



Bank of Russia



# RUSSIAN FINANCIAL MARKET DEVELOPMENT PROGRAM FOR 2019-2021

Moscow  
2019

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Material prepared by the Financial Market Strategy Department

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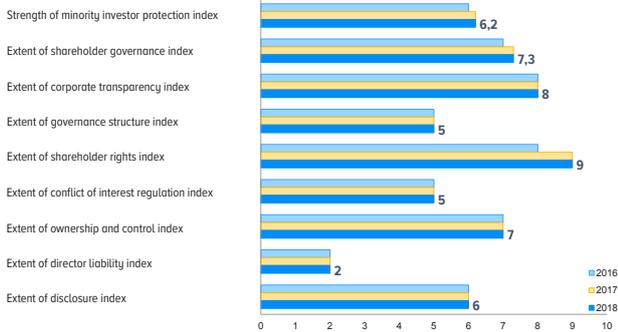
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# RUSSIAN FINANCIAL MARKET AS OF JANUARY 1, 2019

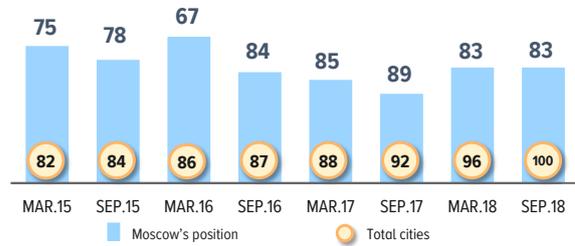
## The Global Financial Centres Index (GFCI) points, January 2019



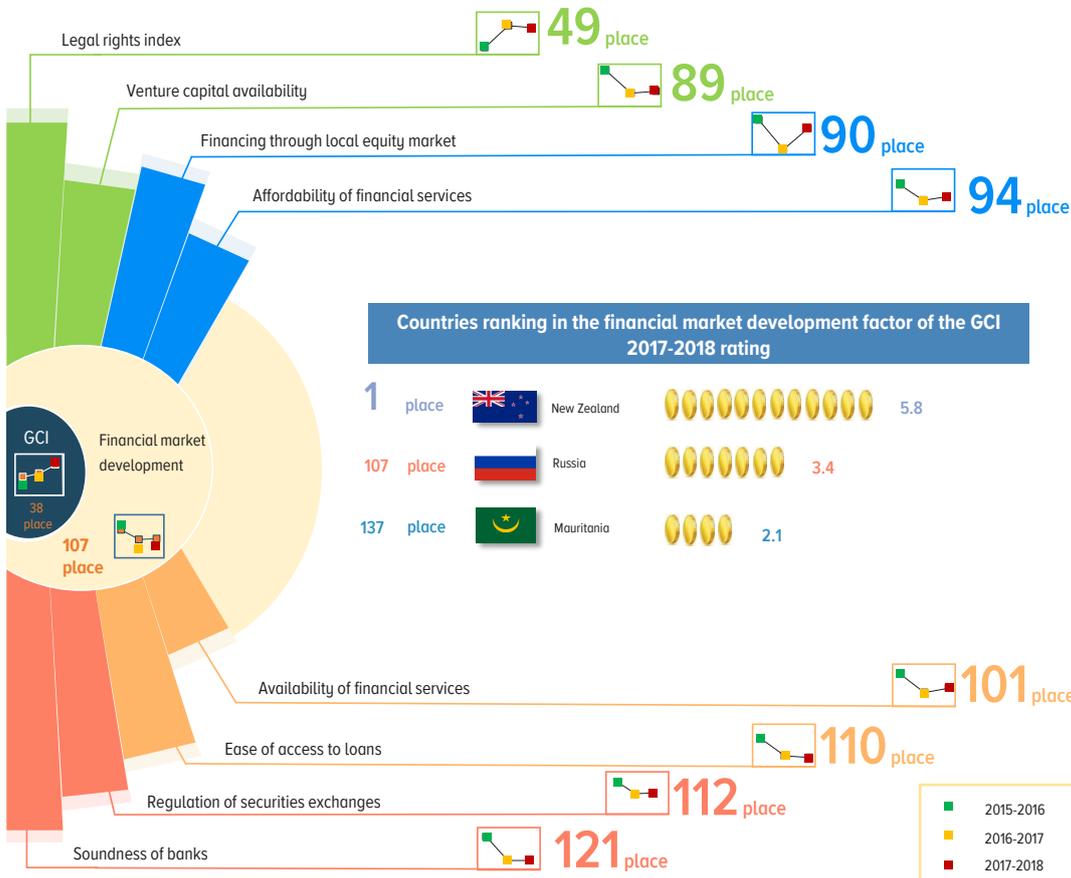
## Indices of the Protecting minority investors component within Doing Business ranking for Russia



## Moscow's position in GFCI ratings over time



## Components of the Financial market development factor in the Global Competitiveness Index for Russia (GCI)



## INTRODUCTION

*The Bank of Russia presents the Russian Financial Market Development Program for 2019–2021. The document discusses goals and principles the Bank of Russia will follow to develop the financial market, its current condition, development prospects and activities for the next three years.*

*Pursuant to the Federal Law ‘On the Central Bank of the Russian Federation (Bank of Russia)’ once every three years a Program is worked out and executed by the Bank of Russia in interaction with the Government of the Russian Federation. The Bank of Russia makes the Program public to achieve predictability, comprehensibility and transparency of its activities. Informing the market of its plans the Bank of Russia thus reassures all stakeholders of its readiness to cooperate with a view to join efforts to fulfil its initiatives.*

*Implementation of the Guidelines for Development of the Russian Financial Market in 2016–2018 brought about tangible results. The Bank of Russia vigorously cleansed the financial market of misconducting and unviable players, improved mechanisms for weeding out toxic companies, tightened requirements for corporate governance employed by market participants, introduced a conduct supervision system<sup>1</sup>. We also transitioned to electronic communication with supervised entities, contributed to substantial improvement in infrastructure sustainability, laid the foundation for extensive application of fintech in financial services, introduced elements of proportionate regulation for banks and promoted integration in the Eurasian Economic Union (EAEU), in particular the creation of a common financial market.*

*The Bank of Russia will publish the assessment report on implementation of the Guidelines for 2016–2018 in its 2018 Annual Report.*

*While the Guidelines were in force the Bank of Russia developed a number of core strategies covering specific aspects of financial market development. The Bank adopted the Guidelines for Financial Technology Development in 2018–2020 designed to support innovations and create a fintech-friendly environment and the Strategy of Improving Financial Inclusion in the Russian Federation for 2018–2020, comprising measures for greater accessibility and expanded range of financial services as well as for enhancing mental acceptance of digital channels used to deliver such services.*

*At present, there is a number of strategies adopted by the Government of the Russian Federation between 2008 and 2017<sup>2</sup> to promote development of the financial market. These strategies constitute the conceptual basis for the Program upon adjustment for changes in the internal and external factors and events that have taken place since their approval.*

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<sup>1</sup> Conduct supervision is a process where behavioural models of market participants are controlled with a focus on interactions between suppliers and consumers of financial services.

<sup>2</sup> The Russian Pension System Long-term Development Strategy (2012), The Russian Insurance Sector Development Strategy until 2020 (2013); the Strategy for Improving Financial Literacy in the Russian Federation for 2017–2023 (2017), the Strategy of the Russian State Policy for Consumer Protection until 2030 (2017).

*In preparing this document, special attention was given to ensuring its alignment with the Guidelines for 2016–2018. The Bank of Russia has preserved the priority goals of financial market development, namely:*

- 1) Improving the standard of living through the use of financial market instruments;*
- 2) Facilitating economic growth by providing competitive access to debt and equity financing and risk hedging instruments to Russian economic agents;*
- 3) Creating conditions for financial sector growth.*

*The Bank of Russia has limited to four the number of directions for development, yet expanded their coverage and informed them with a value dimension, namely:*

- Creating the environment of trust;*
- Promoting competition in the financial market;*
- Maintaining financial stability;*
- Ensuring access to financial services and capital.*

*The above directions should be regarded as benchmarks specifying how the Bank of Russia achieves its goals for development in the financial market. They extend beyond 2021. The Bank of Russia uses them as a touchstone for practicability of development initiatives. The regulator also observes the general principal of minimum interference with the working of the market except for the protection of its participants against systemic issues the market is incapable to deal with on its own. The Bank of Russia harmonises its measures for financial market development with other areas of its activities. Section I describes this approach in more detail.*

*This document defines the financial market as a system of economic and legal relationships linked to the usage of money as a means of saving and payment, the circulation of financial instruments as well as a cultural and business environment where financial market participants operate. The social function of the financial market is efficient distribution of monetary resources and risks, and the setting of fair prices for financial assets.*

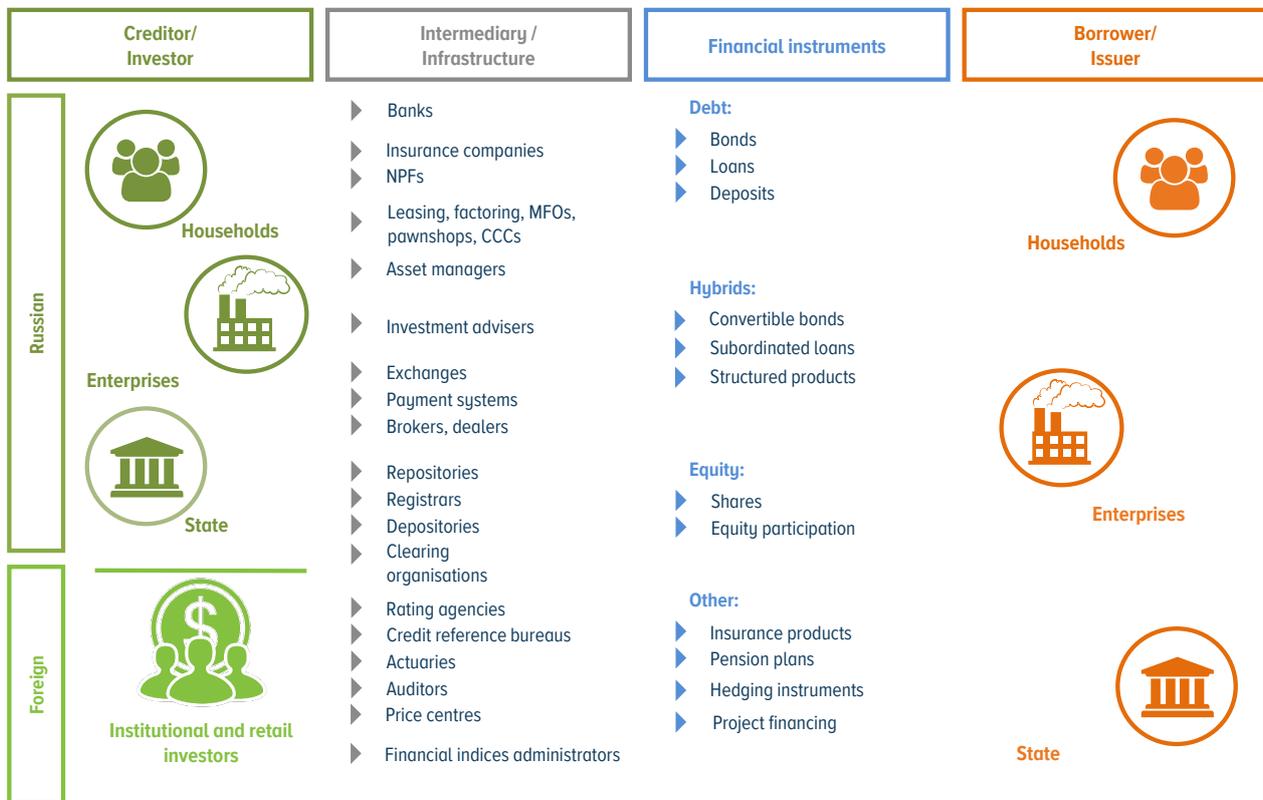
*Development of the financial market requires numerous decisions related to all constituents of this highly sophisticated system. This document places a strong emphasis on the general key principles used by the Bank of Russia in strategic planning and on explaining the particularities and suitability of its decisions. A comprehensive cross-sectoral approach to the financial market as an interconnected whole is further developed in this document.*

*Following up on the preceding Guidelines the document formulates the regulator's approach under new economic and financial conditions. Rapidly developing financial technologies, changing consumer demands, growing volume of cross-border financial activities, and new approaches to regulation across the world offer additional opportunities for industry growth. At the same time, they pose certain challenges that require attention and timely response by the regulator.*

*The Financial Market Development Program is based on the assessment of the current state of the market, identified weaknesses and exploration of possible solutions with the instruments available to the regulator. The Bank of Russia also determines its priorities taking into account trends in the world finance as they manifest themselves in the Russian context.*

*Section II of this document contains the Bank of Russia's view on the most significant global tendencies that will, in the regulator's opinion, shape the environment in which the financial market will evolve over the medium-term horizon.*

## Key elements of the financial market of the Russian Federation



The measures for the financial market development in 2019–2021 proposed in Section III are based on the analysis of its current state and the ways the regulator can respond to the challenges and opportunities arising with the changes in the external environment.

For the sake of convenience, the development measures in Section III are grouped into a relatively small number of projects. Each project has a positive effect on several areas of the financial market simultaneously.

Implementation of these projects is expected to bring about structural transformations in targeted areas. However, this effect may manifest itself only in several years as the operational and cultural conditions in the market adjust.

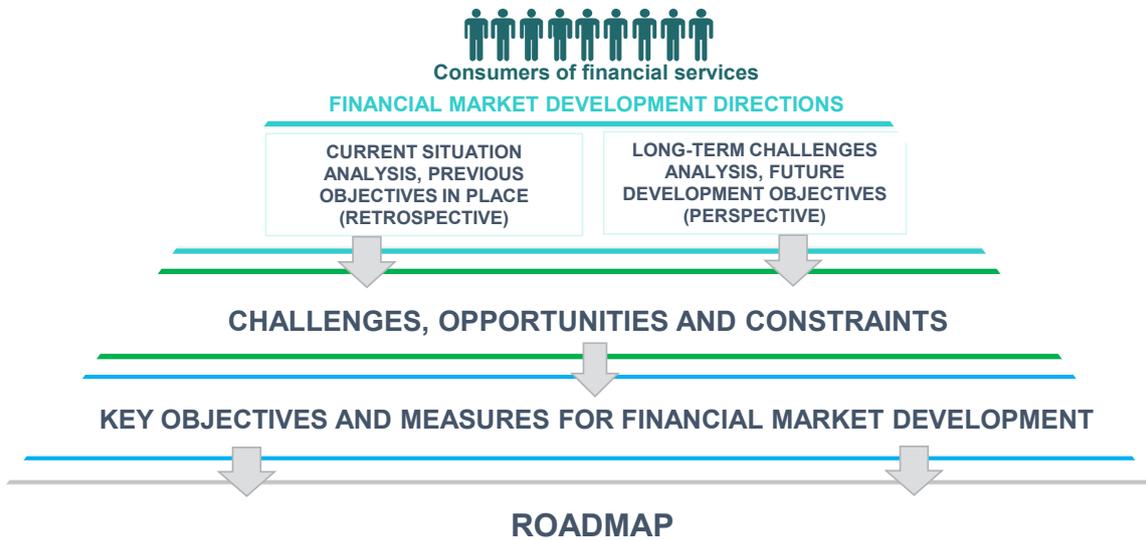
The Bank of Russia plans its actions on the strength of the most probable scenarios for the financial market development. At the same time, there is full awareness that no plan is capable to fully account for the multiplicity of possible scenarios.

Implementation of the Program bears the risk of performance gaps, which will result in growing dissatisfaction of our key stakeholders. Section IV focuses on the risks the Bank of Russia bears and how it plans to manage them. Section V sheds light on the expected results and sets outcome indicators for the Program.

The financial market is not only relations between economic agents but first and foremost relations between people. That is why an individual is the main focus of the Bank of Russia's strategy. The capability of the Russian financial market to improve the standard of living, create a more favourable business environment, and further economic growth. The ultimate gauge of the state of the financial market is satisfaction of the general public with financial products and services as well as improvement of the overall financial cul-

ture. The Bank of Russia believes this approach meets the long-term interests of all financial market participants and society at large.

