

Russia's Modern Banking Law



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Abstract

In this study, the author offers a very general review of banking legislation in Russia. The author discusses the main statutory acts which regulate banking activity and the Central Bank of the Russian Federation (Bank of Russia). The author describes the Bank of Russia's functions. He concludes that, in modern market conditions, it is extremely important to develop civil regulation and reduce administrative regulation; however, he finds that, unfortunately, the Bank of Russia is still subject to administrative management. Considering the nature of the relationships between the Bank of Russia and private credit organizations, the author insists on the need for a partnership, forged on principles of dispositive regulation, between them. More generally, this work considers the problems of domestic financial regulation through the theoretical prism of free banking. Current Russian banking legislation only focuses on the creation of the best mechanism for the organization of credit and financial relationships. The author considers not only the requirements for state financial policy, but also the interests of private credit organizations, which serve as the engine of the financial market and strengthen the banking system as a whole. Until recently, many aspects of the Russian banking system have been a compromise between the old and new conceptions of the economy. For this reason, the upholding of free market ideas is essential in order to develop banking legal theory. The author criticizes the emerging tendency to reduce the role of liberal financial institutions, such as the increasing role of the Bank of Russia as a mega-regulator. Considering this, the author recommends the application of immediate counteractions against the above-described tendency and supports the strengthening of the independence of credit organizations. He emphasizes that this is the only approach to fully develop the existing banking system.



Keywords

Banking law, banking system, the Central Bank of the Russian Federation, functions of the Central Bank, banking system reform, free banking

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The Development of the Modern Banking System

Russia's market-based banking system is still quite young. Since 1990 tremendous effort has been made to convert Soviet banks into a banking system that is based on entirely different principles. At the same time, it is still too early to tell whether the rigid centralization, deriving from the previous state monopoly in banking, has been fully overcome.¹ Many elements of the

¹ Nefedov D.V. The legal status of commercial banks. Candidate of Jurisprudence Science Thesis. St. Petersburg, 1994.

Russian banking system are still a compromise between the old and the new perceptions of the economy.

In 1987 the Soviet state established five banks, which specialized in different sectors: the USSR Foreign Trade Bank (Vneshekonombank), the USSR Bank of Industrial Construction (Promstroybank), the USSR Agricultural Bank (Agroprombank), the USSR Bank of Residential Construction and Social Development (Zhilsotsbank), and the USSR Savings Bank (Sberbank). This reform was expected to enable the lending institutions to have an influence in the relevant sectors of the economy; however, the abovementioned specialization of the banks did not produce expected results.² The banks continued to use administrative control methods when dealing with their clients, and the monopoly persisted. This structure formalized the division of the spheres of influence between the banks in accordance with relevant governmental agencies, with which they were associated. At the same time, each enterprise was assigned to a specific bank branch. Given this monopoly, the activities of Promstroybank, Agroprombank and Zhilsotsbank were confined to the distribution of resources between their branches. At this point, the administrative methods ceased to be efficient, further aggravating the economic imbalance. At the same time, the number of bank staff increased. The nature of lending patterns did not change and the lending operations were performed in accordance with the state plan. The division of the spheres of influence in accordance with governmental agencies the banks served ruled out any competition between the banks and resulted in a lack of cooperation between agencies.³

Further reform was becoming imminent. Faced with inefficient state banks, Soviet enterprises began to establish commercial banks, with proposals to replace the existing banking system with a traditional two-level system. Unable to compete with commercial banks, Promstroybank, Agroprombank and Zhilsotsbank launched a campaign to open new branches, which ultimately expedited the collapse of the system.

Banks' budget allocations were not regulated and, the banks faced the problem of being unable to obtain further funds. In May 1989 the specialized banks were transformed into self-sustainable institutions in a last-ditch attempt to reform the existing banking system. From this point, the banks' branches became the main features of the banking system, while the relationships between banks and their clients became partnerships.

