International criteria for the country’s banking system efficiency assessment

Abstract. Modern trends in banking require application of new approaches to the banking system assessment, revealing the banking sector potential and the shocks caused by the system risks. Therefore, the problem of harmonization of national and international standards and criteria for banking system’s efficiency assessment is of great importance. In the article, Russia’s banking system efficiency has been assessed by means of the methods of economic-statistical, structural-dynamic and ratio analyses; and on the basis of this assessment recommendations on system efficiency improvements in terms of compliance with international standards have been proposed. It is concluded that transition of the Russian baking system to Basel III standards is essential in order to improve efficiency of the Russian banking and comply the requirements of national and international standards.

Keywords: Bank; Banking System; Efficiency; Development Potential

JEL Classification: E44; G21

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1. Introduction. Current conditions of the integration of the Russian banking system into the world economy have increased the role of banking in the Russian economy. Commercial banks as basic financial institutions directly influence macroeconomic processes, which necessitates their performance efficiency assessment due to the following reasons.

Firstly, the basic function of the banks as financial intermediaries is transformation of savings into investments, which is achieved by means of the accumulation of companies’ or population savings, and is an essential condition to provide expanded reproduction.

Secondly, banks extend credit to economic entities, meeting their need for financial resources and inciting sustainable development of the economy. Crediting process is inseparably connected with the credit issue mechanism and directly influences country’s monetary system.

Analysts note that banking specificity and financial institutions’ role in the country’s economy require continuous and high-quality control over the banking system as a whole and some banks in particular [1-3]. Close cooperation of the national banking system and international financial institutions leads to the fact that any crisis in the world economy directly impacts the state and prospects of the development of the Russian credit organizations. Due to aforementioned, it is necessary to create an efficient system of banking supervision in Russia, which will provide sustainable development for not only the banking supervision system but the economy as a whole.

2. Statement of the Research Problem. The problem of assessment of the country’s banking system has become an urgent one in current conditions when interaction of the national and world banking systems determines the necessity of the
use of international criteria in the assessment of banking efficiency. Studies reveal that efficient development of the country’s banking system provides an adequate level of the economic growth [4, p. 219], and the decrease of the investment activity of banks causes deformation of financial and economic relations and decline in manufacturing, which increases the gap between financial and business sectors of the national economy [5, p. 6]. Therefore, the issue of the assessment of the banking system’s efficiency taking into consideration international criteria is of great importance.

3. Brief Literature Review. Efficient banking is a top-priority problem of modern banking management, and banking can be considered efficient not only if a bank has a positive financial result (profit), but also in general sense if a bank achieves the set goals taking into consideration the sustainable development of the commercial bank. The issues of the assessment of banking efficiency are studied in the works of G. Beloglazova (2014), O. Lavrushin (2012), V. Manuilenko (2011), A. Marshall (1993), T. Petrova (2014), P. Rose (1998), J. Sinkey (2007), P. Samuelson (1993) and many others.

1. Purpose. The objective of this article is to study the Russian banking system in terms of its efficiency based on international criteria and to use the obtained data for the creation of guidelines for the banking activity.

5. Results. In modern banking management, there are various techniques for the assessment of efficiency. In the Russian banking practice, banking system’s efficiency is assessed considering the indices of the return of equity and assets of commercial banks [6, p. 9], as well as the ratio of bank equity and assets to GDP. By these indices, in The Concept of the long-term social and economic development of the Russian Federation for the period until 2020 is envisaged the growth of the share of bank lending up to 80-85% by 2020.

International standards for the assessment of banking efficiency are based on the sufficient level of bank equity and reduction of risks of the commercial banks’ activities. First of all, regulation of banking system efficiency within the world community is based on the criteria of Basel Committee on Banking Supervision [7, p. 28].

A confirmed of researchers, e.g. Brunnermeier M. (2009), confirmed that the fact 2008 world financial crisis had shown inconsistency of the then current system of financial regulation based on the standards of Basel II [8, p. 79]. In 2010, Basel Committee on Banking Supervision approved new criteria for the assessment of capital adequacy - Basel III; the transition to these standards will have been completed by 2019. V. V. Manuilenko (2011) notes that current criteria of the efficiency of banking system assessment, specified in Basel III, are a standardized set of techniques for the commercial bank’s capital’s analysis for qualitative reduction of risks related to banking (credit, market, operational risks) [9, p. 11] and banking business efficiency provision. Only these factors combined on the basis of the risk-oriented approach to supervision make Basel III standards capable of inciting banking efficiency in the world banking system. Transition to Basel III standards of the Russian baking system is necessary not only to improve Russian banking efficiency, but to provide compliance of the requirements of national and international standards.

The Central bank of Russia imposes tougher requirements for the sustainable development of commercial banks than Basel Committee on Banking Supervision. Thus, applied according to the Russian standards capital adequacy ratio requirements is 25% higher than the limits of Basel Committee; Bank of Russia also carefully monitors the recording and use of subordinate loans; and liquidity coverage ratio requirements are comparable to the requirements of Basel III standards and are permanently monitored by the national regulator. In T. Petrova’s (2014) opinion, due to the high degree of concentration of country’s banking system, only a few Russian banks (52.2% of international capital and equity in full [10, p. 58]). In 2014, the share of 200 biggest commercial banks in terms of assets in total assets of the country’s banking system was 97.3%, and relative share of the 5 biggest banks in assets was 55%.