## Cascade approach to financial market development planning



## 10 GUIDELINES FOR 2016–2018: IMPLEMENTATION RESULTS<sup>3</sup>

### 1 Protecting financial services consumers' rights and improving financial literacy in the Russian Federation

- The Strategy for Improving Financial Literacy in the Russian Federation for 2017–2023 was adopted
- Over 7,000 lessons were given at secondary schools
- Fincult.info web-portal was launched. It contains, besides other things, services and tests for self-evaluation of financial knowledge and capabilities
- Centres to process typical consumer complaints were set up
- Campaign to raise awareness of the general public and financial services' consumers about monetary policy issues was carried out

### 2 Improving financial inclusion of households and micro-, small- and medium-sized enterprises (SME)

- The Strategy for Improving Financial Inclusion in the Russian Federation for 2018–2020 was adopted
- Uniform standard of lending to SME was developed
- Recommendations on accommodating disabled clients at banks and non-bank financial institutions were presented
- The maximum annual contribution to individual investment accounts (IIAs) was increased to RUB 1 million
- The MIR card was issued and infrastructure for national payment instruments was prepared
- Financial institutions have been allowed to assign a lower credit risk factor to corporate borrowers registered in the Republic of Crimea or the Federal city of Sevastopol

### 3 Discouraging malpractice in the financial market

- Fit and proper requirements for owners and senior managers of financial institutions have been tightened, cross-sectoral control introduced
- The Competency centre (centre of excellence) to counter illegal activity in the financial market was established

### 4 Enhancing appeal of investment in shares of listed companies by improving their corporate governance

- “Cascade” corporate actions, electronic voting, and a single channel for disclosure were introduced
- Implementation of the Corporate Governance Code has been started on a systemic basis at public joint-stock companies

### 5 Developing the bond and syndicated loan market

- First commercial bonds programmes were issued
- Usage of national credit ratings for regulatory purposes has started
- The pricing center of the National Settlement Depository (JSC) was accredited
- Federal laws on structural bonds and on syndicated loans were passed

### 6 Improving financial market regulation, optimising regulatory burden on financial market participants

- Proportionate regulation of credit institutions was introduced
- Basel II and Basel III international regulation standards were implemented, as well as other standards of the Basel Committee

<sup>3</sup> Including measures added after the date of approval of the document to those initially planned.

on Banking Supervision adopted as part of anti-crisis reforms, including:

- Requirements for leverage ratio calculation for banks with general licenses
  - Structural liquidity standard (Net Stable Funding Ratio) calculation and compliance procedures for systemically important credit institutions (SSCIs) on a consolidated basis
  - Standardized approach to assessing securitisation exposures to calculate banks capital adequacy ratio
  - A new method to assess credit risk for banks' investments in funds to calculate capital adequacy ratio
- Major microfinance organizations, credit cooperatives and agricultural credit cooperatives were designated as a stand-alone group subject to continuous supervision
  - Professional participants of securities market transitioned to sectoral accounting standards and XBRL-based reporting

## 7 Training financial market professionals

- A new examination programme to qualify as a certified financial market specialist was developed
- Thematic trainings and round tables for representatives of law enforcement agencies were held

## 8 Promoting electronic interactions in the financial market

- Guidelines for the financial technology development in 2018–2020 were approved
- The Bank of Russia's "regulatory sandbox" has been launched
- A mechanism and legal framework for remote identification were created
- A uniform procedure for electronic interaction with financial institutions was introduced
- The Financial Sector Cyberattack Monitoring & Response Centre (FinCERT) was established

## 9 International cooperation for regulatory rule-making and their implementation in the global financial market

- The Russian banking regulatory framework was assigned the highest mark for conformity with Basel II, Basel 2.5 and Basel III standards for the first time by the Regulatory Consistency Assessment Programme (RCAP) of the Basel Committee on Banking Supervision
- The World Bank mission acknowledged progress in the implementation of the Principles for Financial Market Infrastructures (PFMIs) standard adopted by the Committee on Payment and Settlement Systems of the Board of the International Organization of Securities Commissions (CPSS–IOSCO) into the Russian legislation
- Implementation of the Solvency II concept in the Russian insurance sector has begun

## 10 Improving financial market stability toolbox

- New mechanism of financial recovery of credit institutions with the Bank of Russia's direct participation in these banks' capital was created
- The national reinsurance company was established
- Regulation of the central counterparty (CCP) was reformed
- Macroprudential regulation and a concept of macroprudential stress-testing were introduced
- Legal and technological conditions for the launch of new services of the Bank of Russia's payment system were created; systematically important payment systems, which operators are registered in Russia, underwent evaluation for compliance with the CPSS–IOSCO PRMI standard
- Supervision over banks and non-bank financial institutions (NFIs) was reformed, supervision and oversight in the national

payment system (NPS) were centralized to ensure consistent risk-based approach

➤ Performance of the internal capital adequacy assessment procedures (ICAAPs) of

the credit institutions was evaluated for the first time

➤ Mechanism for insurance company financial recovery was introduced

## KEY PERFORMANCE INDICATORS OF THE GUIDELINES FOR THE DEVELOPMENT OF THE RUSSIAN FINANCIAL MARKET IN 2016–2018

No.	Key target name	Best result	2016	Current value	Target value
1	Financial knowledge indicator	6	1.97	1.7 <sup>2</sup>	2.5
2	Satisfaction with the Bank of Russia's responses to the complaints received via the Bank of Russia online reception	100%	33%	54.4% <sup>2</sup>	55%
3	Financial services price accessibility index for businesses	7	4.1	3.4 <sup>3</sup>	5.0
4	Financial services price accessibility index for adult population	0	0.82	0.70 <sup>4</sup>	0.70
5	Share of products and services accessible to retail customers via online sales channels	100%	18%	68% <sup>5</sup>	85%
6	Minority investors protection index	10	5.67	6.2 <sup>6</sup>	6.7
7	Share of domestic bonds issued by Russian domestic companies in the total volume of borrowings by Russian domestic companies	over 20%	15%	21.2% <sup>7</sup>	20%
8	Introduction of proportionate differentiated regulation of financial market participants	<i>Well-developed system of proportionate regulation</i>	<i>Partial implementation</i>	<i>Improvement of proportionate regulation system<sup>8</sup></i>	<i>Well-developed system of proportionate regulation</i>
9	Number of issued types of the financial market specialist qualification certificates	10	7	7 <sup>9</sup>	10 <sup>12</sup>
10	Level of paper workflow expenses in the financial market	0	100%	78% <sup>10</sup>	80%
11	Compliance with the commitments by the Russian jurisdiction to implement certain international principles	<i>Implemented fully</i>	<i>Implemented partially</i>	<i>Implemented to a great extent<sup>11</sup></i>	<i>Implemented to a great extent</i>
12	Rank assigned during assessment update of compliance with the Principles for Financial Market Infrastructures by the Russian jurisdiction regarding the regulation of:				
	– central counterparty	4	2	4 <sup>12</sup>	4
	– central depository	4	2	4 <sup>12</sup>	4
	– repository	4	1	4 <sup>12</sup>	4
	– payment systems	4	4	4 <sup>12</sup>	4
13	Classes of standardised over-the-counter derivatives subject to mandatory central counterparty clearing	2	0	0 <sup>12</sup>	2

<sup>1</sup> Based on the adult population survey conducted in April-May 2018.

<sup>2</sup> As of January 1, 2019.

<sup>3</sup> Based on company CEOs survey in 2016 and 2017.

<sup>4</sup> Based on the adult population survey conducted in April-May 2018.

<sup>5</sup> As of July 1, 2018.

<sup>6</sup> Figure for the year of 2018.

<sup>7</sup> As of January 1, 2019.

<sup>8</sup> Improvement of the proportionate regulation system for credit institutions, introduction of the system for professional market participants and microfinance organisations, proportionate regulation model improvement in the microfinance market.

<sup>9</sup> As of January 1, 2019. Federal Law No. 283-FZ of July 3, 2016 'On Independent Qualification Assessment' states that July 1, 2019 all qualification assessment procedures except the one it stipulates are terminated. The system of certification of financial market specialists will transform into a new model of admission of financial market specialists based on fit and proper requirements and independent qualification assessments conducted by qualification assessment centres in accordance with the above law. Therefore, in 2018 the target indicator of 10 types of qualification certificates of financial market specialists became irrelevant.

<sup>10</sup> Assessment based on the survey of 18 out of 30 respondents over 6 months in 2018.

<sup>11</sup> Basel II and Basel III international standards for the regulation of bank and non-bank financial institutions are implemented. Assessment of important payment systems, which operators are registered in Russia, for their compliance with the Principles for Financial Market Infrastructures CPSS-IOSCO standard is completed. Measures to align the Russian legislation with the International Association of Insurance Supervisors Insurance Core Principles (IAIS ICP) partially implemented. Criteria and principles for the assessment of quality of financial indicators and activities of administrators are synchronized with the IOSCO-FSB principles to the greatest extent possible. Work towards a more comprehensive implementation of the Objectives and Principles of Securities Regulation of the International Organization of Securities Commissions (IOSCO OPSR) continues.

<sup>12</sup> As of January 1, 2019.

### 1. Protecting financial services consumers' rights and improving national financial literacy

These measures contributed to the rise of the overall awareness of the public of the financial market as well as its confidence in financial instruments. The Bank of Russia's educational campaign aimed at the public and business ensured their better understanding of the monetary policy and reduced inflation expectations.

A new model for processing individuals' typical complaints aided the prompt receipt of information from financial services consumers needed for oversight and supervision. It has also improved the quality and efficiency of our measures to raise awareness of the current legislation, which promotes individuals' financial literacy.

### 2. Improving financial inclusion for households and micro, small and medium-sized enterprises (SME)

Comprehensive implementation of the Strategy for Improving Financial Inclusion in the Russian Federation for 2018–2020 will enable consumers currently deprived of full access to financial services, particularly residents of remote, underpopulated and hard-to-reach territories, SMEs, individuals with low-income, the disabled, the elderly, and other groups of population with low mobility to use basic financial services on a systemic basis through application of new information technologies.

Systematisation of measures realised by the Bank of Russia together with the authorities and financial market participants will allow to form a common understanding among market participants and financial services consumers of the mid-term plans and performance benchmarks related to progress in various components of financial inclusion.

Introduction of uniform standards of lending to SMEs streamlines the procedure

of granting loans to SMEs, improves financial stability of credit institutions, reduces their risks, and facilitates interaction between credit institutions, e.g. in loan securitisation transactions. In general, it results in lower rates for the final borrowers and gives impetus to lending to the SME segment.

Raising the cap on annual instalment on individual investment accounts (IIAs) has led to inflow of individual investors to the stock market.

Further expansion of MIR cards usage has promoted financial inclusion by lowering the threshold of cashless payments in retail trade and service sectors.

### 3. Discouraging malpractice in the financial market

Strengthened requirements for the business reputation of senior managers and owners of financial institutions will increase confidence in the financial market and improve stability of financial intermediaries.

Establishment of competency centres to counter illegal practices in the financial market has created a system designated to cleanse the market from misconducting financial intermediaries to ensure its stable functioning and fair competition.

### 4. Enhancing appeal of investment in shares of listed companies by improving their corporate governance

The measures taken to improve corporate governance strengthened competitiveness of the Russian financial market and improved its investment appeal.

The new regulation enabled the “cascading” of the corporate actions via the accounting system. It has created comfortable conditions for investors who can exercise their corporate rights using modern information technologies without direct interaction with the issuer. Technology has allowed to join information disclosure procedure and provision of similar information

to the central depository. It will reduce issuers' costs.

The Bank of Russia systematically works on consistent improvement of corporate governance in the Russian public joint stock companies (PJSC). We persistently encourage issuers to adopt the Corporate Governance Code and publish annual reviews of corporate governance practices in PJSCs. The average level of compliance with the Code increases every year.

### 5. Developing the bond and syndicated loan market

Measures taken by the Bank of Russia towards developing the bond market and advancing its appeal for investors have led to an increase in trade volumes and entry of new issuers. The launch of commercial bonds programs eased access to the capital market for new SME borrowers.

The use of national credit ratings for regulatory purposes helped maintain stability and ensure sovereignty of the national financial market.

The development of price centres accredited by the Bank of Russia is designed to prevent price manipulation practices, increase financial market transparency and ensure fair valuation of assets.

Given the current economic conditions and lower traditional bonds yields, structured bonds will become a more appealing product with higher returns for investors.

### 6. Improving financial market regulation, employing proportionate regulation, and optimising regulatory burden on financial market participants

Optimising the regulatory burden on financial market participants is a necessary condition to upgrade competitiveness of the sector. Proportionate regulation introduced in the banking and microfinance sectors promotes competition and improves financial inclusion of economic agents, especially SMEs.

Standardisation of supervisory processes increases transparency, simplifies the interaction between the regulator and financial market participants, creates a level playing field for financial institutions across the nation and reduces excessive administrative burden. Improvement, optimisation, and unification of reporting make it more comparable, thus enhancing the quality of risk management.

The introduction of publicly accessible and thoroughly compiled basic XBRL taxonomy should significantly simplify the remaining work on unification of reporting forms submitted by organisations supervised by the Bank of Russia in accordance with international financial reporting standards.

### 7. Training financial market professionals

The measures taken to improve the existing system of certification of financial market professionals have contributed to the formation of a competitive domestic job market for financial professionals and added confidence in financial institutions.

Thematic trainings and round tables conducted for representatives of law enforcement agencies were designed to raise the professional qualification of participants and their capacity to address financial issues.

### 8. Promoting electronic interaction in the financial market

The Bank of Russia adopted the Guidelines for Financial Technology Development in 2018–2020. The document outlines the key goals and objectives of the introduction of new technologies to the financial market including supporting innovations and ensuring financial inclusion for households and businesses. Fintech is expected to benefit both financial market participants by drastically cutting transaction costs and consumers thanks to wider access to various financial products and services.

The Bank of Russia’s “regulatory sandbox” has been launched as a mechanism to pilot new financial services and technologies that require changes in legislation. The sandbox is used to simulate the working of innovative financial services, products, and technologies for the purpose of testing hypotheses on positive effects their implementation may produce.

A mechanism and legal framework for remote identification were created. Remote identification helps to provide individuals with distance financial services thus furnishing equal access to them regardless of location.

The uniform procedure for electronic interaction with financial institutions and transition to distance paperless interaction substantially enhances timeliness of supervision, eliminates redundant and duplicate reporting, increases reliability and quality of incoming information, makes it possible to streamline the format of electronic data exchange between regulators and cuts the costs incurred by the supervised entities.

The Bank of Russia’s Financial Sector Cyberattack Monitoring & Response Centre (FinCERT) works out and implements measures to counter cybercrime and mitigate cyber risks in order to provide information security to the financial market participants and ensure transparency, integrity, and security of financial operations.

#### 9. International cooperation for regulatory rule-making and their implementation in the global financial market

The continued introduction of international standards to the regulation of banking and insurance sectors, as well as payment systems contributed to the harmonization of national legislations, increased stability of financial institutions in the abovementioned areas, lower systemic risks, and growth of confidence in financial institutions.

#### 10. Improving financial market stability toolbox

A new mechanism of financial recovery of credit institutions allowed to prevent losses to clients and ensured banks’ fast rehabilitation and their compliance with regulatory requirements.

The reframing of regulation of the central counterparty resulted in its designation as a separate type of a non-bank credit institution and creation of a comprehensive risk-oriented regulatory model. This revision provides for systemic risk mitigation, ensures sustainable operation of the Russian financial market, cuts the costs of financial market participants, and lays the groundwork for the centralised clearing of a wide range of financial instruments, including OTC derivatives.

Introduction of macroprudential regulation is aimed at stemming the risks of foreign currency lending and ensuring financial stability in consumer and mortgage lending. The adopted legislative amendments allowing the Bank of Russia to impose macroprudential add-ons based on the Board of Directors’ decision help to carry out its macroprudential policy in a more time efficient way.

On the back of growing risks and the Bank of Russia’s emerging role as a mega regulator the importance of assessing the systemic effects of macroeconomic shocks is substantially growing.

The recently developed concept of macroprudential stress testing that accounts for risks of interconnected bank and non-bank financial institutions results in a timely identification of potential systemic risks on a macro level.