But even these changes could not help salvage the Soviet banking system, as it continued to be centrally managed and plan-based. This set-up made the system inefficient, prompting the need for its modernization. The modernization of the system required the creation of a two-level system, and the main difference between the old system and the new one would be the complete rejection of the state monopoly over banking activity. This system was going to target the development of private banking capital, while retaining general government regulation.⁴

The last wave of banking system transformations began in July 1990 with the Russian Republic's specialized banks declared as the property of the Russian Soviet Federative Socialist Republic (RSFSR). The Russian Republican Bank of the USSR Gosbank was converted into the State Bank of the RSFSR. Two main laws established the legal reform framework of the new banking system: RSFSR Law *RSFSR Central Bank Act (the Bank of Russia)* and RSFSR Law *Bank*

² Nefedov D.V. The main problems of the development of the Russian banking system. In the collection «Business in Russia in the XXI century». Moscow, 2003. P. 78.

³ Austrian School of Economics. Chelyabinsk, 2011. P. 37.

⁴ Nefedov D.V. About the status of credit organizations. *Russian Annual Review of Business (commercial law)*. no 1. St. Petersburg, 2007. P. 138.

and Banking Functions Act.⁵ The former law formalized the status of the central bank, which comprised the first level of the two-level banking system.⁶ The latter law defined the status and guarantees pertaining to the activities of private lending institutions to form the second level of the system, thus laying a solid foundation for further improvement of the two-level system.

Specific Features of the Legal Status of the Central Bank of the Russian Federation

From September 1, 2013 the Bank of Russia assumed the functions of the financial markets' mega-regulator in Russia. The bank also received authority over insurance and securities market regulation, in accordance with Federal Law no 251-FZ of July 23, 2013 *Amendments to Certain Legislative Acts of the Russian Federation in Connection with the Transfer to the Central Bank of the Russian Federation the Authority to Regulate, Control and Supervise the Financial Markets*.⁷

As a result, the Bank of Russia, in cooperation with the Russian government, will develop and implement policy aimed at ensuring the stable operation of the Russian Federation's financial market; regulate, control, and supervise the activities of financial institutions; control and supervise issuers' compliance with RF laws on joint stock companies and securities; regulate, control, and supervise corporate relationships in joint stock companies; protect the rights and legitimate interests of shareholders and investors in financial markets, of insured parties and persons and beneficiaries, as well as insured persons under mandatory pension insurance programs, depositors and participants of non-state pension schemes. Thus, the functions of the Bank of Russia can be divided into two main groups: banking regulatory functions and regulatory functions pertaining to other financial systems.

The Bank of Russia comprises the first level of the Russian banking system, its legal status defined by federal legislation. The Bank of Russia is state-owned, which means that its charter capital and other property are considered federal property. The Bank of Russia reports its operations to the State Duma of the Federal Assembly, the lower house in the Russian legislature. At the same time, as part of the authority awarded to the Bank of Russia by the Constitution of the Russian Federation and federal legislation, it has operational independence. As such, federal government bodies, government bodies of the constituent entities of Russia, and municipal governments cannot interfere in the Bank of Russia's activity.

The dualism of the Bank of Russia's legal nature is the key feature of its status,⁸ whereby the bank is simultaneously a managing body of the Russian economy and an ordinary commercial organization.⁹ In cooperation with the Russian government, the Bank of Russia develops and implements a common national monetary policy to protect and secure the stability of the ruble; issues cash and arranges its circulation; sets up a refinancing system; establishes payment settlement rules; estab-

⁵ Geivandov Ja.A. *Central Bank of the Russian Federation: Legal Status, Structure, Functions, Powers*. Moscow, 1997. P. 37.

⁶ Edwin G. Dolan, Colin D. Campbell, Rosemary G. Campbell, *Money, Banking, and Monetary Policy*. Moscow.- L., 1991. P. 134.

⁷ Legislative Acts of the Russian Federation. 2013. no 30 (Part 1). Art. 4084, as well as RF Presidential Decree no 645 of July 25, 2013 *Abolition of the Federal Service for Financial Markets, Amendments to and Recognition of Some Acts of the President of the Russian Federation as Void*// Legislative Acts of the Russian Federation. 2013. no 30 (Part II). Art. 4086.

