Towards a Brave New World – Reshaping Financial Regulation

BS & BG: What should be fixed?

by Alexey Simanovskiy

Member of the Board
Director
Banking Regulation and Supervision Department
Bank of Russia
Warnings

1. All expressed views have exclusively expert nature and can not be taken as official position of the Bank of Russia or any of its divisions.

2. Concerns particular banks in the healthy environment of banking industry.

3. Shapes of animals are used in the presentation exclusively for illustration of the view expressed and can not in any way be referred to any political or social aspect.
Russian banking system: Breath of the crisis

Dynamics of banking sector indicators in 2002-2010, %
(January 1, 2002 = 100%)

- Assets of banking sector
- Capital of banking sector
- Overdue debt on loans, deposits and other placements
- Provisions for possible losses on loans, deposits and other placements
## Russian banking system:
### Business card

<table>
<thead>
<tr>
<th>Metric</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Operating credit institutions as of 01.05.10</td>
<td>1047</td>
</tr>
<tr>
<td>Assets to GDP as of 01.01.10</td>
<td>75.4%</td>
</tr>
<tr>
<td>Herfindahi Hirschman index (HHI) as of 01.01.10</td>
<td>0.087</td>
</tr>
<tr>
<td>Capital of GDP as of 01.01.10</td>
<td>11.8%</td>
</tr>
<tr>
<td>Credit institutions that had their banking licences revoked (cancelled) in the period from 01.09.08 to 01.05.10</td>
<td>75</td>
</tr>
<tr>
<td>Credit institutions that were under rehabilitation procedure in the period from 01.09.08 to 01.05.10</td>
<td>22</td>
</tr>
<tr>
<td>Credit institutions under rehabilitation procedure as of 01.05.10</td>
<td>18</td>
</tr>
<tr>
<td>Costs of banks rehabilitation (% of GDP)</td>
<td>&lt; 3.0</td>
</tr>
<tr>
<td>For reference. 2009 GDP's growth (%)</td>
<td>- 8.0</td>
</tr>
</tbody>
</table>
Failed banks: Risk profile

Fat-tailed bank = Failed bank
Russian experience: Fat-tailed banks

Who are they?

Too big to fail
Too quick to tail
Too tricky to trail
Too «VIP» to jail
Russian experience: Causes of fat tails

Conflict of owners interests is resolved in favor of owners
Russian experience:
Fat-tailed banks governance

Form – over – substance governance

Form – yes …
(Board, top managers, meetings, documents, policies, risk management, internal control …)

Substance – NO !
Russian experience: Fat-tailed banks supervision

Form – over – substance supervision

Supervisors seemed
Too sick to seek
Too meek to speak
Too weak to kick

Sleeping beauties with no duties
Russian experience: Lessons for supervisor

Lesson 1. Of conservatism
Opportunities are realized seldom
Threats – always
Be on guard!

Lesson 2. Of secrecy
“Wolfs” of risks penetrate banks in “sheep’s skin” of economic prosperity
Undress lie to the truth!

Lesson 3. Of pro-activity
The most dangerous risk is non-identified risk
Dig to the substance!
## Russian experience: Addressing lessons

### 1. More responsibilities

<table>
<thead>
<tr>
<th>Who</th>
<th>What</th>
</tr>
</thead>
<tbody>
<tr>
<td>Major owners</td>
<td>Soundness &amp; Transparency</td>
</tr>
<tr>
<td>Board members</td>
<td></td>
</tr>
<tr>
<td>Top managers</td>
<td></td>
</tr>
<tr>
<td>Supervisors</td>
<td>Substantial approach, Penetration, Conservatism</td>
</tr>
</tbody>
</table>
Russian experience: Addressing lessons

2. More conservative risk regulation and supervision

3. More supervisory power
   (+ judgement + measures to personalities)

   - Lower transparency – higher risks
   - Higher concentration – higher risks
   - More owners servicing – much higher risks
Russian experience: Addressing lessons

4. More focus on individual risks!

5. Restriction to fat tails

For reference. Acceptable tail size
International experience: addressing lessons

<table>
<thead>
<tr>
<th>What</th>
<th>How</th>
</tr>
</thead>
<tbody>
<tr>
<td>More balanced macroeconomy</td>
<td>Focus on systemic risks!</td>
</tr>
<tr>
<td></td>
<td>Less cyclicality!</td>
</tr>
</tbody>
</table>

Quiz

1. What is enough to reach the goal?
2. Isn’t it too much to keep the soul?
3. Is regulation responsible for all?
Addressing lessons:
How much is enough?

How much is not too much?

NB: Too much makes double Dutch
How much is enough:
Unresolved issue
How much is enough: Unresolved issue

Risk-focused supervision:

What is the right focus?

– Whom we are hunting for, Winnie?

– Don't know, but our chances grow each minute.
BS & BG: What should be fixed?

Contact information
Address: 107016, Moscow, 12 Neglinnaya
Actual address: Moscow, 12 Zhitnaya
Phone: +7495 957-84-01; +7495 957-84-10
Fax: +7495 957-84-16
Email:vom@cbr.ru

A.Yu. Simanovskiy

Thanks for your attention!