The conducted reform of banking supervision yielded the following results: centralised supervision, development of a common supervision standard, faster supervisory decisions, strengthened consolidated supervision over the participants of

banking groups. Performance of the internal capital adequacy assessment process (ICAAPs) for credit organizations was evaluated for the first time. The supervisory standards were developed and risk-based approaches were introduced in the supervision of non-bank financial institutions along with the centralization of the national payment system (NPS) oversight and supervi-

sion that made it possible to apply unified risk-oriented approach to the NPS parties.

A financial recovery framework for insurance companies where the Bank of Russia would participate was put in place. Its prime objective is to mitigate systemic issues in the insurance sector that may emerge due to an unstable financial position of an insurance company.

## SECTION I. GOALS AND DIRECTIONS OF FINANCIAL MARKET DEVELOPMENT

### SUCCESSION MATRIX OF DEVELOPMENT DIRECTIONS: 2016–2018 GUIDELINES (DOWN) VS 2019-2021 PROGRAM (ACROSS)

	A1. Promoting competition in the financial market	A2. Building integrity and trust	A3. Maintaining financial stability	A4. Ensuring access to financial services and capital
Direction 1. Protecting financial services consumers rights and improving national financial literacy				
Direction 2. Improving financial inclusion for households and micro, small and medium-sized enterprises				
Direction 3. Discouraging malpractice in the financial market				
Direction 4. Enhancing appeal of investment in shares of listed companies by improving their corporate governance				
Direction 5. Developing the bond and syndicated loan market				
Direction 6. Improving financial market regulation, employing proportionate regulation, and optimizing regulatory burden on financial market participants				
Direction 7. Training financial market professionals				
Direction 8. Promoting electronic interaction in the financial market				
Direction 9. International cooperation for regulatory rule-making and their implementation in the global financial market				
Direction 10. Improving financial stability toolbox				

-  – Strong effect
-  – Moderate effect

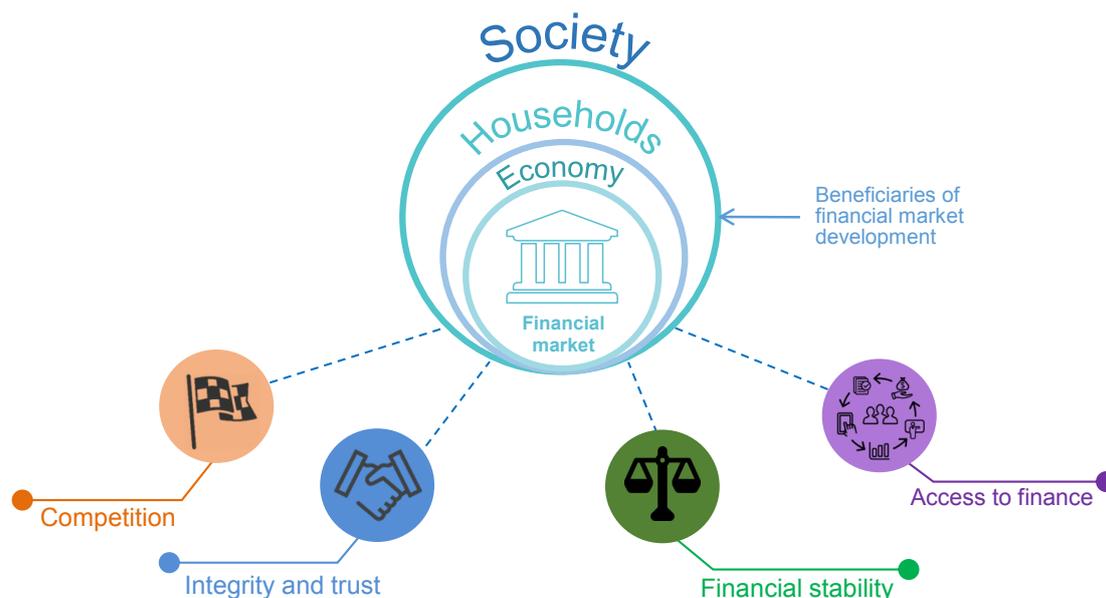
## Goals and directions of financial market development

Financial market development is one of the Bank of Russia's overarching objectives. The regulator enables the financial market to fulfil its core function of channeling savings into investment in a transparent, efficient and secure way. Thus, environment is created for capital formation, which determines the level of national wealth and public well-being.

The Guidelines for 2016–2018 determined main stakeholders of the financial market development and presented a hierarchy of development goals, which have a nested structure: (1) increase well-being, (2) support economic growth and (3) ex-

pand the financial industry. This document abides by the development goals set forth in the Guidelines for 2016–2018. At the same time the realisation of ambitious supranational projects, such as creation of the EAEU common financial market, holds a potential for the increase in the number of stakeholders whose interests the Bank of Russia takes into consideration when planning development measures.

In order to achieve these goals the Bank of Russia outlines a number of development directions. They determine how the Bank of Russia serves the public interest and the interests of the economy and financial industry in terms of the Russian financial market development.



### Competition

Competition in the financial market is a dynamic rivalry between market participants rendering similar or substitute financial services and striving to occupy a firm position in the market, which would reap higher return on capital in the foreseeable future.

Fair competition is defined as a market environment where individual players vie for consumer loyalty while not being capable

to substantially influence the conditions of goods circulation. Competition stimulates businesses to adopt innovative solutions, leads to improvement in the quality of services to consumers, and drives down prices.

The Bank of Russia facilitates the elimination of regulatory and behavioural barriers that impede fair competition. This helps make the Russian financial market more efficient and ensures its competitiveness on the international level.

## Integrity and trust

As a system of relations between the suppliers and consumers of financial services, the financial market cannot function properly either without economic or social capital. Trust is an essential element of the latter.

An environment where trust is well-developed helps to reduce transaction costs otherwise required to protect the market participants against misconduct. Over the longer term, it may reduce the need for the supervisors' interventions.

Viability of financial institutions and security of lenders' and depositors' funds are essential conditions for the formation of an environment of trust in the financial market. Reliability of the national currency, payment systems and market technologies constitute the groundwork of such an environment.

The Bank of Russia pays specific attention to the protection of the financial services consumers' and investors' rights, prevention of losses of their funds and ensuring their free circulation, thereby enhancing overall trust in its own actions.

The Bank of Russia promotes trust and confidence in the financial market by combating market manipulation, erecting barriers to misconduct, illegal or unlicensed activities in order to eliminate the edge it has over the sound business practices, regulating conflicts of interest, and introducing elements of corporate culture based on the priority of customer interests. Evidence suggests that there is a direct link between poor corporate culture and misconduct.

Information transparency is an important element of environment of trust, since it gives market participants extra confidence in the fairness of price discovery.

That said, accurate, timely and relevant information as such is no more important than availability of appropriate infrastruc-

ture and instruments for data processing to the market participants.

It is also crucial for the information to be comprehensible, so consumers could understand it and make a conscious choice of financial products, which, largely, depends on their financial literacy.

Trust has a significant effect on how actively the population uses services offered by the financial market, thus enhancing its growth and development.

Understanding consumers' behavioural patterns is a significant part of the Bank of Russia's approach<sup>4</sup>. For example, the way information is delivered, deliberately created emotional context or exploitation of cognitive vulnerabilities can lead to non-optimal decisions. In certain cases, this may lead to undesirable consequences, such as purchasing services that do not meet the consumer's needs or the violation of his rights.

The Bank of Russia takes an active stance in protecting consumers against any possible abuse by the sellers of financial services of behavioural irrationalities considering such protection the key component of environment of trust in the market.

## Financial stability

Financial stability implies uninterrupted and efficient operation of the financial market, including the process of converting savings into investment, and its resilience to internal and external shocks.

Maintaining financial stability reduces costs the economy incurs due to the financial risk events, increases predictability of the price of capital for economic agents, ensures uninterrupted provision of services and prevents escalation of structural imbalances. In its turn, resilience against shocks reduces the systemic risk premium includ-

<sup>4</sup> Based on his research, Nobel laureate Richard Thaler provides simple examples illustrating the role of behavioural irrationalities in making individual financial decisions.

ed in the price of financial products making them more accessible to consumers.

## Access to financial services and capital

Sustainable growth of the national economy is not possible without investment, which in its turn largely depends on capital availability. A key task of the Bank of Russia is to create better conditions for attracting financing by a broad range of entities. Formation of a solid institutional investor base in the financial market, primarily consisting of private pension funds, insurance companies, investment funds and households, is an essential prerequisite of access to capital. Mature market infrastructure and instruments, competition, environment of trust, and market sustainability are also key.

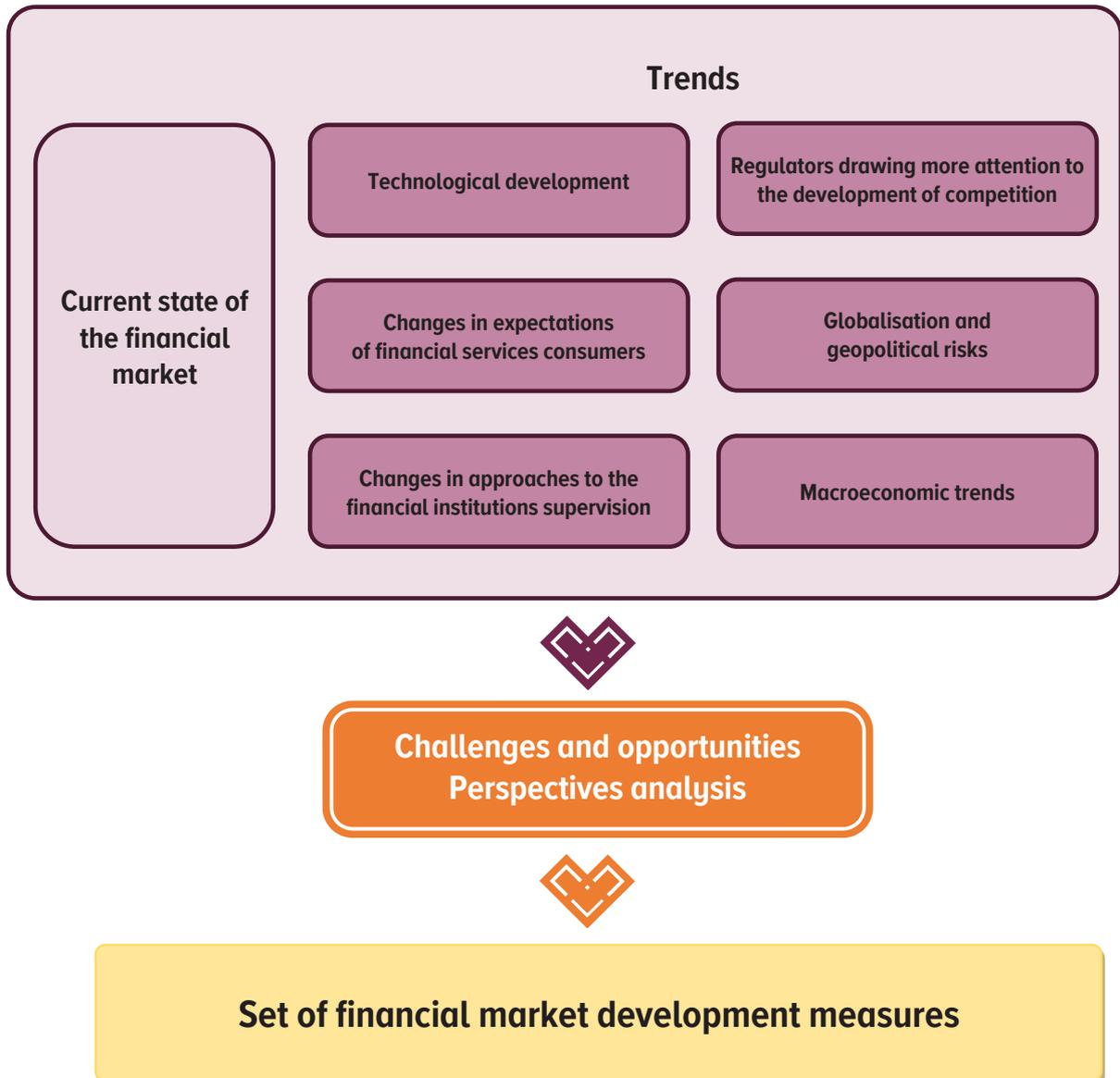
Enabling consumers to use financial products they need for private or business purposes is another important attribute of

accessibility. Financial services accessibility may be viewed from four angles, namely availability of delivery channels, price affordability, variety, and ease to understand.

Ensuring the accessibility of financial services for all members of society is an important socio-economic task. Higher penetration of financial services contributes to the financial market growth and development of competition and stimulates economic activity.

The Bank of Russia places a special emphasis on improving speed and quality of access to financial services for consumers from remote and rural areas, SMEs and people with limited access to financial services (individuals with low income, the disabled, the elderly, and other groups of population with limited mobility). As for the individuals connected to the Internet, the Bank of Russia works on improving the speed and quality of online access to financial services.

## SECTION II. CURRENT STATE OF THE RUSSIAN FINANCIAL MARKET: TRENDS, CHALLENGES AND OPPORTUNITIES



## Current state of the Russian financial market

The level of financial market development is determined by the fundamental characteristics of a country's socio-economic standing, such as diversity of economy, standard of living, maturity of government and law institutions, the level of integration of the domestic financial market into the global market, etc.

The model of the Russian financial market is quite similar to those of other emerging economies<sup>5</sup>. Its key features include the dominance of banks over non-bank financial institutions (NFIs)<sup>6</sup>, the reliance of economic agents on their own funds for capital investments, and the prevalence of budgetary and intercompany channels in redistribution of financial resources over channels provided by financial intermediaries.

Poor capital market development and absence of a solid institutional investor base, comprised of insurance companies and pension funds, limit the economy's ability to convert households' savings into long-term investments required to achieve sustainable economic growth and improve the standard of living. Over the past years, the inflow of foreign investment has slowed down substantially because of restricted access to the external capital markets in consequence of financial and economic sanctions imposed by a number of countries against Russia.

<sup>5</sup> Research by M. Stolbov, I. Goloshchapova, O. Solntsev et al. published on the Bank of Russia website 'Comparison of the Financial Sector Models of Russia and Other Countries' confirms the similarity of financial markets in Russia, Indonesia, Argentina, Columbia, Kazakhstan, Turkey, Peru, Uruguay, Macedonia, the Philippines, Pakistan, Mexico and a number of other countries.

<sup>6</sup> By the end of 2018, the assets of Russian credit institutions totaled 91.4% of GDP, while the assets of the three main NFO groups—namely, private pension funds, insurance companies, and mutual investment funds (measured at net asset value)—were 4.0%, 2.5% and 3.2% of GDP respectively.

The Russian financial market also possesses other traits. That includes a relatively high level of concentration in certain sectors, primarily in the banking sector, where top-5 credit institutions account for 60.4% of the sector's total assets<sup>7</sup>.

Households' activity in the financial market remains low. Bank deposits<sup>8</sup> dominate the structure of households' savings. It is largely thanks to the Bank of Russia measures that have strengthened the banking system (including reliable functioning of the deposit insurance scheme). Another reason is traditionally low confidence in non-bank financial intermediaries as a result of shadow or misconducting market participants.

Unscrupulous sellers of financial services trigger a negative response from consumers. While the level of households' confidence in financial institutions varies greatly, 26% of population consider it acceptable to default on a loan, and 38% believe that a short delay in repayment of a loan is all right<sup>9</sup>. This is clearly more the result of Russian borrowers' low awareness of financial consequences (for example, underestimation of credit history importance) than their low ethics. This fact was confirmed by the financial literacy survey<sup>10</sup> conducted in 2016 by the Organisation for Economic Cooperation and Development (OECD) in 26 countries, where Russia ranked 23rd.

<sup>7</sup> In terms of concentration, the Russian banking sector would have occupied a median position among EU countries but is, in fact, closer to countries with low levels of concentration. In 16 EU countries the share of the five major banks is substantially higher: the maximum concentration is in Greece (97.0%), followed by Estonia (90.3%) and Lithuania (90.1%). In 12 EU countries the concentration is lower, in particular in Luxembourg (26.2%), Germany (29.7%) and Austria (36.4%).

