at banks, post offices, railways, schools under the supervision of state bank established in 1860. It was in this period where trade started reviving in Russia and the first private sector bank also got emerged and during 1881-1883, law was made for entry and exit of commercial banks (Kemme 2001: 12; Sberbank Perspective Report 2005: 2). One can witness the significance of 19th and 20th century in the field of development in Russia, one can see not only rise of capitalism but also the growth of banks consisting of 39 commercial joint stock banks with 242 branches and savings offices were around 4000 in number. In 20th century, banking system had interesting contours of development under New Economic Policy that resulted in establishment of State Bank of Russian Federation and also considered quite efficient in the period of Great Patriotic war in which banks and savings offices aided in raising funds to cover the military expenses (Kemme, 2001).

Russian Banking System-Around end of the 20th century, Russian banking system was largely stable with State Bank dominated the credit sector and was under the state management and control, nonetheless, in later years Russian economy started making a move from a Soviet planned economy to a market based economy(Sberbank Report 2005:11) (Lane 2002:11).

It is very important that banks need to perform their required functions, in a contemporary world banks perform multifaceted task from collecting deposits and facilitating savings and then furthering these deposits into futuristic investment projects thereby enhancing growth and development in an economy, but the banks in the centrally planned economy, largely acted as a passive role, these institutions fulfilled merely book keeping functions for recording the authorities decisions. Sutela (2004) discusses about the use of "accounting money" and "cash money" during the soviet period. (Sutela 2004:5)

> The payments system was quite simple and sound; cash was used only for household transactions and enterprise deposit transfers were made within the mono-bank for inter-enterprise transactions. Capital and investment funds were available via direct grants from the state budget according to the central plan. Apart from issuing cash money, the state bank was responsible for monitoring the "principle of unity of physical (material) and financial (monetary) planning" (Sutela 2004: 7).

Garvey(1977) and Tompson(2000) in their study discusses about the other characteristics of banking and credit system in which annually credit extension and redemption was made of which banks simply makes payment and state audit simply monitors the plan. Research also shows that monetary policy during soviet times was also accommodating that simply makes sure that cash supplies meet the demand and enterprises deposit creation from the state budget corresponded to plan, both according to micro objectives as well as balancing in the aggregate to prevent inflation (Garvey 1977 and Tompson 2000: 186).

Wachtel(2001) in his research focuses on the relation between financial intermediaries and economic growth of economies and contemporary capitalistic economies have multi range of institutions for smoothening this process. But in planned economies, administrative arrangements conduct this and the banks in reality look like real banks but the functions were entirely different from those that operate in market oriented system. Hence the very first motive in transition process is to establish market based financial institutions. (Aslund 1996: 505)

Vernikov(2007) and Sberbank(2005) report helps in understanding the evolution of Russian banking system. Their research examines the law and legal institutions emerged that aided in evolution of Russian banking system. Vernikov and Sberbank report emphasized that

> "In Russia, a new stage in the development of the banking system began in 1990 with the adoption of the Law on Banks and Banking. This new law introduced a two-tier banking system, with the upper level represented by the Central Bank of Russia (CBR) and the second layer by Commercial Banks, other lending institutions and the representative offices of Foreign Banks. During this period, the CBR was granted the exclusive right to issue money with its main function being the support of the rouble: a constitutional function, which it performed independently of other state authorities" (Vernikov 2007: 10; Sberbank Perspective Report 2005: 7).

Russia in beginning of 1990s, state owned banks namely Promstroybank, Zhilsotzbank, agroprombank, Sberbank) were restructured to universal joint stock commercial banks that serves the customers independently of their sector. Country was going through transition process towards market economy thereby leading to political and economic changes that lead to the issue of hyperinflation due to liberalization of prices that led to mushrooming growth of commercial banks that can be easily understood by the data that shows that the number of new commercial banks rose to 1,181 in 1st May 1991 but by 1994, this number increased to 2009 reaching a peak of 2,583 in July 1996. During this phase, a sign of relief was observed in the year 1995 when banking system becoming stable and develop with the largely equilibrium of rouble, reduction in inflation and strict CBR supervision requirements for commercial banks as a result the operating banks started to fall and the establishment of new banks slowed down.