As a result of financial and economic crisis of 2014, caused by the currency crisis affected Russia’s banking system, stabilization measures to improve banking efficiency and provide capital adequacy of Russian banks had to be taken [10, p. 44]. The result of the application of the stabilization measures introduced in December, 2014 was the growth of the regulatory capital which, according to the methodology of international standards, exceeds the capital calculated according to the Russian methodology by 9%. As a whole, regulatory factors contributed to the 1.5% increase of the capital adequacy ratio H1 at the beginning of 2015, and due to the outrunning growth of the capital bases of banks in comparison with GDP, their ratio increased from 10.7% to 11.2% during the year (Figure 1).

The researchers note that 2008 crisis consequences were found in the ratio of bank capital and GDP up to 2011 [11, p. 41], when this ratio was at the minimum level for the period of the research (9.4%). Since 2012, amongst other things, a gradual growth has begun due to the implementation of the international standards Basel III in the Russian banking system. Following the results of 2015, the share of the banking capital has made 14.8% of GDP in Russia. Having overcome the world crisis consequences, Russia’s banking system developed qualitatively from 2011 to 2014, which facilitated general economic growth as well as the development of the country’s financial sector [13-14]. Stabilization of the economic development in Russia in 2012-2013 determined the positive dynamics of the post-crisis development of the country’s banking system, which was expressed in the expansion of the basic banking activities [15-16]. Destabilization of the geopolitical situation in 2014-2015 led to the deceleration of the banking activities growth, first of all, in terms of crediting. The banking sector responds to crisis with a certain time lag, which suggests manifestation of crisis consequences in the structure of assets of Russian banks in 2015-2016.

The growth of earnings of Russian banks as an eventual financial effect of their activities during the previous period is provided by the reduction of expenses, first of all, due to the slowing down of the creation of provisions for possible bad debts. This is caused by the growth of the quality of bank lending and reduction of risks connected with banking activities [17, p. 43], and the growth of «working» assets, mainly, credit operations.

In 2012, there was an increase of the growth rate of the capital base of banks which was 16.6% against 10.8% in 2011. This increase was provided by the increase of the growth of earnings of Russian banks. In 2012, the increase of banking capital was provided by the capitalization of banking sector profit. The greatest absolute increase of the capital of country’s banking system was provided by the strategic bank PJSC Sberbank of Russia (the increase was 250.2 bln rubles), PJSC VTB (99.1 bln rubles), and PJSC VTB 24 (37 bln rubles). Since 2012, dependence of

Fig. 1: Share of banking capital in Russia’s GDP
Source: Authors’ elaboration based at the Russian Federation Federal State Statistics Service data

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the banking sector of Russia on the refinancing by the Bank of Russia has significantly grown. The credit exposure by the banking sector of Russia on the refinancing by the Bank of Russia has 2.3% (2.4% in 2011), and return on equity (ROE) was 18.2% (17.6% in 2011). In spite of the reduction of weighted mean values of indices of the banking system earnings, in 2012, the level of return on assets increased in 501 banks, which was more than 50% of the total number of credit organizations, and return on equity increased in 496 banks (52% of the total number of banks). There is a tendency for these values’ decrease: ROE decreased to 14.1% in 2013 and to 7.6% in 2014; ROA decreased to 1.7% in 2013 and 0.9% in 2014. Following the results of 2015, ROA of five largest banks has made 1%, ROE - 7%. All other banks have shown either zero or negative values of profitability.

The base characteristic of the country’s banking system directly influencing its efficiency is assessment of management quality [18]. It is carried out in terms of the risk management system, internal control level, strategy risk management, management of risks of financial incentives of the personnel. The results of these activities are represented in Figure 2.

The most important condition required to provide efficient operation of the country’s banking system is close interaction and cooperation with the regulatory agency (the Central Bank of Russia) and different supporting organizations (the Agency for Deposit Insurance, the Russian Bankers’ Association, the Credit Bureau). High quality procedural guidelines for the assessment of the efficiency of commercial banks and activities for banking improvement, complying with the current international and state standards are required.

6. Conclusion. The mechanism of international criteria application to improve efficiency of the country’s banking system should meet the real capabilities of the Russian banks, which is reflected in the following:

- tightening of the insurance system of banking risks;
- creating of the specialized credit organizations as financial institutions with formalization of their functions and criteria
- improvement of procedures of calculating and reporting financial indices to assess the system’s efficiency.

Therefore, the necessity to develop new approaches to the assessment of banking system efficiency is conditioned by high requirements for reliability and sustainability of commercial banks, stable creation of bank resources and reserves, bank risks management; and implementation of international standards will facilitate the sustainability of the development of the country’s banking system as a whole.

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