<sup>8</sup> By the end of 2018, household deposits in Russian banks totaled RUB 28.5 trillion (27.6% of GDP).

<sup>9</sup> Russians' Trust in Banks. Series "Sociology. Statistics. Publications. Sectoral Reviews". Moscow: NAFI, 2017, No. 8 (12), December.

<sup>10</sup> OECD/INFE International Survey of Adult Financial Literacy Competencies. OECD, 2016.

Trust is a long-term social capital phenomenon formed and accumulated over many years. It is based on the timely identification, prevention and suppression of financial institutions' misconduct and financial difficulties that pose a threat to creditors' funds. Despite the measures taken to improve the stability of financial institutions, the process of cleansing the Russian financial market from vulnerable and misconducting players is still ongoing.

At the same time, it is crucial to be able to respond to problems at an early stage and thus prevent harm to financial services consumers and financial market stability. Expansion of opportunities to apply professional judgment<sup>11</sup> and introduction of supervisory stress testing will allow to move to a proactive approach in supervision without increasing the regulatory burden on bona fide participants.

Other essential constituents of trust include typical modes of interaction in the market, also known as ethical culture and market reputation. Trust in the financial market is established, when regular interactions evidence that participants act professionally, observe the law, meet high business standards, and clearly understand how reputation boosts business opportunities. Currently, such matter as prevention of conflicts of interest, personal responsibility of managers and owners of financial institutions for breach of law are insufficiently addressed in the regulation<sup>12</sup>.

As of late, the Russian financial market has undergone numerous regulatory changes. Regardless of all their significance and positive effect on the long-term development, these innovations compel financial organizations to adjust their operation pro-

cesses thus causing certain inconvenience. Moreover, frequent changes in rules may adversely affect households' understanding of such changes and, as a result, their overall trust in the market. In this respect, an important task for the regulator is to find a balanced pace of development that will be comfortable for all stakeholders.

#### Bank of Russia measures

- Promote a competitive environment in the financial market.
- Build up financial market potential to convert savings into long-term investments, foster the development of sources of capital and capital market instruments.
- Implement measures to increase trust in the financial market: improve market transparency and integrity, purge misconduct, strengthen management of conflicts of interest, and improve the ethical side of the financial environment.
- Develop instruments of proactive supervision.

#### Technology development

Technological innovations in the financial industry has been a major global phenomenon in recent years, which continues to gain momentum. The use of digital technologies to provide financial services (digitalisation) spurs innovations in the financial sector.

Currently, digitalisation is an important driver of financial market development, emergence of more convenient and more secure products and services.

Digital technologies imply fundamental changes in the principles of services provision and in business processes of companies' interaction with their clients, other financial market participants, and regulators. They also lead to higher volumes and speed

<sup>11</sup> This concept is described in more detail in Section III on page 30.

<sup>12</sup> This is confirmed by the report prepared by the joint IMF / World Bank mission under the Financial Sector Assessment Programme (FSAP) conducted in 2016.

of transactions thanks to the use of new digital instruments and platform solutions.

Customer-centred approach is becoming the key factor of companies' success and predetermines further technology development areas.

The accessibility of financial services improves owing to new channels of their delivery, while the product line expands.

For financial market participants, the introduction of new technologies means reduced costs, an opportunity to adjust their services to customers' needs through efficient data processing, and easier exchange of information. Technological innovations help to increase financial market efficiency, reduce market entry costs for new companies, and shape consumer preferences.

Financial technologies alleviate the need for additional intermediaries thus putting pressure on traditional business models of financial institutions because of tighter competition from new delivery channels.

Though the scope of services based on financial technologies is very narrow compared to traditional financial operations, their growth rate is quite impressive. The explosive growth of technologies is accompanied by emergence of a substantial number of small-sized fintech companies. On most occasions banks and other financial institutions prefer to collaborate with such companies<sup>13</sup>.

In the meantime, global digital giants have already joined the competition. This may radically change the landscape of the financial market in the coming years. Alibaba, Apple, Facebook, Google, Amazon, Baidu and other companies of the same calibre have already started full-scale expansion into the financial services market, including the Russian one.

Opting for one-click services is a fast emerging «pattern» of consumer preferences in the financial market. The associated trend towards standardization of financial products makes platform solutions to deliver financial services possible, which may lead to the dominant role of distributors over primary producers. The key factor in this model is efficiency, that is, low unit costs, which determine product price and convenience of its delivery to consumers.

Hence the anticipated competitive advantage of large technology companies that can monetize the huge amount of data they have accumulated on their users. Once implemented, this model may drastically change competition in the financial market. At the same time, traditional financial institutions will have to transform for the sake of survival.

In addition to new opportunities, the widespread introduction of financial technologies bears potential risks for market participants and the stability of the financial market. Managing such risks may require unorthodox methods. It is obvious that optimal regulatory measures in this area must not hold back innovations. That will require a reasonable balance between the protection of financial services consumers and their personal data, and market efficiency.

The use of financial technologies is stimulated through the creation of a technological and regulatory environment, which is conducive to testing and implementing innovations.

Another important global trend is the use of new technologies to improve effectiveness of regulators. SupTech<sup>14</sup> is the term that is gaining in popularity. It implies the improvement of existing methods of supervision and regulation through new technologies to ensure effective identification and

<sup>13</sup> *Beyond Fintech: A Pragmatic Assessment of Disruptive Potential in Financial Services. Part of the Future of Financial Services series. World Economic Forum in collaboration with Deloitte. August 2017.*

<sup>14</sup> *Supervision technology.*

assessment of risks, as well as data collection and analysis. In the Russian financial market, this trend manifests itself in the improvement of the Bank of Russia's interaction with its supervised entities, such as the creation of online accounts for the parties of information exchange, the use of new formats for the supervisory filing, etc.

The matching development, RegTech<sup>15</sup>, involves the use of innovative technologies by supervised financial institutions to increase the efficiency of regulatory compliance and risk management, which enables them to fulfil internal control requirements faster and at a lower cost.

The future of the Russian financial market partly depends on resolving the issues posed by financial technologies. While increasing the accessibility and convenience of financial services and cutting their cost, digitalisation also creates new challenges and complicates the existing ones.

#### Challenges and opportunities for the Russian financial market

- Remote identification is designated to solve the problem of availability of financial service delivery channels and fundamentally transform business models of financial sector participants that are based on physical presence. It is also crucial to ensure effective protection of personal data provided by customers.
- Cyber threats pose danger not only to individual consumers but also to the system as a whole, as unexpected failures may lead to large-scale consequences (creating price shocks, continuity risks, and synchronous behaviour of algorithms), which threatens financial stability both on the national and global scale.

- The use of artificial intelligence and machine learning is related to problems in interpreting and verifying data in mathematical models applied by market participants, which may lead to erroneous decisions and increase risks to financial stability.
- Slow regulatory environment changes (taking no less than one year), as compared to the fast implementation of financial innovations (time-to-market of less than three months), the blurring of traditional boundaries of the financial market, increased fragmentation and complexity of the market structure - all create challenges to the traditional system of regulation.
- The use of big data helps to attract and retain customers (financial services consumers), shape the competitive environment, and counter fraud in the financial sector. At the same time, it is linked to a number of risks. They include the risk of losing control of data and its unauthorised use, restriction to competition in terms of access to personal data, non-optimal collection and storage of data, and mistakes in data interpretation by specialists and users.

#### Bank of Russia objectives

- Create and promote digital financial infrastructure.
- Develop cybersecurity standards.
- Create a friendly environment for technology development, including RegTech.
- Promote SupTech at the Bank of Russia.
- Determine approaches to validation of algorithms and applications.
- Develop mechanisms to protect consumers of high-tech financial services.

<sup>15</sup> Regulatory technology.

## Growing attention among regulators to the development of a competition-friendly environment

Any of the key functions of the financial market, that is, converting savings into investments, price discovery, execution of payments and settlements, risk transfer, may fail or be distorted due to the absence of a level playing field among competing businesses. Insufficient competition limits availability, increases costs, leads to a passive attitude towards the implementation of technological innovation, that is, hinders the financial market development. A well-developed competition-friendly environment and fair competition are, on the contrary, one prerequisite of its efficient operation.

The actions of foreign regulators in the recent years testify to their recognition of competition as a driving force of the financial market development. The European Union, Russia's leading trade and financial partner, works consistently to build a system of regulation designed to promote competition. In particular, it has adopted MiFID II/MiFIR<sup>16</sup> and PSD 2<sup>17</sup> that provide for equal rights and obligations for market participants and elimination of factors that may harm competition.

The United States Securities and Exchange Commission, the British Government<sup>18</sup>, the Australian Securities and Investments Commission, the European Bank for Reconstruction and Development and other international organisations follow suit. For example, the Australian regulator pays attention to instances "where a lack of competition contributes to inappropriate conduct by firms, insufficient choice, limit-

ed access and poor-quality financial products"<sup>19</sup>.

Currently, we observe greater competition in the key segments of the Russian financial market. Executive Order of the President of the Russian Federation No. 618 of December 21, 2017 'On State Competition Policy Guidelines', as well as subsequent approval by the Government of the Russian Federation of the roadmap for promotion of competition in the financial market<sup>20</sup> reflect the growing attention of authorities to this issue.

The high stake the state continues to hold in banks, insurance companies and market infrastructure, which to a great extent resulted from a forced response to past episodes of instability in the financial market, also poses risks to competition. The existing structure of the 'salary projects' segment is one of the challenges for competition. Domination of certain participants hinders the creation of equal competitive opportunities in such adjacent segments as payments, transfers, and lending. In the long run, the Bank of Russia seeks to develop competitive environment and fair competition in the financial sector in cooperation with the Federal Antimonopoly Service of Russia and other federal executive authorities.

The key to the Russian financial market competitiveness is the striking of an optimal balance between the industry's expenses to satisfy regulatory requirements and the level of freedom of enterprise. Proportionate regulation and an optimised regulatory burden on financial market partici-

<sup>16</sup> *Markets in financial instruments directive (MiFID II) and Markets in financial instruments regulation (MiFIR) effective from January 3, 2018.*

<sup>17</sup> *Payment Services Directive (PSD 2) effective from January 13, 2018.*

<sup>18</sup> *CMA Open Banking Proposal.*

<sup>19</sup> *ASIC's corporate plan 2017-18 to 2020-21, p.9.*

<sup>20</sup> *Action plan (Roadmap) for promotion of competition in branches of the economy of the Russian Federation and making particular activities of natural monopolies subject to competitive market mechanisms for 2018-2020 (approved by Directive of the Government of the Russian Federation No. 1697-r of August 16, 2018).*

pants will lead to higher competition in the financial sector and arrival of new entrants.

Lately, traditional financial institutions have actively resorted to the services of third-party providers, thus forming a stable trend in the Russian financial market. The Bank of Russia views this trend as positive because it cuts the cost of an «entry ticket» for new players, helps improve the quality and reduce the price of services (and, as a result, expenses of market participants) thanks to specialisation, and supports the diversification of the financial sector. However, it is essential to control the level of risks, first and foremost operational risks, generated by such third-party providers.

Granting financial companies equal access to data enabling the provision of targeted services to consumers and improving risk management is a crucial factor for the promotion of competition. The Bank of Russia presses for the ability to process data, not just an access to them, to be a competitive advantage. At the same time, efficient protection should be put in place against the cyber risks and the use of personal data to gain unjustified competitive advantages, deceive consumers or commit other abuses.

#### Challenges and opportunities for the Russian financial market

- Opportunity to share the infrastructure (for example, with Open API) facilitates competition. However, there is also a risk of monopolisation in the event of a collusion of large market participants and restricted access for the smaller ones.
- Possibility to purchase certain financial services from any companies without incurring additional transaction costs (commoditisation) limits cross-subsidisation of products by financial institutions and contributes to fairer pricing. At the same time, the level of inclusion for some population groups may fall

due to growth in prices of various previously subsidised services.

- Expanded data access and new financial technologies help financial institutions to manage their risks more efficiently and offer cheaper targeted services to consumers, which positively affects both services' quality and speed of provision. On the downside, there is also a resulting risk of reduced inclusion for particular population groups.
- The authority accrued within EAEU allows to influence the Union's agenda, particularly when shaping the common financial market architecture.

#### Bank of Russia objectives

- Ensure equal access to infrastructure and data for all market participants.
- Provide the Bank of Russia with a role of a coordinator and communicator between the stakeholders in complex multilateral infrastructure projects (for example, the Marketplace platform).
- Enhance competitive environment by fostering a common financial market in the EAEU.
- Improve proportionate regulation.
- Create and develop the Faster Payments System, build a platform for remote identification, form a legal basis for the implementation of open interfaces (Open APIs).

#### Changes in expectations of financial services consumers

Changes in habits, demands and expectations of financial services consumers impacts the financial market development and determines to a great extent the regulator's approaches. Richard Thaler, who won the Nobel Prize for his research in behavioural economics, had proved that irrationalities in human behaviour could be predicted and their outcomes modelled.

Surrounding environment influences behavioural changes. Digital progress has led to the emergence of a whole generation of people who spend the majority of their time online. In the last decade, businesses have become more client-oriented, thus raising the consumer demand for quality of services. As more and more routine operations could be carried out online, people are becoming more and more aware of the value of time. They perceive the need to go somewhere or to stand in a queue as a loss of time and get frustrated.

Consumers need to receive financial services in a simple and quick fashion, get transparent and justified offers and do everything with one click. There is a growing demand for simplified solutions and standardised 'basic' options. Over the long term, this may radically change the product range expected by the customers of financial institutions. Moreover, providers of financial services may change too, with traditional financial institutions being replaced by technological companies with an established customer base from related business sectors.

Research conducted in Russia and other countries in recent years shows that the greater share of labour force comprising millennials<sup>21</sup>, or Generation Y, born in 1980–2000<sup>22</sup>, despite the differences from earlier demographic groups, do not yet require any radical changes in the contents of financial services<sup>23</sup>. However, there are other trends than require attention from the regulator and market participants.

In spite of the Russian youth showing a relatively high propensity to save<sup>24</sup>, most of them are inclined to invest money in quality experiences, which do not always have long-term value. Moreover, the desire to control their own lives reduces tolerance to "mutual" schemes. Over the mid-term horizon, this may create a demand for the rebalancing of the existing pension system based on the mechanism of intergenerational transfer by incorporating an individual savings component.

By the end of 2000s, the progress in communication technologies and environmental activism has given a strong impetus for the development of sharing economy. In Russia, a consumption model based on sharing a service is at a nascent stage of development. However, should this tendency persist, people might get less and less inclined to own things, since the ultimate value for consumers is in using, not owning. This, in turn, may affect the balance of savings in the economy and the strategy of their accumulation by individuals.

Financial market can stimulate investment that helps maintain and improve living conditions. Global challenges related to climate change, past environmental damage, and reduced biodiversity have led to creation and development in foreign financial markets of special institutions and financial instruments intended for sustainable development, one example of which are green bonds. Russia will have to join this global trend and explore how to form a national system of financial instruments for sustainable development and organise methodological and verification frameworks for responsible financing instruments.

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<sup>21</sup> According to the Russian Federal State Statistics Service, as of January 1, 2017, they comprised 52% of the working age population.

<sup>22</sup> This timeframe is not completely rigid.

<sup>23</sup> However, the coming-of-age Generation Z might require a complete reimagining of the market, but there are yet no surveys of their financial behaviour.

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<sup>24</sup> Supported by the research of financial behaviour and savings habits of the population of the Russian Federation commissioned by the Ministry of Finance of the Russian Federation (Report for the Fifth Stage. Demoskop CJSC. Moscow, 2015).

### Challenges and opportunities for the Russian financial market

- Accounting for behavioural irrationalities may help achieve public goals, but financial companies can also use them for unscrupulous purposes in violation of consumer interests<sup>25</sup>.
- Simplicity of receiving services distances clients from making financial decisions and thus reduces their ability to make an informed choice.
- An AI robotic assistant may compensate for the lack of financial literacy, at the same time creating demand for new mechanisms of consumer protection.
- The risk of insufficient pension savings among the younger generation leads to potential financial restrictions in older age.