⁸ Smith V. *The Rationale of Central Banking and the Free Banking Alternative*, Mosccow, 1996. P. 45.

⁹ Huerta de Soto J. *Money, Bank Credit and Economic Cycles*. Chelyabinsk, 2008. P. 254.

lishes rules for banking operations, accounting and reporting in the banking system; performs state registration of lending entities; issues and revokes banking licenses to and from credit institutions and auditing firms; supervises the activities of credit institutions; registers securities issued by credit institutions; conducts various types of banking operations; regulates foreign exchange operations, including the purchase and sale of foreign currencies; sets the procedure for affecting settlements with international foreign states; arranges and exercises currency exchange regulation; and contributes to the development of Russia's balance of payments forecast.¹⁰

The Bank of Russia's functions can be divided into two categories: civil and administrative functions. At the same time, Russian legislation emphasizes that, as part of its administrative functions, profit-making is not the Bank of Russia's key goal. The administrative function is to be solely used to manage the banking system. Consequently, despite the contradictions in its key functions, the Bank of Russia's key purpose is to regulate the banking system.¹¹

In accordance with its public functions, the Bank of Russia can perform the following operations: extend loans against securities or other assets for a term no longer than twelve months, unless otherwise set forth by the federal law on the federal budget; buy or sell checks, promissory and transfer bills, normally, commodity-based ones, with bill due dates not exceeding six months; buy and sell government bonds in the open market; buy and sell bonds, certificates of deposit, and other securities with maturity dates not exceeding one year; buy and sell foreign currencies, as well as other payment documents and obligations in foreign currencies put up for sale by Russian and foreign credit institutions; buy, keep and sell precious metals and other valuable assets; conduct settlement, cash and deposit operations and accept securities and other assets for safe-keeping and management; issue warranties and bank guarantees; conduct operations with financial instruments used to manage financial risks; open accounts in Russian and foreign credit institutions in the Russian Federation and in foreign states; draw checks and bills in any currency; conduct other banking operations and transactions on its own behalf, unless otherwise prohibited by law.

The Bank of Russia has special legal status, and is limited by law to a significant extent. Thus, the Bank of Russia cannot perform banking transactions involving legal entities which do not have banking licenses, or natural persons, except for services provided by the Bank of Russia to its clients in the regions, which have no credit institutions; purchase shares in credit and other agencies; perform operations with real estate, unless it is to ensure the activities of the Bank of Russia, its enterprises, institutions and organizations; engage in trade or manufacturing; or prolong granted credits.¹²

The Bank of Russia's other powers comprise its administrative functions. Some researchers claim that the scope of these functions provide the bank with a special position, suggesting that the bank's key role is banking.¹³ The author disagrees with this position. The administrative functions of the Bank of Russia are divided into three main categories:

¹⁰ Vinogradov S. V. State Control over the Set-up of Credit Agencies: Legal Issues // *Economy and Law*. 1998. no 3. P. 118.

¹¹ Nefedov D.V. The system of modern financial law. *Jurisprudence*. 2011. no 4. P. 130.

¹² Nefedov D.V. Comparative Law Analyses of General and Specific Nature of Bank Legal Capacity// Comparative Law Analyses in Researches of Legal Institutions and Phenomena in terms of Field Specific, Country Related and Time Specific Issues. Reports of Comparative Law Reseraches Lab, NRU HSE, St. Petersburg. 2011. P. 162.

¹³ Nefedov D.V. The main directions of improving the banking system. In the collection «Actual problems of science and practice of commercial law». Edit. 1. St. Petersburg, 1995. P. 85.

- 1) the implementation of a single monetary and credit policy;
- 2) the arrangement of cash circulation;
- 3) the regulation of and supervision of banking activity.