Credit system in any economy, can be visualized by the demand side and supply side. Credit is demanded by various sectors of an economy for growth and development purposes and by financial and non-financial intermediaries, out of which banks remain the dominant source of credit mobilization. Credit system in the Soviet era was simple, since payment was made for wages and arrears, but changing times has made credit system all the more complex and complicated. Contemporary, Russian credit system includes the banking industry consisting of, State Controlled Banks, Foreign Banks, Intra-group Banks, Diversified Banks, small and medium sized (Moscow Region) regional banks and consumer lending banks provide a diversified loans including, automobile loan, expanding card market, growing retail banking and mortgage lending. Major players in Russian banking industry are "Sberbank of Russia, Bank of Moscow, Alfa Bank, Raiffeisen Bank (Moscow), ZAO Citibank and MDM Bank". Structure of banking sector liabilities includes cocktail of "bank accounts, loans, deposit and other funds raised from resident credit institutions and non-resident institutions, resident and non-resident household deposits, funds raised from non-resident organizations, debt obligations issued and other liabilities"[1] (Sharp 2000: 8).

Russian banking sector not only suffered with soft legal constraints, lack of bankruptcy laws and excessive risk taking by the banks and all these gave rise to the problem of Non-Performing Loans (NPLs) or credit risk. (Svetlana 2001: 25; Malyutina 2001: 19) Risk is an indispensible part of all dynamics of human life may be society, culture, polity or economy and risk is nothing but a sort of uncertainty whose likelihood to take place can be calculated and it is important in a society to make efforts to reduce or curtail this uncertainty and reducing risk so that efficiency and productivity can be increased and restored. There are data dynamics given in table in Appendix shows the indicators of Russian banking industry of which Deposits to GDP ratio, Private sector credit/GDP ratio and EBRD index of banking sector reform reflects that improvement has been made yet lot reforms are required for the banking sector to be at par with global banking industry. Very recent in 2021, The Economist Intelligence focuses on the risk in Russia as a whole namely sovereign risk, currency risk and banking risk in which banking sector risk is rated at B as banks are well capitalized with capital adequacy ratio is nearly 13percent and have strong liquidity buffers but this report also shows that NPLs is quite high around 10percent but keeping sufficient levels of provisions lessens risk to the sector, nonetheless rising percentage of NPLs[2] entails the responsibility of proper credit risk management in the banking sector as a whole for making institution more competitive and profitable.

Several tables and data given in appendix gives an indication that the issue of credit risk and NPL is present in Russian banking sector but domestic economic dynamics and externals factors do impact on the changes in the NPLs. Since the percentage of NPLs is still not very less, hence it is very important for the Central Bank of Russia to focus on managing it through proper credit risk management.

Conclusion- Credit risk is one of the risks that banks generally takes into consideration while assessing their profitability and adopting credit risk management in order to curtail the percentage of credit risk. High percentage of credit risk is not desirable in a banking industry as it affects its productivity and efficiency but having zero credit risk is not possible hence minor percentage of credit risk will be there in almost economies banking sector, Russia is one such country where banking sector is under transition and had moved towards market economy since last few decades and banking sector also need to catch up with the latest regulations and norms but literature and data reflects that credit risk in the NPL(proxy of credit risk) is present in the banks hence it is important that regular and timely required regulatory policies and risk management to keep the percentage of NPLs under control in times as well.

[1] To see more on Russia's credit system, see www.cbr.org Bulletin reports and Annual reports.

[2] https://country.eiu.com/article.aspx?articleid=210832004&Country=Russia&topic=Risk&subtopic=Credit+risk&subsubtopic=Overview

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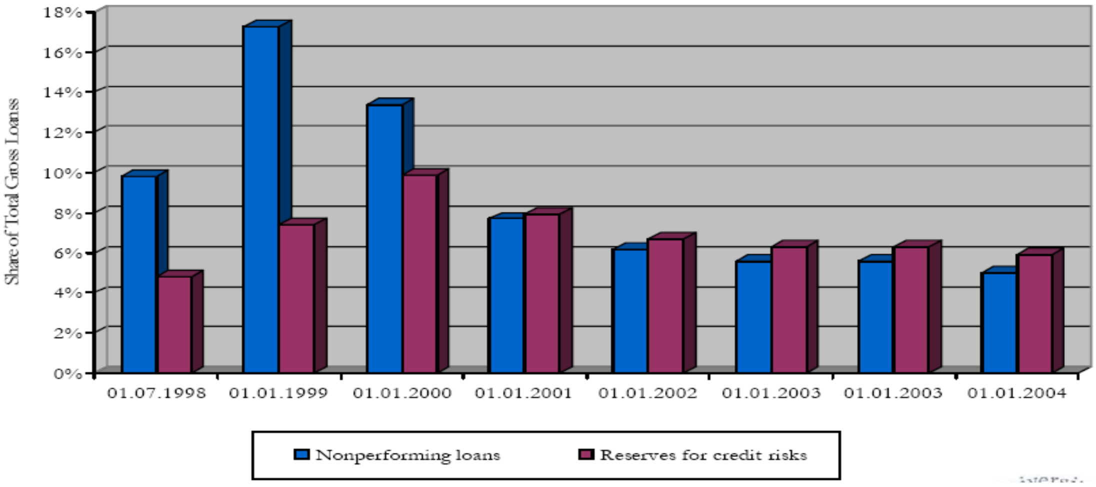
Appendix