### Bank of Russia objectives

- Create conditions for the development of individual pension plans.
- Account for behavioural irregularities when protecting the rights of consumers.
- Increase transparency of pricing in the financial market.
- Create a technology-friendly environment in the financial market.
- Create new methods for protecting consumers against technological risks.

## Globalisation, regionalisation, and geopolitical risks

Globalisation is an objective trend creating both opportunities and risks for the financial market development. Globalisation processes bring uniformity to the world-

wide market, where any financial instrument can be bought or sold at a comparable price in any part of the world regardless of national borders.

Technological progress and financial innovations associated with it are the key driver of modern globalization. With the spread of the Internet, financial services have become simpler and more accessible, easily crossing national borders. Growing functionality of financial technologies allows their users to independently receive information and acquire financial products from foreign providers without proper control from the regulator.

As a result, cross-border financial services are provided more and more often by financial intermediaries operating beyond the country's internal regulatory space. The extraterritorial nature of such services makes it harder to protect consumer rights (primarily the rights of retail consumers) due to differences in the legislation and law enforcement practices of various jurisdictions. International financial organisations and national regulators pay particularly close attention to determining approaches to authorising providers of cross-border services<sup>26</sup>.

To protect consumer rights when the legislation of the Russian Federation has no control over the provider of financial services or the supply channel, the Bank of Russia will strive to cooperate with foreign regulators in the areas of information exchange, harmonisation of regulation, supervision and monitoring, and mutual recognition of national regulatory regimes. Joint efforts are also required to counter money laundering and financing of terrorism.

<sup>25</sup> In Russia, risky financial behaviour is typical for 14.4% of the population. Another 11.5% belong to socially vulnerable groups and can be easily tricked by fraudsters (according to the Financial Culture website. URL: <https://fincult.info/upload/iblock/ab4/Паттерны.pptx>).

<sup>26</sup> The Group of 20, the Financial Stability Council, the Organisation for Economic Cooperation and Development, the Basel Committee on Banking Supervision, the International Organization of Securities Commissions, and the International Association of Insurance Supervisors.

The exterritorial nature of financial services traded in global markets is a breeding ground for regulatory arbitrage. Specifically, since financial services can be provided remotely and since capital can move quickly and differences in regulation of the financial sector in various jurisdictions still persist, financial transactions may be easily settled through countries with softer legislation, especially softer tax code. Regulatory arbitrage also distorts competition among financial intermediaries in different national markets.

Under the influence of globalisation, modern global financial architecture shifts towards higher concentration of capital. The role of major global financial centres is also growing, along with increasing cross-border consolidation of stock exchanges, OTC systems, clearing and depository organisations, and other elements of the global financial infrastructure. Instant access to information coupled with the growing use of trading algorithms make instant changes in the direction of global capital flows possible under the influence of short-term factors.

Geopolitical risks are also growing. The current trend of using economic methods to achieve political goals may pose a threat to financial stability on a global scale and create risks to national economic security.

Concurrently, the process of regionalisation is underway and includes current efforts to promote financial integration within the Eurasian Economic Union and cooperation within the BRICS.

In this context, the role of supranational rules of regulation is growing. They ensure unification of the market space, monitoring and regulation of systemic risks, and harmonisation of regulatory practices by eliminating regulatory arbitrage between jurisdictions on the global and regional level.

As a global financial market participant, the Bank of Russia intends to continue integrating the Russian financial infrastructure

into the global infrastructure by promoting cooperation with leading international financial organisations. This will allow to introduce best practices to the domestic financial market, improve its competitiveness and investor appeal, ensure comparable regulatory burden and create conditions to attract long-term investors to the Russian economy.

### Challenges and opportunities for the Russian financial market

- Regulatory arbitrage resulting from the exterritorial nature of financial services.
- Lack of established approaches to authorising organisations that provide cross-border services, which would ensure protection of consumer rights.
- Threats to financial stability due to speculative capital flows, growing volatility in the global commodity and financial markets.
- Increased complexity of anti-money laundering and combating the financing of terrorism (AML/CFT).
- Objective necessity to bolster AML/CFT requirements leads to growing regulatory burden on financial companies.
- Expansion of the financial market beyond national borders offers new opportunities for growth but requires harmonisation efforts.

### Bank of Russia objectives

- Improve the effectiveness of cooperation with foreign regulators, especially in terms of information exchange.
- Create conditions for mutual recognition of national regulatory regimes.
- Introduce generally accepted standards, especially international regulation standards, and best practices to the Russian financial market.
- Create supranational financial bodies and harmonise the mutual market space with partner countries.

## Global trends in financial institutions supervision

Over the last decades, there has been a stable trend towards sophistication of relationships among financial market participants. Technological development has also led to gradual dilution of financial sector boundaries, since more and more financial services are provided outside the walls of financial institutions<sup>27</sup>.

More nuanced regulation is not always capable of protecting market participants against financial losses. In such conditions, the ability to quickly adapt to a dynamic market situation without the need for lengthy adoption of new rules becomes the key trait of regulation. As a response to such challenges a number of developed countries have introduced regulatory and supervisory systems largely based on professional judgment<sup>28</sup>.

It is important to understand that a supervisory system based on professional judgment is not synonymous to indulgence, subjectivity, selective approach to violations or deregulation. If done scrupulously, such supervision reduces the need for excessively detailed regulation and spares market participants unnecessary administrative work. The professional judgment-based supervision calls for an appropriate internal control system, better staff qualifications and better mechanisms for transparency and public accountability of the regulator.

For successful implementation of the professional judgement-based supervision it is crucial that financial institutions and society trust the regulator. Implementing this kind of supervision is considered difficult in emerging economies where level of trust is generally low. Otherwise, according to the Asian Development Bank, countries that are focused on developing their financial markets by encouraging innovations can successfully employ such supervision<sup>29</sup>.

Supervision based on professional judgment implies a high level of interaction between the supervising authority and reporting organisations in order not to punish but to prevent offences. Thus, such supervision very often goes hand in hand with the regulator acting as an advisor as well as increased attention to the executives of financial institutions, their conduct, competence, business reputation, and to the elimination of conflicts of interest.

This last trend is based on the simple idea that behind every offence there is not only the organisation but also people who make decisions. A growing number of regulators start to pay attention not only to the stability of financial institutions but also to their business and ethical culture, i.e. the motives and adequacy of decisions made by their top managers and adherence to the principle of personal responsibility<sup>30</sup>. Assessing the quality of corporate governance is becoming an important additional instrument for forecasting stability of a financial institution.

The Bank of Russia follows the world tendencies. In July 2017, the regulator published a public consultation paper 'On the

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<sup>27</sup> According to the S&P Global Market Intelligence 2016 data, PayPal, an organization which does not have a banking license, was the largest holder of household cash in the USA, while Starbucks ranked sixth in this list.

<sup>28</sup> Professional judgment is the regulator's reasoned professional assessment applied in addition to, or in the absence of, formalised requirements, which utilises a set of qualitative and quantitative indicators and prioritises the economic or factual substance over the legal form.

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<sup>29</sup> Information from the Asian Development Bank website. URL: <https://www.adb.org/sites/default/files/publication/159338/adbifinancialmarketregulationandreformsemergingmarketshighlights.pdf>.

<sup>30</sup> For example, De Nederlandsche Bank (the central bank of the Netherlands) has supervised the culture of decision-making in financial institutions since 2010.

Use of a Reasoned (Professional) Judgment in the Bank of Russia's Supervisory Practice'. The professional community generally approved of what the paper proposed.

There already exists regulation allowing for a certain level of professional judgment-based supervision. It is applied with respect to credit institutions to determine the exposure to related parties. However, a complete shift to supervision based on professional judgment is still far ahead.

The present regulatory approaches are designed to harmonize the requirements for financial market participants. This makes it possible to sustain market development, on the one hand, and avoid any additional risks, on the other hand. The optimisation of the regulatory burden on financial market participants is instrumental in improving competitiveness of the market.

These principles underpin the development of proportionate regulation and risk-oriented approach to supervision of financial institutions in Russia. A balanced distribution of supervisory functions between the Bank of Russia and self-regulatory organizations (SROs), among other things, should facilitate it.

#### Challenges and opportunities for the Russian financial market

- Transition to professional judgment-based supervision will reduce the regulatory burden and protect consumers more effectively.
- Absence of public consensus about the prospect of wider application of the professional judgment by the Bank of Russia.
- Professional judgment requires a checks and balances system.

#### Bank of Russia objectives

- Extend the application of professional judgment and assessment of the quality of corporate governance in financial institutions to new supervisory areas.

- Boost qualification of supervision personnel, build reliable systems of internal control and procedures ensuring unbiased professional judgment.
- Develop proportionate regulation and supervision of financial institutions.
- Increase the use of stress testing under supervision of financial institutions.
- Heighten the role of self-regulation to set requirements for business standards and practices in some sectors of the financial market.
- Introduce technological solutions in supervision (SupTech).

### Macroeconomic trends

Given the high level of openness of the Russian economy, its financial market functioning and development in 2019–2021 will be determined both by internal and external factors.

According to the Bank of Russia forecast, the GDP annual growth rate in 2019 will be between 1.2 and 1.7% up to 1.8–2.3% in 2020. Further ahead, economic growth may accelerate if structural measures successfully implemented. This, in turn, will have a positive impact on the ability of the economy agents to make savings and create a demand for financial services.

Meanwhile, the average income per capita and share of household funds involved in organized savings system remain low. It is a challenge for the regulator, which should be taken into account when setting a direction of the financial market development.

Another challenge is the demographic situation in the country. It limits economic growth potential and strains the pension system, which is a source of long-term finance for the economy. The planned pension contribution freeze until 2020 will hold back the flow of the pension money into the financial market. In its turn, it hampers the development of the bond and alterna-

tive long-term financial instruments markets. Hence, the Bank of Russia will have to work together with the Government of the Russian Federation to find a balanced approach to solving the macroeconomic issues.

The inflation targeting-centred monetary and fiscal consolidation policies will create conditions for macroeconomic and financial stability integral to financial market development. In particular, over the medium term the application of the fiscal rule, which has been in effect since early 2017, will create conditions for reducing dependence of the Russian economy and public finance on the world oil market cycles.

Inflation expectations remain sensitive to single shocks and continue to affect inflation. The Bank of Russia's efforts to maintain stable and low inflation, coupled with its active information policy and measures for improving financial literacy, will anchor the expectations of all groups of economic agents around the 4% inflation target. Adjustment of inflation expectations is a rather lengthy process. Therefore, financial market participants may still look forward to high nominal returns on financial instruments for quite a long time and, as a result, maintain appetite for riskier investments. This situation also requires attention on the part of the regulator.

Under the three-year forecast in case of positive economic growth rates lending activities will expand at a rate requisite for growing effective demand without posing risks to the price or financial stability. The dynamics of lending, including the consumer one, will continue to hold the regulator's attention. In the event of any imbalances in particular segments of the lending market, the Bank of Russia will offset them by macroprudential policy measures.

As far as the external conditions are concerned, the ongoing normalisation of the

monetary policy in major national economies may be accompanied by changes in the scale, structure and direction of capital flows between advanced and emerging markets and greater price volatility in financial markets. The Bank of Russia will monitor the external risks and use all available instruments to mitigate such risks when necessary.

Over the mid-term horizon the Bank of Russia takes into account the possibility of some sanctions expansion. As access to external sources may get hampered, the development of internal sources of financing becomes crucial.

#### Challenges and opportunities for the Russian financial market

- The need for a stable contribution-based pension system acting as a source of long-term finance in the economy.
- Excessive inflation expectations as a contributing factor to demand for high nominal returns on financial instruments, especially long-term, and to the high-risk investments attractiveness.
- The external risks, which may lead to increased volatility in the domestic financial market.
- Difficulty of attracting foreign investments call for internal investment resources for development.
- Consistent fiscal and monetary policies lay the ground for maintaining economic stability required for the financial sector development and reduction in inflation expectations.
- Economic growth can accelerate in case structural measures are successfully implemented.
- The expansion of lending activity at the rate compatible with higher effective demand should not pose risks to the price or financial stability.

### Bank of Russia objectives

- Develop a contribution-based pension system.
- Implement proportionate regulation of the financial sector in order to reduce (optimise) the regulatory burden in the low interest rate environment.
- Develop instruments of long-term investments (shares and long-term bonds).
- Develop instruments to hedge the price risk.
- Pursue a consistent and transparent policy and ensure timely communication in all areas of the Bank of Russia activities, which is intended to reduce inflation expectations and raise trust in the regulator's policy and the financial market.

## SECTION III. FINANCIAL MARKET DEVELOPMENT PRIORITIES FOR 2019–2021



## 1. Creating favourable conditions for the development of competition in the financial market

Promoting competition in all segments of the economy is one of the priorities of the Russian Federation economic development strategy<sup>31</sup>. A competitive environment in the financial market ensures effective operation of market mechanisms and stimulates its participants to improve the quality of their services and reduce costs.

The Bank of Russia considers competition as one of the key factors contributing to higher financial market efficiency. Therefore, it has initiated establishment of an intergovernmental working group for the development of competition in the financial market, which includes representatives of the Federal Antimonopoly Service of Russia, the Bank of Russia, the Ministry of Finance of Russia and the Ministry of Economic Development of Russia. The task force drew a roadmap, measures therefrom were included in the plan of the Russian Government on the development of competition for 2018–2020.

This cross-sectoral roadmap contains measures for the promotion of competition in the banking, insurance and other financial market sectors.

That said, the Bank of Russia is not only going to limit itself to the implementation of measures set forth in the roadmap and will continue working on new initiatives. In particular, the Bank of Russia will assess the current situation and offer a number of steps for the promotion of competition in collaboration with financial institutions in the field of payroll programmes.

Besides that, to provide equal access to infrastructure and data in the financial mar-

ket, the Bank of Russia intends to realise a number of regulatory and technological measures:

- ensure conducive legal conditions for collection, storage, and processing of data, which will assist to lower regulatory barriers for innovative business solutions and to shift the focus of competition from the access to data to the efficiency of data processing.
- promote competition in the merchant acquiring services market to improve the quality of services and reduce prices.
- develop electronic document exchange mechanism between the Bank of Russia and financial market participants (including shift to complete digital registry) as well as encourage filing via XBRL taxonomy, and expand functionality of the online profile accounts of the participants under the information exchange. All this will result in reduced regulatory burden, streamlined information preparation and submitting to the Bank of Russia and lower expenses of financial market participants thus promoting competition in general.
- form a legal basis for the implementation of open application programming interfaces (Open API) by market participants and develop the corresponding standards. Open APIs are introduced to create an environment of trust by way of standardised interaction between the parties and to ensure equal access for service providers to the information at the disposal of financial institutions. These steps are a prerequisite for financial market development based on open information exchange.
- create basis for the introduction of ISO 20022 standard “Financial services. Universal financial industry message scheme” (“UNIFI”), which will help re-

<sup>31</sup> Decree of the President of the Russian Federation of 21 December 2017 No. 618 ‘On the governmental policy guidelines for development of competition’.

duce expenses of financial market participants and accelerate both domestic and cross-border transactions.

- create a legal framework for transacting in digital financial assets.

## 2. Developing infrastructure platforms

Creating conditions for the financial market digitalisation and a favourable environment to introduce and implement financial technologies is one of the Bank of Russia's priorities. New infrastructure platforms will help the financial market to become more competitive and inclusive, improve the quality and range of financial services, and reduce the costs of financial companies.

The remote identification platform development will make it possible for individuals to receive financial services distantly with the Unified System of Identification and Authentication (USIA) and Unified Biometric System (UBS).

To develop the payment services market, the Bank of Russia will continue working on the Faster Payments System (FPS) creation and its further development, which allows a real-time P2P transfer of funds on a 24/7/365 basis using the cell phone number, as well as C2B and P2G payments. This system will raise the appeal of cashless settlements and funds mobility for consumers.

The implementation of the Marketplace project (a system for distant retail financial products (services) distribution and financial transactions registration) will ensure equal access to the financial market for customers, promote competition and increase security of the financial services usage. Building on the pilot stage empirical results the Bank of Russia plans to create a transparent and supportive regulatory environment to ensure the efficient running of the system.

Information on closed deals and investors' positions will be kept in a unified register of financial transactions, a single source of truth ("golden record") in the system. Customers are expected to see information of all closed transactions on their "My account" page and receive statements from the register upon request.