Structure of the Central Bank of the Russian Federation

The Bank of Russia has a vertically integrated centralized structure, comprising the central office, territorial institutions, the cash processing centre (CPC), and other organizations. The National Financial Council operates through the Bank of Russia, while the bank's central office includes a board of directors and a chairperson. The Bank of Russia's territorial institutions are autonomous and perform some of the functions of the Bank of Russia across Russia's regions. The regional territorial institutions are based in economic regions and cover several constituent entities of Russia. They comprise the main departments in the regions, territories, and autonomous districts of Russia, in Moscow and St. Petersburg, and national banks in the republics of the Russian Federation. The main departments take part in the implementation of the state monetary and credit policy, ensuring the banking system's development and strengthening; the efficiency and continuous operation of the settlements system; the regulation and supervision of activities of credit institutions in the securities market; the foreign exchange control; the analysis of the state of the economy and its development prospects, as well as the analysis of regional financial markets. A territorial institution has no legal status and is empowered with authority in accordance with the Bank of Russia's regulation and statutory acts.

Cash processing centers (CPCs) are structural units of territorial institutions. The main goal of the CPCs is to ensure the existence of an efficient, reliable and safe payment system in Russia. The CPCs have contractual relationships with credit institutions, representative and executive bodies, local government authorities, federal treasury bodies, and other clients.

The Legal Status of Credit Institutions

The second level of the banking system comprises multiple credit institutions. They have the legal status of private companies and perform their activities in compliance with specific federal legislation.¹⁴ There are two types of credit institutions in the Russian banking system: commercial banks and non-bank credit agencies.

Commercial banks are private credit companies which have the exclusive power to perform the following operations: accept money on deposits from natural persons and legal entities; on its behalf and at its own expense, deploy the funds they hold subject to conditions of repayment, interest payment, maturity and security; and open and maintain bank accounts for natural persons and legal entities. Some banks have special legal status in the Russian banking system, due to the nature of their mixed ownership, whereby the state or state companies own a significant part of shares in their authorized capital.

In addition to the banks, the banking system includes other institutions which undertake banking operations. They are the so-called non-bank credit agencies, represented by different specialized financial institutions. A non-bank credit institution has the authority to perform limited banking operations, which are set out by the Bank of Russia. These institutions have

¹⁴ Nefedov D.V. Issues of improving the banking system of the Russian Federation. *Code-info*. no 11, December 2002.

different areas of specialization and client bases, and offer one or two types of services. These institutions comprise various non-bank credit institutions, non-bank settlement credit institutions and non-bank credit institutions that can take deposits.¹⁵

All banking operations are divided into two categories: banking operations and transactions performed by credit institutions. The first category comprises the following: 1) taking deposits (sight and time) from individuals and legal entities; 2) using deposited funds; 3) opening and maintaining bank accounts for individuals and legal entities; 4) making payments across their accounts to the order of individuals and legal entities, including correspondent banks; 5) collecting funds, bills of exchange, payment documents and providing cash services for individuals and legal entities; 6) buying and selling foreign currency in cash or non-cash; 7) accepting and placing deposits in precious metals; 8) issuing bank guarantees; and 9) transferring funds to individuals who do not hold an account with the bank in question (except for post transfers).

In addition, non-bank credit institutions can implement the following transactions: 1) issue bank guarantees, providing for discharge of monetary obligations; 2) purchase rights to demand discharge of monetary obligations; 3) manage assets under trust relationships with individuals and other legal entities; 4) conduct transactions in precious metals and precious stones in accordance with the law of the Russian Federation; 5) rent out special premises and safes for storing documents and valuables to individuals and other legal entities; 6) engage in leasing operations; and 7) provide consulting and information services, etc. Moreover, a credit institution can conduct other transactions in accordance with Russian law.

Issues relating to the establishment, reorganization and liquidation of credit institutions are stipulated by federal laws and specific bylaws. Specifically, these issues are described in the second chapter of the Bank Law, which outlines the conditions for licensing banking activity, the procedures for registration documentation preparation, opening of branches, and liquidation of banks.¹⁶ In the first instance, the founders (members) of a bank prepare necessary incorporation documents. In accordance with current legislation, banks can only be established as companies. Incorporation documents are submitted to a Bank of Russia territorial institution, in accordance with the location of the future bank. This documentation confirms the future bank's solvency and the qualification of its future managers. Following a review of the submitted documentation, the territorial institution draws up a statement on the feasibility of incorporating the bank and sends it directly to the Bank of Russia. The timeframe for the review of incorporation documentation is six months. The Bank of Russia reviews the relevant documentation and decides whether the bank in question can be registered, communicating its decision to the relevant authority in charge of registration of entrepreneurs. It takes a final registration decision.