Graph 1: Magnitude of Non-performing Assets and Reserve of Credit Risk (1998-04)



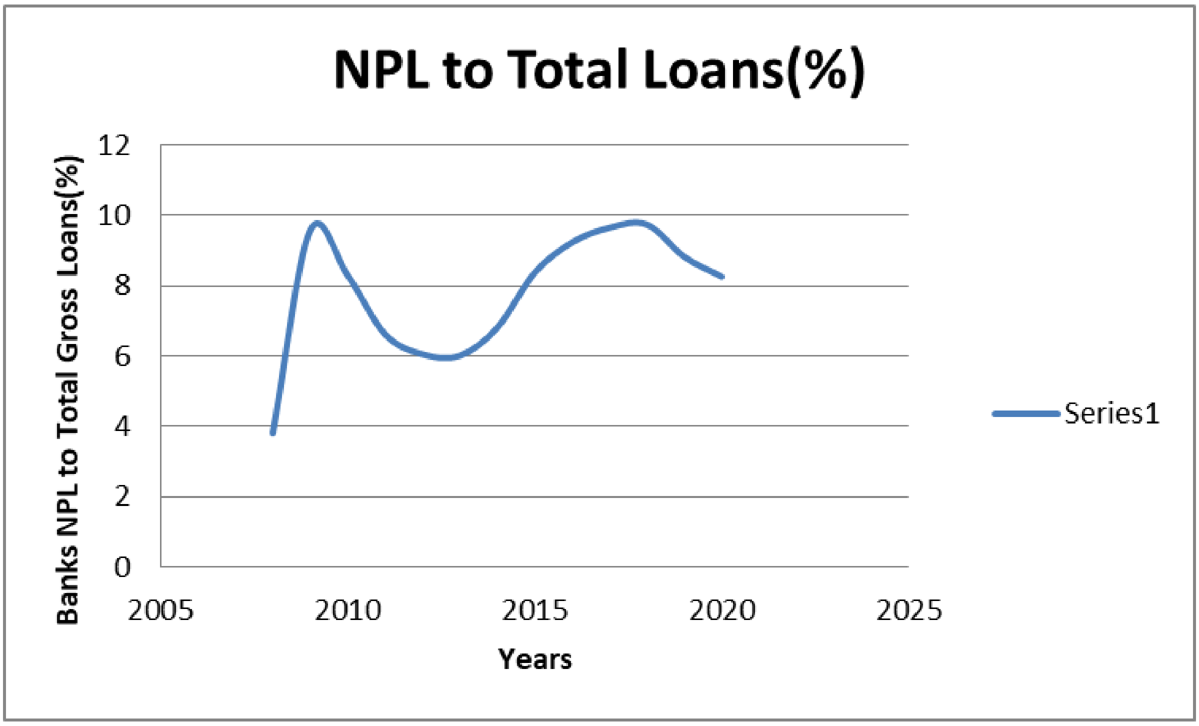
Source: Central bank of Russia Report: 1999-2005.

Table 1: Portfolio of Loans in Russian Banks (2005-08)

Year	Standard loans	Substandard loans	Doubtful loans	Problem loans	Bad loans
2008	53.2	35.8	8.8	1.0	1.2
2007	51.6	35.5	10.3	1.2	1.5
2006	48.2	36.6	12.0	1.5	1.7
2005	46.9	37.1	12.2	1.9	1.9

Source: Central bank of Russia, Various Banking Supervision Reports (2007, 2006 and 2004).

Chart 1.NPL to Total Loans(%) in Russia



Source: World Bank data