The Digital Profile Platform will create convenient and secure infrastructure for online data exchange between the authorities and businesses. It will also enable individuals to manage their digital personal data. Such an environment will simplify access to government data, improve customer experience when receiving commercial and governmental services, reduce their cost and upgrade quality.

Besides that, in 2019–2021 the Bank of Russia plans to put into action measures facilitating platform solutions, which include putting in place a regulatory framework for the robotic advisor operation with a view to protect their clients and expand the potential of their use in the financial market.

Cyber resilience of financial institutions and for their customers is an integral feature of digital financial market. The Bank of Russia is developing national information security standards that will enhance the market participants' confidence in financial technologies.

## 3. Enhancing financial inclusion

In 2018, the Bank of Russia approved the Strategy for Improving Financial Inclusion in the Russian Federation for 2018–2020. Its main goals are:

- improve the level of inclusion and the quality of financial services for financial consumers in remote and rural areas, SMEs, and for population groups with limited access to financial services (low income, the disabled and elderly,

and other groups of population with low mobility).

- increase the speed and quality of access to financial services provided to customers via Internet.

The Bank of Russia goes on implementing the Action plan (Road map) for improving financial inclusion for people with disabilities, low mobility population groups, and the elderly in 2017–2019.

New element of the Russian pension system, which is called the individual pension capital (IPC) scheme, will work toward better financial inclusion, higher quality of financial services for the population and income level of retirees.

The IPC is a private pension scheme for individuals that provides for a contribution by beneficiary himself (under a favourable tax regime) and/or his employer as a source of retirement disbursements. An employer will be allowed to co-fund his employees' contributions and obtain certain preferences in accordance with applicable law.

The key IPC advantages are simplicity, clarity, and profitability as well as a wide range of options available to its participants. They include, inter alia, a "trial period" during which the participant is entitled to refuse making further contributions and return previously invested funds. Besides that, the participant will be able to determine at his discretion the percentage of income that makes the contribution or decide to suspend payments. The IPC funds will be secured by the equity of private pension funds and the system of pension savings guarantees.

Once introduced, the IPC will improve the quality of services to households by using a central operator, which is a specifically designed high-tech facility. It will be 'one-stop' solution for beneficiaries with online notification system and secure data storage.

The IPC implementation will require close cooperation between the Bank of Russia and the Government of the Russian Federation, particularly the Ministry of Finance of Russia and the Ministry of Labour of Russia.

## 4. Developing long-term finance segment

By converting savings into investments, a well-developed capital market plays a crucial role in economic growth. In order to develop the financial market the Bank of Russia, within the scope of its mandate and in coordination with the Government of the Russian Federation, intends to take steps to develop financial instruments and establish the IPC.

Over the next three years one of the key projects designed to increase the total amount of investments in the economy, long-term investments in the first place, will be developing bonds and other financial instruments market. To that end, the Bank of Russia plans to:

- increase accessibility of equity and debt investment instruments (limited circulation bonds, convertible securities, and non-voting preferred shares).
- further simplify the securities registration procedure, first and foremost through offering a technological capability to register issues online with no need to submit original documentation in paper.
- further simplify access to traditional mechanisms of debt and equity financing for innovation firms and SMEs as well as develop alternative capital raising mechanisms including collective investment vehicles.
- improve the individual investment accounts (IIA) regulation.

The IPC incorporation will be the other priority. The long-term nature of savings

accumulated in the pension system will allow managers to employ investment strategies with a long-term horizon, thus yielding higher returns without taking excessive risk.

The Bank of Russia intends to promote instruments for financing investment projects by domestic and foreign investors (including mezzanine financing), thereby prepares the ground for inflow of long-term financial resources to the economy.

## 5. Developing corporate relations

An environment of trust in the financial market cannot be created solely within the framework of the investor-intermediary relationships. It also requires hard work to promote trust between investors and funds recipients. For equity investors, the regulation of corporate relations between an issuer and a shareholder is designed to create conditions conducive to mutual trust. In general, the regulation of joint-stock companies and their corporate bodies should grant rights, rather than impose obligations and responsibilities, outlining non-controlling shareholders as a weak party. However, the flipside of such an approach may be corporations' propensity to abstain from raising investments mobility, and their resorting to an ever growing range of mechanisms to protect themselves against 'unfriendly' shareholders.

Information transparency is one of the most important issues in the investor-issuer interaction. For purposes of reducing excessive formal requirements the Bank of Russia intends to create such an environment which does not obstruct investors in making investment decisions in the torrent of repeated and insignificant information. This will help issuers reduce their information disclosure expenses without creating an information vacuum for investors.

Pursuant to current Russian legislation, the Bank of Russia is the regulator of corporate relations in joint-stock companies and thus is directly involved in the implementation of the Action plan (Road map) approved by Directive No. 1315-r of the Government of the Russian Federation of 25 June 2016 on the improvement of corporate governance.

Along with updating the legal framework of the corporations and their members (members, participants, stockholders) functioning, a key factor of equity financing appeal for investors is further implementation of the best corporate governance standards, as set forth by the Corporate Governance Code (hereinafter referred to as the Code), recommended by the Bank of Russia. Effective corporate governance does not only strengthen confidence in Russian companies on the part of shareholders and investors, but also increases their investment attractiveness and shareholder value.

To date, shareholders, directors, and top managers of quite a few companies have not appreciated the value and effectiveness of corporate governance methods and instruments for the improvement of business models development. At present, applying the Code is not only a way of building a balanced relationship between executives, shareholders, and investors but also a tool of efficient corporate management aimed at a sustainable long-term growth.

The Bank of Russia will continue to monitor the level of corporate governance efficiency in joint-stock companies and help them introduce best practices in this domain. Presumably, this work will be mainly conducted in the form of clarifications and information letters. Preparation of additional methodical and guidance materials will provide joint-stock companies with a handy tool kit to utilize the most advanced principles of corporate governance. Any legisla-

tive changes will be pin-point aiming to remove barriers that prevent the introduction of the best corporate governance practices in companies. Enhancement of the Code is planned to address new challenges and opportunities arisen from information technologies.

## 6. Developing supervisory approach by the Bank of Russia

Stable and coordinated functioning of market mechanisms and market participants' observing letter and spirit of the law are the foundation of the financial market development. Increased sophistication and diversity of financial products and business models in financial institutions, wider application of new technologies in financial services, blurring boundaries of the financial sector pose new challenges for the regulator to ensure effective supervision and financial stability.

Under the Program one of the priority tasks for the Bank of Russia is to increase promptness and timeliness of supervisory action and endue it with preventive characteristics. The expanded use of professional judgment will help respond to issues in financial institutions at an early stage and make revisions of regulation less frequent, thus reducing the regulatory burden on honest market participants.

To ensure the preventive nature of supervision, the Bank of Russia plans to assess feasibility of more extensive oversight of corporate governance and decision-making in financial institutions. That will allow to anticipate risks with identifying some particularities of corporate governance that may have negative impact on overall financial institution performance.

The supervisory stress testing will receive a new impetus. The Bank of Russia intends to set up a comprehensive analytical system, which will be integrated in-

to all-embracing supervisory process. This system provides decision-making support based on an independent real-time review of bank resilience on individual, group and sectoral levels. Its objective is to improve accuracy and timeliness with which the supervisor can assess resilience of separate banks.

One of the financial market elements that strengthens confidence in the provided financial information is the external audit, which is mandatory for most participants.

The external audit is a tool of raising users' confidence in the disclosed information (by bank- and non-bank financial institutions, issuers, whose securities are traded on stock exchanges) including information about their financial standing, operational results and business continuity risks. Therefore, the external audit should be qualified, scrupulous and independent.

The Bank of Russia is oriented on the long-term stability of financial market participants and risk reduction for investors and consumers of financial services. The regulator will seek to strengthen the role of the external audit in providing valid information on the financial standing of financial market participants, enhance confidence in their financial statements and mitigate risks associated with failures of good faith and competence on the part of external auditors.

Besides that, an important task for 2019–2021 is to create conditions and mechanisms for the interaction between the Bank of Russia and audit firms who are service providers to the financial market participants.

The Bank of Russia is eager to share responsibility with federal executive authorities in view of measures to be taken in order to improve the quality of audit of financial institutions and public companies.

The Bank of Russia will continue applying the proportionate regulation of financial institutions, which should promote competition in the financial market and accessibility of financial services to the population and SMEs, in particular in the regions.

Measures taken to improve consolidated supervision of financial groups, banking groups, and banking holdings will also raise the effectiveness of credit institutions supervision and lower systemic risks. The analysis of financial institutions' activities on a consolidated basis will help to better assess the risk profile within the group, as well as timely prevent financial institutions from bearing excessive risks and protect interests of creditors and investors more effectively.

## 7. Countering misconduct, preventing offences

Under the Program, the Bank of Russia will be focused, among other things, on the formation of an environment of trust in the financial market by countering misconduct and prevention of offences.

Under the Guidelines for Development of the Russian Financial Market in 2016–2018, the Bank of Russia expanded requirements to the business reputation of members of management and officers of financial institutions<sup>32</sup>. In 2019–2021, the Bank of Russia plans to use the concept of business reputation more extensively under regulation of financial institutions and public companies and to increase personal responsibility of the financial institution executives for various types of misconduct and misstatements in the financial reports of public companies. These measures will seek to prevent

unscrupulous individuals from holding positions in corporate bodies.

Governance in financial institutions is closely connected to the issues of identifying and managing conflicts of interest. The latter are of special relevance for organisations serving as agents or providing agent-like services (for example, investment advisers, brokers or special depositories). The Bank of Russia is considering an option to introduce a legal framework that envisages excluding or at least disclosing conflicts of interest that may harm clients as well as weighs scenario of certain practices interdiction associated with conflicts of interest that are detrimental to clients.

In 2019–2021, the development of instruments for identifying misconduct and ensuring the certainty of punishment are areas of particular importance. It comprises further implementation of technologies of automated financial market monitoring (including big data tools), development of the Situation centre for the monitoring of the organised market, and introduction of statistical expertise mechanism with stochastic algorithms implemented.

We also plan to introduce and expand the scope of professional judgment for separate action evaluation.

These measures shall speed up the investigation of offences and help prosecute a wider range of involved persons.

Plans are underway to enshrine a deal with the regulator in law. Such a deal will result in significantly lower pecuniary punishment for those market participants who plead guilty to market manipulation and/or unlawful use of insider information, actively assist in investigations and compensate for the harm.

The Bank of Russia elaborate the legal framework that provides for the Bank of Russia's authority to collect evidence of violation. An accompanying stride is consid-

<sup>32</sup> Federal Law No. 281-FZ of 29 July 2017 'On amending certain laws of the Russian Federation with regard to improving mandatory requirements for financial institutions' founders (participants), management bodies, and officials'.

ering the feasibility of introducing a whistleblowing system and modernising the measures of proportionate punishment.

An integral part of measures to discourage misconduct in financial market is to fortify the Bank of Russia's cooperation with the law enforcement and federal executive bodies, self-regulatory organisations (SROs) and public organisations. In this respect, the Bank of Russia plans to organise joint thematic training courses and hold round tables to share experience.

The Bank of Russia will effectuate these measures in accordance with the principles of clarity, transparency, and predictability. To this end, the Bank of Russia intends, among other things, to actively promote a dialogue with the financial market participants to come to common grounds on what constitutes integrity in order to work out a corresponding market-wide code of Conduct.

A special focus is placed on international cooperation, particularly to the end of taking countering measures on a cross-border scale. Following this path, the Bank of Russia plans to explore the possibilities and conditions to join the Enhanced Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information established by the International Organisation of Securities Commissions (IOSCO EMMoU).

## 8. Developing international cooperation

Acting in pursuance of the Treaty on the Eurasian Economic Union (EAEU) of 29 May 2014, the Bank of Russia, together with the financial regulators of the EAEU member states, will continue working on the financial integration within the EAEU to form a common financial market of the EAEU by 2025, with Russian financial market as its part.

Within this framework, the Bank of Russia makes significant efforts to build an architecture of the mutual market admission and the EAEU common trading and payment areas and takes part in the harmonisation of the member states' legislation.

The creation of the common financial market allowing for provision of cross-border financial services and use of a common financial infrastructure offers new opportunities for the development of the financial market of the Russian Federation as the largest in the EAEU.

To lay the foundation for the common payment area with new financial technologies implemented there is a plan to determine the ways to create a financial messaging system based on distributed ledger technology, and a faster payments system as well as to collaborate national payment card systems. The Bank of Russia is engaged in drafting an international treaty on determining the EAEU procedure for the exchange of credit bureaus data.

Besides that, the Bank of Russia intends to help harmonise regulation related to the information security and create conditions for common payment area within the EAEU.

The Bank of Russia also gives attention to advancing cooperation with its BRICS partners in the area of finance.

For example, the Bank of Russia takes part in setting up the BRICS Bond Fund under the management of the Bank for International Settlements (BIS). A national currency – denominated bond fund implies the creation of a two-tier mechanism: first, the central banks of the “five” contribute to the fund managed by the BIS which resources will be redistributed into the BRICS national bond funds.

The project will foster the creation of alternative channels for long-term financing of Russian companies and increase the depth and liquidity of the Russian bond market.

## 9. Improving regulation of credit bureaus

Granting banks and microfinance organisations transparent, quick and free (i.e. non-discriminatory) access to information about existing and potential customers plays a crucial role in the fair pricing of services offered by these institutions and improvement of their performance.

In this respect, the Bank of Russia intends to develop the credit records by expanding the amount of information available to credit bureaus and giving them special rights to receive, process, and transfer personal data on strict condition that such information is properly protected.

The Bank of Russia expects that promoting competition in the credit reporting market will contribute to further expansion of the line of products and services provided by credit bureaus and improvement of their quality. The provision of traditional services like credit reports and scores will be augmented by alternative sources of data and borrower assessment models, including behavioural scoring based on social media and other available legal sources, as well as by usage of methods of the big data analysis to improve the quality of assessment of creditworthiness and payment discipline of potential borrowers.

Besides that, increase in availability of data to credit bureaus is expected to be linked with the Bank of Russia's extended powers to establish the procedure of assigning a special identifier to each transaction with credit exposure.

In 2019–2021, it is planned to enhance supervisory powers in respect of credit bureaus, in particular:

- in case of repeated and/or grave violations of law entitle the Bank of Russia to de-list credit bureaus from the state register with no arbitration court engaged.

- extend the requirements for financial soundness toward the credit bureaus owners to cover a credit bureau's controlling parties.
- entitle the Bank of Russia to establish qualification requirements for credit bureaus' top managers.
- oblige credit bureaus to file financial and operational reports with the Bank of Russia.
- designate certain credit bureaus as qualified ones, which will be authorised to provide users with information on their indebtedness.
- create a legal status for a credit bureau agent acting in the name and on behalf of a credit bureau.

## 10. Protecting consumer and investor rights

Protecting consumer and investor rights remains one of the top priorities for the Bank of Russia.

In 2017, after discussions with the financial market participants the Bank of Russia elaborated the concept for improving protection of investors' interests in the financial market via legislative determination of the investor categories and their investment profile. The concept contains proposals, which establish special conditions for financial market operations conducted by individual investors<sup>33</sup>. In 2019, the Bank of Russia will discuss and implement the concept of corporate investor qualification system upon the differences of their investment profile.

The creation of an alternative mechanism of dispute resolution between consumers and financial institutions will al-

<sup>33</sup> Draft federal law No. 618877-7 'On amending the Federal Law 'On the securities market' and certain laws of the Russian Federation' was submitted to the State Duma of the Federal Assembly of the Russian Federation on 28 December 2018.

so help strengthen confidence and protect consumer rights. The establishment of the financial ombudsman scheme serves this purpose<sup>34</sup>. Law provides for its gradual introduction in 2019–2021, as a mandatory pre-court stage of handling financial consumers' complaints about breach of contract by financial organisations and their obligation to cooperate with the financial ombudsman. Settling disputes by the financial ombudsman will be faster and less costly than litigation. The expertise of, and high professional requirements to, the financial ombudsman will ensure that the disputes will be handled with necessary competence. Advancement of the scheme will reduce the workload of the judicial system of the Russian Federation.