However, the registration of a bank does not mean that the bank in question has legal status. The bank will not be able to carry out banking operations immediately following registration and has to obtain a special license from the Bank of Russia. One of the prerequisites for obtaining a license is the full payment of the equity capital within one month of registration. Registration is cancelled when the equity capital is not paid within the allotted time frame.

Special legislation stipulating bankruptcy procedures for credit institutions was enacted in 1998 as a response to the economic crisis in Russia. Federal Law no 40-FZ, dated February

¹⁵ Non-Bank Credit Agencies: Incorporation, Operation and Dissolution / under the editorship of G.A. Tosunyan. Moscow, 2000. P. 27.

¹⁶ Bank of Russia Guidelines no 135-I April 2, 2010. Procedure for Taking the Decision by the Bank of Russia on the State Registration of Credit Institutions and on the Issue of Licenses to Conduct Banking Operations. Bank of Russia Newsletter. no 23, 2010.

2, 1999, Insolvency (Bankruptcy) of Credit Institutions Act is the central legislation for bankruptcy procedures.¹⁷ The insolvency (bankruptcy) of a credit institution implies its inability to discharge its monetary and payment obligations to creditors, as confirmed by an arbitration court. The credit institution is considered insolvent if it fails to discharge its obligations within one month from the due date and if, after revocation of the license, the value of the credit institution's assets is not sufficient to enable it to discharge its obligations to its creditors.

The specific feature of this law is the regulation of the so-called measure to prevent bankruptcy, including: 1) the financial recovery of credit institutions; 2) the appointment of provisional administrators for the credit institution's management; and 3) the restructuring of credit institutions. The law stipulates a number of reasons which could prompt the above measures. If such reasons can be established, credit institutions undertake financial recovery and restructuring measures. In such an instance, the Bank of Russia can instruct the credit institution to implement financial recovery and restructuring measures, as well and appoint provisional administrators.

In order to trigger the financial recovery of credit institutions, the following measures can be undertaken: provision of financial aid by members and other persons; changes to the structure of assets and liabilities; changes to the organization's structure; alignment of the equity capital with own equity, as well as other measures. A provisional administrator is a special management body appointed by the Bank of Russia. While the provisional administrator is in charge, the authority of the credit institution's executive board can be either limited or suspended. The Bank of Russia sets out the conditions for the appointment of provisional administrators. The provisional administration can be appointed for a period not exceeding nine months, although the Bank of Russia can extend this period by no more than three months.

In certain cases, the Bank of Russia can request for a specific credit institutions to be restructured through merger or consolidation. Once the Bank of Russia submits a request for restructuring, the manager of the credit institution must submit a petition for restructuring of the credit institution's management body within five days from the receipt of such a request. Simultaneously, the management of the credit institution must notify the Bank of Russia of the decision taken within 10 days upon receipt of such petition.

During credit institution bankruptcy cases, only bankruptcy administration can be used, not mutual agreement. A bankruptcy petition can be filed by the credit institution itself, the credit institution's creditor, including individuals with the right to claim against the credit institution concerned, the Bank of Russia, the prosecutor, and the tax authorities.

This overview of Russia's existing banking legislation demonstrates that the Russian banking system is still developing. The existing two-level banking system that took its shape in the early 1990s is still heavily affected by the rudimentary reactive effects of centralized regulation, which has recently manifested itself through the strengthening of the Bank of Russia's financial regulator role. According to the views expressed above, we can expect that actions to ensure a deregulation of the banking system and consolidation of credit institutions' autonomy will be implemented in the near future.¹⁸ This will contribute to the development and further improvement of the banking system.

¹⁷ Legislative Acts of the Russian Federation. no 9. 1999. Art. 1097.

¹⁸ Hayek von F. Private money. Moscow, 1996. P. 24.



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