One of the methods to improve consumer protection and prevent misconduct is the introduction of conduct supervision. Conduct supervision is a process where behavioural models of market participants are controlled with a focus on interactions between suppliers and consumers of financial services. Conduct supervision utilizes the risk analytics mechanism, which assesses the ratio between the number of claims against a specific company and the average number of claims across the market. If threshold is exceeded the Bank of Russia will bolster its supervisory measures against the respective companies.

In recent years we have observed a growing number of non-regulated companies providing financial services to individuals outside the country of their registration. The Bank of Russia plans to proactively regulate cross-border financial services in order to increase public awareness of potential risks and prevent customers from using services offered by dishonest providers.

The Bank of Russia also considers elaboration of the requirements for the distribution of pre-contractual information, advertising of financial products, and the restrictions on dissemination of information regarding illegal services in the financial market. Additionally, there are plans to create a system of regulation and supervision over financial agents, who interact directly with consumers of financial services as representatives of financial institutions.

## 11. Enhancing financial literacy

Building on the Guidelines for 2016–2018 the Bank of Russia will continue efforts to improve financial literacy of the population. Financial literacy is the foundation of consumer confidence in financial market and the first line of consumer defence against abuses from financial services providers. Financial literacy also helps consumers obey financial discipline. Conversely, low financial literacy is a mental barrier hindering financial inclusion as it prevents consumers from acquiring greatly sophisticated financial products, which are becoming more and more widespread. The Strategy for the Improvement of Financial Literacy in the Russian Federation in 2017–2023 was adopted by the Directive of the Government of the Russian Federation No. 2039R of 25 September 2017. The Ministry of Finance of the Russian Federation, the Bank of Russia and other interested federal executive authorities, and organisations jointly work on the Strategy.

The purpose of the Strategy is to create a basis for financially literate behaviour of the population. Its Action plan includes:

- increase the scope and quality of financial education and develop an appropriate institutional base and methodological resources for the community of academics.

<sup>34</sup> Federal Law No. 123-FZ 'On the ombudsman for financial consumers' of 4 June 2018.

- develop mechanisms for the interaction between the authorities and society to enhance financial literacy of the population, which include informing them about financial consumer rights and ways to protect them, as well as forming socially responsible behaviour of financial market participants.

Besides, on September 8, 2016 the Bank of Russia and the Ministry of Education and Science of the Russian Federation signed an agreement on cooperation for improving the financial literacy of the Russian population and approved a schedule of the measures to be applied in academic institutions in 2017–2021, which include:

- integrate the fundamentals of financial literacy into federal state educational standards and model basic educational programmes at all levels of education.
- prepare methodological guidelines in the area of additional vocational education.
- train and upgrade skills of teaching staff involved in financial literacy education programmes.

## 12. Improving instruments for financial market stability

Further development of the financial market infrastructure is an important task aimed at increasing its stability and competitiveness and creating favourable conditions for long-term investments. In this regard, the Bank of Russia plans to:

- by 2021 conduct a Level 2 assessment of adherence to the Principles for financial market infrastructures (PFMI). The CPSS-IOSCO working group will qualitatively assess whether the Principles are fully implemented in the Russian legislation.
- implement a central counterparty (CCP) resolution and the recovery regulation

to ensure provision by the CCP of significant services in the financial market on going concern.

- optimise the financial information reporting requirements for CCPs.
- improve the quantitative information disclosure requirements for CCPs in compliance with international standards.

A successful completion of the Level 2 assessment, which is planned for 2020–2021 under the authority of the CPSS, will be a milestone on the road to mark up internationally approved competitiveness of the national financial market infrastructure.

While the role of the Bank of Russia as a mega regulator grows does grow importance of evaluating the systemic effects of macroeconomic shocks. To this end, the Bank of Russia uses macroprudential stress testing, which allows to define the risks of financial institutions on a group basis, as well as interconnections between these institutions. In 2019–2021, the Bank of Russia plans to continue developing instruments for macroprudential stress testing, such as expanding the perimeter of stress testing to securities industry participants, leasing companies, and development institutions; evaluating systemic impact arisen from participants' group actions; taking into account mutual effects of financial and real sectors shocks.

## 13. Developing banking sector

To support stability and limit the banks' exposure, the Bank of Russia plans to continue the gradual implementation of new regulatory approach stipulated by the documents of the Basel Committee on Banking Supervision (BCBS).

Basel II Pillar 2 (Supervisory Review Process) implementation into the Russian practice will proceed. In this respect, the

Bank of Russia's task will be to evaluate the quality and outcome of the Internal Capital Adequacy Assessment Process (ICAAP) of credit institutions and banking groups<sup>35</sup>. The Bank of Russia will annually assess the consistency of credit institutions' ICAAP with their business models and size of their operations. Capital adequacy of banks as a measure of their ability to cover all significant risks, given the strategy of a particular institution and stress testing results, will concurrently be estimated.

Stress testing and modelling of processes in particular banks and banking groups in light of their business models will become an important instrument of preventive supervision. Centralisation and introduction of supervision standards will positively develop banking supervision on qualitative level.

The Bank of Russia will also carry on implementing Basel II Pillar 3 (Market Discipline). The priority in this respect will be to make regulatory amendments with enhanced disclosure requirements by banks and banking groups about their performance, risks, appraisal procedures, risk and capital management. These amendments will help raise their transparency for a wide range of stakeholders.

Another important task for Bank of Russia is to develop stimulating regulation, i.e. the regulation that incentivizes credit institutions to expand operations facilitating economic growth.

One of the aims of stimulating regulation is to improve the mechanism of project finance. The Bank of Russia plans to work out measures to increase investment appeal of project finance schemes and to advance public-private partnerships in the Russian regions.

At the same time, the Bank of Russia plans to institute regulation to limit banks' financing of mergers and acquisitions (M&A) that do not lead to economic growth. Only loans extended for this purpose under the federal funding programmes, as well as for investments in equity of the strategic enterprises (organisations) and the defence industry organisations will be exempt from the new rules.

To minimise risks for individuals involved, the Bank of Russia will continue changing the mechanism of shared ownership housing finance schemes, including measures under the Housing and Urban Environment national project. The new mechanism will employ bank financing instead of individuals' paying directly to developers.

Within the framework of promoting SME lending measures will be taken to improve proportional regulation (in correspondence with the size and complexity of bank operations) and to ensure specialisation in SME lending of banks with a basic licence.

Another task for the Bank of Russia will be gradual revision of legislation to strengthen market discipline and prevent withdrawal of collateral. The ultimate purpose of this exercise is preservation of assets of credit institutions and securing their solvency.

The Bank of Russia plans to continue considering applications by major banks for permission to use quantitative credit risks assessment models based on internal ratings for the purpose of regulatory assessment of capital adequacy. Besides, the Bank of Russia will control over compliance by credit institutions with the terms of such permissions.

## 14. Developing securities and derivatives market

Under the existing laws, financial intermediaries, clearing houses and asset management companies are obliged to put their

<sup>35</sup> Since 2018 we have been assessing the quality of the ICAAP and the capital adequacy of all credit institutions. In 2019, such assessment will be conducted for banking groups.

assets into different groups depending on the specifics of their activities. However, the legislation on insolvency (bankruptcy) does not fully account for the intricacy of correspondent relations between financial institutions arising while servicing clients. Moreover, credit institutions in the capacity of professional securities market participants generally do not distinguish between their own and customer assets (except in case of asset management). As a result, customer assets may be mingled with the own assets of an unsound financial institution and be included in the bankruptcy estate.

The very presence of such risks testifies to the fact that the existing legal mechanisms need improvement to ensure adequate protection of an investor against bankruptcy of a financial institution serving him. To form an environment of trust in the financial market, regulation is to be amended in order to remove legal uncertainty in the event of bankruptcy of professional securities market participants so that credit institutions have to record customers' and their own assets separately.

The Bank of Russia will continue working toward enhanced regulation of licensed activities in the national financial market. We witness new remote ways of securities deal execution on trading platforms as well as new complex financial instruments emerge. Against this background we are evaluating whether we need to change approach to regulation of investment activities for their own account, in particular, to broaden the definition of such activities.

In the mid-term, the Bank of Russia will give special attention to securities registrars and depositories. It seems appropriate to harmonise approach to the regulation of similar activities with regard to investor titles to securities. The most recent amendments to the law reflect convergence of

depositories' and registrars' functions (keeping registries of investment unit holders, documentary bonds and liens lock out). The Bank of Russia intends to consider further convergence of regulatory models for organisations that keep a record of titles to securities in order to eliminate regulatory arbitrage and behavioural barriers that prevent fair competition in this area.

To increase financial stability and remove existing barriers preventing the use of a wide range of capital market instruments, the Bank of Russia will continue developing the derivative market, which are crucial hedge instruments against market risks. Measures in this area will ensure that the Russian Federation fulfils its G20 commitments to reform the over-the-counter (OTC) derivatives market.

An initiative to centrally clear OTC interest rate derivatives (IRDs) will be gradually implemented in order to increase transparency and stability of the IRD market. For certain categories of OTC derivatives, which will not be centrally cleared (optionally or mandatory), mandatory margining will be gradually introduced (attaching collateral as a means to secure the fulfilment of obligations under a contract).

Discussions are underway to amend the Russian legislation<sup>36</sup> to include a definition of a hedging transaction compliant with international practice, inter alia, to draw a clear line between hedging and speculative transactions. The risk that hedging transactions are qualified as speculative and the respective tax consequences prevent Russian non-financial companies from using hedging and is one of the reasons for the low liquidity of the Russian derivatives market.

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<sup>36</sup> Currently, a hedge operation is defined only in Article 301 of the Tax Code and is not properly designed for other regulatory goals other than the tax ones.

Certain other steps will be taken to refine regulation of the derivatives market, such as:

- eliminate legal barriers to structure complex contracts with derivatives elements (structured financial instruments).
- minimise legal uncertainty around the notion of a derivative financial instrument, in particular by drawing a demarcation line between it and other contract types, around expanding the list of underlying assets under derivative deal, and providing judicial protection of claims under such contracts signed with foreign parties.

## 15. Developing insurance sector

The insurance sector is an important element of the financial market, directly impacting the quality of life of the people and addressing a range of macroeconomic challenges.

As conditions for attracting foreign financing remain adverse, the role of insurers as institutional investors is substantially growing. Domestic savings have become an essential source for investment, with life insurance being one of the most flexible and rapidly developing mechanisms of attracting long-term financing in the national economy. Over the mid-term horizon, the Bank of Russia plans to implement a suite of measures to create a favourable environment for the development of life insurance sector in the Russian Federation.

Over the last few years the compulsory third-party insurance of motor vehicles (OSAGO) has remained the most sensitive segment of the market. Poor availability of this service in a number of Russian regions and, occasionally, consumer dissatisfaction has threatened not only the stable operation of this segment but also the overall consumer confidence in insurance.

The Bank of Russia will continue creating a balanced OSAGO model, under which the insurers remain economically motivated to operate it, while consumers receive an accessible and quality service.

There is a number of key features of the insurance sector sustainable development and its higher competitiveness and investment appeal. They are adequate and comprehensive assessment of risks that insurance firms face, sufficient size of capital to meet the profile and amount of the assumed risks, a well-functioning corporate governance system, transparency and disclosure.

To this end, the Bank of Russia will place a primary focus on the introduction of the risk-oriented Solvency II-based approach to the regulation of the Russian insurance sector. In view of these changes, some operational, legislative, methodological and technological issues need to be addressed. Lack of qualified personnel also represents a challenge.

In the area of the insurance sector regulation the Bank of Russia contemplates consecutive steps to advance electronic channels of distribution of certain insurance services types, primarily the socially important ones. The Bank of Russia will start to examine an option of rendering some types of insurance services entirely online.

The Bank of Russia is of the opinion that digitalisation in insurance in the first place may positively impact the OSAGO segment, which is a mass market in Russia and still regulated strictly and in detailed way based on Russian insurance legislation and the Bank of Russia instructions.

Digital transformation in the insurance sector can stimulate the creation of an ecosystem for effective interaction among the industry stakeholders, increase information transparency and quality of analytical da-

ta, optimise business processes of insurers, and bring more insurance services into the online environment.

The Bank of Russia will pay special attention to the protection of rights and interests of consumers of insurance services, promotion of competition as well as possible measures to stimulate insurance entities, individuals, and organisations to use voluntary insurance mechanisms on a wider scale.

Fraudulent actions in the insurance sector significantly harm both the sector as a whole and its specific participants and require response from the Bank of Russia. In this respect, we will continue building a systemic approach aimed at countering insurance fraud and establishing appropriate standards, developing effective mechanisms for identification and prevention of fraudulent actions, and creating conditions to stop their proliferation.

One of the mid-term priority tasks is to build a balanced policy for the regulation of branches of foreign insurers (reinsurers), which is due to the authorisation of their operation in the Russian insurance market from August 2021 under the terms of the membership of the Russian Federation in the World Trade Organisation.

## 16. Developing collective investment vehicles and asset management sector

One of the key policy initiatives in the area of private pensions sector will be the IPC launch, a voluntary pension savings scheme with simplified enrolment. The IPC should become an attractive source of long-term investable funds for asset managers without the need to take heightened risks. For more detailed description of the IPC see the subsection “Enhancing financial inclusion”.

The Bank of Russia will proceed with work to improve financial stability of private pension funds (NPF), in particular by stress testing. Requirements for the NPF information disclosure will be introduced as well as elements of fiduciary responsibility for asset management companies and NPFs and professional judgment for the assessment of their activities. Conditions to reduce their expenses will be put into place, such as the right to self-determined investment of pension reserve funds on authorized assets.

Measures will be taken to increase investment appeal of Russian mutual investment funds. The Bank of Russia streamlines the regulatory burden on asset management companies and refines requirements for their disclosure on funds’ operations.

## 17. Developing microfinance sector

The Bank of Russia will continue improving the regulation of the microfinance entities based on principle of proportionality. The plan is to set differentiated requirements for their managers and owners and order of filing with the regulator.

To protect the rights of microfinance borrowers, the outstanding lending ceiling under a consumer loan agreement will be lowered. Lenders will also have to control compliance with mandatory indebtedness benchmarks established by the Bank of Russia. Besides that, to ensure financial stability of the sector the approach to making bad-loan provisions will be reviewed.

With regard to the regulation of pawnshops, the Bank of Russia plans to analyse the need for further improvement of specific legal framework, development of online lending mechanisms, and broader range of authorised business activities of pawnshops given the identified needs of consumers.

In the area of credit cooperatives including agricultural ones the Bank of Russia will take measures to improve their financial stability as well as protection of their members' rights.

To protect the rights of credit cooperatives' members cooperative management conduct will be promoted, which focus will be, in particular, to develop the principle of cooperative solidarity and increase members' involvement.

As for the housing savings cooperatives, the mid-term task of the Bank of Russia is to refine regulation to make their operations more effective and extend their coverage.

## 18. Developing national payment system

Stable functioning of a national payment system and provision of payment services of high quality are essential for the financial market efficacy.

Currently there are a number of positive trends in the national payment system development. They are steady growth of the retail cashless transactions share, increase in entities involved in provision of payment services, introduction of modern financial technologies, and increasing volume of transactions made by customers of credit institutions through remote channels.

In 2019–2021 the Bank of Russia will take measures to further facilitate growth of cashless transactions, promote competition in the payment services market, and reduce the cost of operations, in particular by introducing new financial technologies.

The Bank of Russia payment system will receive an impetus owing to up-to-date payment services (including online payments), provision of flexible liquidity management mechanisms, expansion of the

operational framework of the system, and involvement of indirect participants.

The Bank of Russia will continue improving services offered by the financial messaging system both in terms of attracting new participants and expanding its functionality.

The national payment card system will also get a boost. National payment instruments will be promoted both domestically and in the EAEU and key tourist destination countries.

The Bank of Russia will continue efforts to improve and advance the legislation on the national payment system.

In order to stimulate the development of Russian technologies and Russian payment services, to safeguard interests of Russian banks and consumer rights special requirements will be established for the operation of electronic wallets and other electronic payment means, issued by foreign providers, in the territory of the Russian Federation.

The Bank of Russia also plans to set requirements for operations of payment application providers (for example, Apple Pay or Samsung Pay), which will ensure protection of consumer rights and reduce operational risks of credit institutions using such applications to interact with their customers.

Operations of payment aggregators acting in the capacity of bank payment agents will be enshrined in law in order to promote the infrastructure accepting payment cards and increase accessibility of payment services (particularly for SMEs).

In view of active online trade development and simplified settlement of transactions via online platforms, there are plans to allow transfers between electronic wallets of two organisations, two individual entre-

preneurs, or of an organisation and an individual entrepreneur.

To ensure equal operating conditions for payment systems and minimise risks for

Russian participants we plan to set requirements for operations of foreign payment systems in the territory of the Russian Federation.

## SECTION IV. RUSSIAN FINANCIAL MARKET DEVELOPMENT PROGRAM IMPLEMENTATION RISKS

While developing the Program the Bank of Russia sought to take the fullest account possible of the risks that may prevent their realisation. The Program is executed by the Bank of Russia in cooperation with the Government of the Russian Federation. The Bank of Russia can not be solely and fully responsible for putting in action many measures, which makes a number of risks associated with their fulfilment beyond its control.

The Bank of Russia identifies the following most significant risk factors<sup>37</sup>.

### Cooperation with governmental bodies

The cohesive nature of the Program implies that they reach their highest potential only if all the parties involved make comprehensive efforts to effect them. It means that the development, review, and adoption of proposed legislative changes may take more time than expected.

### Macroeconomic situation

Investment climate deterioration and difficulties in attracting foreign financial resources may have an adverse effect on Russian financial market participants and complicate the fulfilment of measures that require additional expenditures on their part.

### Resource base

Development activities envisaged in the Program requires significant amount of resources from the Bank of Russia's side. A slump in revenue, caused in particular by persisting surplus of liquidity in the banking sector, may cause the risk of necessary resources shortage.

### Geopolitical factors

Geopolitical factors have a growing influence on international relations as the practise of using economic means to achieve political goals is gaining momentum. It may complicate the attainment of a number of objectives, which imply close international cooperation.

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<sup>37</sup> These factors were determined with due regard of the challenges and threats identified in Executive Order of the President of the Russian Federation of 13 May 2017 No. 208, 'On the Strategy of Economic Security of the Russian Federation until 2030'.

## SECTION V. EXPECTED RESULTS AND KEY PERFORMANCE INDICATORS

### Competition

In the coming years the embedding of financial technologies in the business processes of market participants will largely determine what competition in the financial market will look like. To reduce market entrance barriers for new high-tech participants, it is planned to create a mechanism for piloting innovative projects and to decrease regulatory uncertainty around application of innovations. This will expand the range of financial services, make them more convenient and increase consumer satisfaction.

Competitive access to infrastructure and data will reduce the costs of market entry for new participants and help smaller players compete with larger ones on an equal footing. Favourable regulatory conditions for working with data will shift the focus of competition from possessing data to the ability to process it. Proliferation of digital

communication will cut transaction costs, which are particularly significant for small and new companies.

Creation and development of the remote identification platform will help to fully transfer financial services into a digital environment, increase their availability, and boost competition in the financial market.

Spread of systems for distance distribution of retail financial products (the Marketplace project) will help reduce market entrance barriers and encourage competition.

The introduction of open APIs will standardise interactions between market participants and provide equal access to financial institutions' data for providers of financial services.

Greater penetration of remote channels and lower territorial barriers for provision of financial services will help regional players to get into competition for consumers.

Deployment of the Faster Payments System will help to develop the payment ser-

#### COMPETITION: KEY PERFORMANCE INDICATORS FOR 2019–2021

Indicator	Range (min–max)	Current value	Target value
Fulfilment of the Action plan (Road map) for promoting competition in the industries of the Russian economy and transitioning of individual areas of natural monopolies to competitive state in 2018–2020	0%–100%	14%	100%
Level of competition in regional financial markets of the Russian Federation (CBR Composite)*	100–0 points	81	72.9
Qualitative assessment of competition by professional and expert community (survey-based)	0–100 points	Survey in 2019	Improvement by 10%
Share of types of products and services available to individual customers through remote access channels in the total range of products and services offered by financial institutions by sector	0%–100%	80%	85%

\* The index allows to compare the level of competition across different markets.

vices market and to remove interbank hurdles hindering transfer of funds between individuals.

## Integrity & trust

Upon completion of the Program, regulation will be put in place under which individuals and entities will receive financial services that meet their investment profile and will be timely and comprehensively informed about the risks of financial products. A conflict of interest, which may arise in the terms of selling financial products contract, will be clearly defined, while recommendations will be worked out on how to avoid or minimize it.

Activity to improve financial literacy will continue. However, its reaching a level that may be recognised as sufficient will take a long time.

Significance of business reputation of financial market professionals will grow. Unscrupulous individuals will have limited employment opportunities in the financial sector. A greater emphasis on busi-

ness reputation will lead to inevitability of punishment for failing to follow good business practices, while creating conditions to “monetise” good business reputation. Businesses’ leaders will bear greater responsibility for actions detrimental to customers.

The rehabilitation of the Russian financial sector will continue and result in a financial services market driven by scrupulous participants. The expanded use of professional judgment will ensure a proactive approach to supervision and identification of problems in financial institutions at an early stage.

The Bank of Russia will acquire new capabilities to counter malpractices owing to advanced tools, particularly based on Big Data. Improved cooperation with the law enforcement authorities will help enhance certainty of punishment for violations, which caused significant harm.

Implementation of the best practices will improve the quality of public companies’ corporate governance and strengthen confidence in the instruments of equity financing.

### INTEGRITY & TRUST: KEY PERFORMANCE INDICATORS FOR 2019–2021

Indicator	Range (min–max)	Current value	Target value
National financial literacy index	0–100 points	53	57
Level of satisfaction of the population with the Bank of Russia’s responses to the complaints submitted online	1–5 points	3.3	3.6
Composite indicator of corporate governance level in Russian public joint-stock companies	0%–100%	49.9%	52%
Share of adult population satisfied with operation of at least one type of financial institutions	0%–100%	83.9%	87%
Composite index of satisfaction of the population with operation of financial institutions, financial products (services) and channels of financial services provision	0–100 points	51.1	57
Level of trust by customers and counterparties of credit and financial institutions in the security of electronic technologies and services of such institutions	0–100 points	68.53%	80%

## Financial stability

The Program provides for a number of measures to further strengthen financial stability.

As the market evolves, the Bank of Russia shifts its approach to supervision. Certain steps, such as employment of professional judgment and stress testing, will promote proactive supervision and help identify problems of financial institutions at an early stage.

The improvement of macroprudential stress-testing methodology will ensure timely identification of potential systemic risks of banks and non-bank financial institutions on the macro level.

Improved regulation of the derivatives market will increase its transparency and stability, while the expanded use of derivatives for hedging purposes will ensure higher resistance of Russian companies to fluctuations in the global financial market.

Introduction of resolution and recovery regimes for central counterparties will make the Russian financial market infrastructure more resilient.

The risk-oriented approach to regulation based on Solvency II principles will stimulate the insurance market development and ensure the proactive identification of, and response to, individual and market risks.

## Access to financial services and capital

The Bank of Russia expects that by the end of 2021 physical or territorial barriers for financial services provision will have been largely eliminated and the volume of cashless settlements will continue growing. Remote channels for selling financial services will be more widespread, which will lead to an increase in the volume of cashless operations.

Long-term savings instruments will evolve. The creation of the individual pension capital scheme will become an additional pension saving instrument for individuals and a source of long-term finance for the economy.

The simplification of the securities issuance procedure and distribution of best

### FINANCIAL STABILITY: KEY PERFORMANCE INDICATORS FOR 2019–2021

Indicator	Range (min–max)	Current value	Target value
Classes of standardised over-the-counter derivatives subject to mandatory central counterparty clearing	↑	0	3
Implementation of the IMF mission recommendations with respect to improvement of macroprudential stress-testing methods	↑	The concept of macroprudential stress testing is being revised	The final concept of macroprudential stress testing is published
Implementation of modes of financial stability recovery and insolvency resolution of central counterparties	Yes/No	The regulatory act by the Bank of Russia specifying requirements for the contents of the plan for CCP financial stability recovery is finalised	Instruments for resolving the insolvency of CCPs are implemented
Ratio of unauthorised transfers of funds using payment cards to the total volume of such transfers	100-0%	0.0018%	No more than 0.005%*

\* Limit of the allowed ratio of unauthorised funds transfers set by the European Banking Authority (EBA).

practice of corporate governance will enhance the securities market appeal for both issuers and investors.

Integration processes within the Eurasian Economic Union (EAEU) and cooperation with the BRICS members allow Russian companies new opportunities to source financing from these countries.

The liquidity of the Russian financial market will grow along with its competitiveness. Simplified access to the market for foreign companies will also increase domestic competition and improve accessibility of financial services to consumers.

#### ACCESS TO FINANCIAL SERVICES AND CAPITAL: KEY PERFORMANCE INDICATORS FOR 2019–2021

Indicator	Range (min–max)	Current value	Target value
Financial services price accessibility index for businesses ( <i>current value of the indicator is calculated by the World Economic Forum based on global survey; since 2019 the Bank of Russia does its own calculation</i> )	1–7 points	3.4	3.6
Standardized financial services price accessibility index for adult population ( <i>calculation based on the survey commissioned by the Bank of Russia</i> )	1–7 points	5.95	6.1
Share of domestic bonds issued by Russian domestic companies in the total volume of borrowings by Russian domestic companies	0%–100%	21.2%	25.7%

## APPENDICES. KEY PERFORMANCE INDICATORS: METHODOLOGY

### Competition

	<p><b>Fulfilment of the Action plan (Road map) for promoting competition in the industries of the Russian economy and transitioning of individual areas of natural monopolies to competitive state in 2018–2020</b></p>	<p>Number of achieved objectives to the total number of objectives in the road map</p>
	<p><b>Level of competition in regional financial markets of the Russian Federation (CBR Composite – Regional)</b></p>	<p>CBR Composite is based on two standardized indices, Lind and GAP; it allows to compare the level of competition across different markets, for example, to compare subjects of the Russian Federation. The Lind index determines the borders of a monopoly or an oligopoly operating in a competitive environment, while the GAP index determines the level of competition by comparing the average shares of market leaders to the shares of their competitors</p>
	<p><b>Qualitative assessment of competition by professional and expert community</b></p>	<p>Provides an integral assessment based on a survey of market participants</p>
	<p><b>Share of types of products and services available to individual customers through remote access channels in the total range of products and services offered by financial institutions by sector</b></p>	<p>This metric is derived from publicly available statistics and surveys and calculated as the weighted average share of products and services offered to individuals by financial institutions upon repeated rendition of such products and services through remote access channels in the total range of products and services offered by financial institutions from the following sectors: banking, insurance, microfinance, collective investment and asset management, securities and commodities market</p>

## Integrity & trust

	<b>National financial literacy index</b>	The index is based on a survey of adult population and takes values from 0 to 100 points
	<b>Level of satisfaction of the population with the Bank of Russia's responses to the complaints submitted online</b>	The index utilizes a point-rating system based on a survey of satisfaction of applicants with the Bank of Russia's responses. It takes values from 1 to 5, where 5 is the highest. The final value is an average value for the designated period
	<b>Composite indicator of corporate governance level in Russian public joint-stock companies</b>	<p>The composite indicator has two components. The first component is derived from the data provided by PJSCs in their reports on compliance with the Corporate Governance Code and the assessment by the Bank of Russia of quality of explanations on non-compliance (partial compliance) with the Corporate Governance Code</p> <p>The integral indicator is calculated as the sum of shares of PJSCs (listed in QL1 and QL2 of the Moscow Exchange) in the upper quartile by level of compliance with the Corporate Governance Code with a weight of 60% and share of such PJSCs in the two upper quartiles by the quality of explanations with a weight of 40%</p>
	<b>Share of adult population satisfied with operation of at least one type of financial institutions</b>	<p>The index is based on the survey of adult population (aged 18+) conducted within the scope of the Bank of Russia's annual measurement of financial inclusion indices and calculated as the share of adult population who answered 'rather satisfied' or 'fully satisfied' to the question about their satisfaction with the functioning (services) of financial institutions when ordering and/or using financial services or in other cases in respect of at least one of the following types of financial institutions: banks, microfinance organisations, credit consumer cooperatives, agricultural credit consumer cooperatives, pawnshops, insurance entities (insurance firms, mutual insurance companies and insurance brokers), non-governmental pension funds and brokers.</p> <p>Possible answers: 'completely dissatisfied', 'rather dissatisfied', 'rather satisfied', 'fully satisfied', 'have not used' and 'cannot say'</p>
	<b>Composite index of satisfaction of the population with operation of financial institutions, financial products (services) and channels of financial services provision</b>	The index is based on a survey commissioned by the Bank of Russia. It utilizes statistical data analysis methods and lies within a range of 0 to 100 points, where 100 is the highest value
	<b>Level of trust by customers and counterparties of credit and financial institutions in the security of electronic technologies and services of such institutions</b>	The calculation of the indicator is based on sociological surveys conducted by external organisations

## Financial stability

	<b>Classes of standardised over-the-counter derivatives subject to mandatory central counterparty clearing</b>	The index measures the number of classes of standardised OTC derivatives within the Russian jurisdiction subject to CCP clearing
	<b>Improvement of macroprudential stress-testing methods</b>	The implementation of modes for the financial stability recovery and insolvency resolution of CCPs. The metric is a qualitative assessment (yes/no) of development of new methodology, which takes into account the specifics of financial stability recovery modes
	<b>Implementation of modes of financial stability recovery and insolvency resolution of central counterparties</b>	Qualitative assessment (yes/no) of development of new methodology, which takes into account the specifics of financial stability recovery modes
	<b>Ratio of unauthorised transfers of funds using payment cards to the total volume of such transfers</b>	<p>The ratio of the volume of unauthorised funds transfers to the total volume of payments through the national payment system in a year.</p> <p>The source of this index is the reporting form 0403203 'Information about identified incidents related to the violation of requirements for the protection of information in the process of funds transfers' (Bank of Russia Ordinance No. 2831-U of 9 June 2012).</p>

## Access to financial services and capital

	<p><b>Financial services price accessibility index for businesses</b></p>	<p>The Bank of Russia calculates the index based on the survey data using instruments similar to the ones utilized in the World Economic Forum global competitiveness index (the survey has not been conducted since 2018, the current value is based on the report from 2017–2018). The index characterises to what extent the cost of financial services hinders business activities. It takes values from 1 to 7, where 7 is the highest value.</p>
	<p><b>Standardized financial services price accessibility index for adult population</b></p>	<p>The standardized financial services price accessibility index for adult population is calculated using the formula: <math>7 - (X * 6 / 4)</math>, where</p> <p>X is the financial services price accessibility index for adult population, which is a sum of the shares of the adult citizens (ranging from 0 to 1), who refused to use the services listed below during the reporting period:</p> <ul style="list-style-type: none"> <li>• taking out a loan from a bank because of high cost</li> <li>• opening a new account with a bank because of high cost</li> <li>• opening a term deposit with a bank because of low interest rate</li> <li>• entering into a voluntary insurance agreement because of high cost</li> </ul> <p>The index (X) is based on the survey of the adult population commissioned by the Bank of Russia and takes values from 0 to 4, where 0 is the highest value (0% of the adult population refused to use financial services during the reporting period because they were dissatisfied with the cost) and 4 is the lowest value (100% of the adult population refused to use financial services during the reporting period because they were dissatisfied with the cost)</p>
	<p><b>Share of domestic bonds issued by Russian domestic companies in the total volume of borrowings by Russian domestic companies</b></p>	<p>The index is based on the Bank of Russia statistical data and calculated as a ratio of volume of domestic bond issues by Russian domestic companies to sum of the volumes of bond issues by Russian domestic companies, of bank credits issued to non-financial and financial domestic institutions, and of the part of the external debt of Russia corresponding to the external debt of banks and other organisations, except for domestic bonds issued by them and acquired by non-residents (included earlier in the calculation).</p> <p>The index includes bonds issued by Russian domestic companies nominated both in roubles and foreign currency.</p> <p>The volume of bank credits issued to non-financial and financial domestic institutions used in the index does not include interbank loans, loans and other funds given to individual entrepreneurs, and non-performing loans.</p>