

License Revocation Causes and Consequences

Imran Rasimovich Bashirov

Student of Financial University Under the Government of the Russian Federation, Moscow

Abstract: This study deals with possible causes of an unprecedented increase in the revocation of banking licenses, necessary grounds for cancellation of a license, possible consequences of its revocation as well as the ways of affecting the performance of the Russian banking sector. This study also reveals members of the banking sector having benefited from the revocation of banking licenses.

Key words: License revocation, banks, causes of revocation, consequences of license revocation

INTRODUCTION

The number of banks having terminated their activity due to the revocation of the license has been steadily growing in recent years. A particular concern is raised by the fact that the wave of revocations started to hit large credit institutions. This raises an indefiniteness and many questions about causes of license revocation, the parties concerned therein and the main question is what the consequences a revocation of licenses will have.

Objective of this study is to understand the possible true reasons for the revocation of licenses and its consequences. Familiarization with this study will allow us to consider the license revocation from different perspectives.

POSSIBLE CAUSES OF WAVE OF BANKING LICENSE REVOCATIONS

Rates of license revocation and liquidation of banks are growing (Fig. 1) for example, there were 29 of such banks in 2012, 43 banks in 2013, then 39 banks in 6 months in 2014 (as of June 2, 2014) and by the middle of November 2014 there was 81 defunct credit institutions (1). By the end of 2014 the statistics may show twofold increase compared to 2013 (Fig. 1).

“Why do the banks have their license revoked?” There may be many answers to this question. We shall consider the main reasons: recovery of banking sector. It is clear that there are weak banks which undermine and potentially ready to undermine the industry. It is in the community interest to close them.

Preparing for crisis: You know that women before getting pregnant have to undergo medical examination more intensively than during dental care, in order to be ready to minimize any health problems in the critical

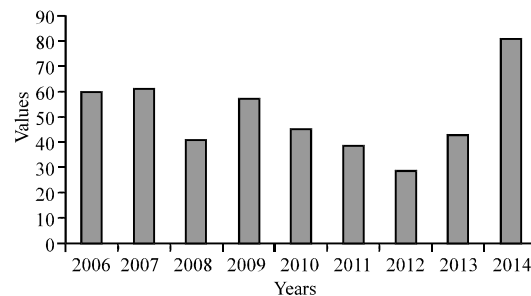


Fig. 1: Number of defunct banks

period. From this perspective, all that happens today is crucially important. Mikhail Savchenko has written well enough about this issue: “The country has nearly 900 banks. Some part is engaged into money laundering and most banks work under substandard risks. In case of crisis, this house of cards will collapse burying the whole economics. Nabiullina sorts out the mess. She rightly does.”

Increase of Russian public confidence in the banking sector:

This is the opinion of the Minister of Economic Development (ex-first deputy chairperson of the Central Bank of Russia) of Russian Federation Aleksei Uliukaev. This statement is controversial: it rather arouses mistrust in the economically illiterate people towards the banks which, of course, results in deposit runoff to large or state banks.

To keep the ruble from falling:

Some experts believe that the weakening of the ruble gives the government two ways out: either devaluation or support of the ruble (purchasing dollars, creating a deficit in rubles). The first case hits the ordinary public, making their savings melt away; the second case affects the banks: decrease of money in their system will lead to inability to fulfill the obligations to their depositors and further to revocation

of their license. "Supporting the banking system and national currency is two goals contradicting to each other and the Bank of Russia will sooner or later have to choose between them" the Head of VTB 24 Mikhail Zadornov stated in the interview to the channel "Russia 24". Of course, the Central Bank will defend the ruble (Anonymous, 2002): we place the public interests above the interests of the banking community but we must remember that the banks today are the basis of the economics.

No conspiracy theories and plans: it is a common practice when the bank is closed if it does not comply with the requirements of the regulator and the market.

That is all, without any omissions and intrigues. The Central Bank used to carry out its activity very softly: it gave banks many warnings and time for remedying their situations. However such soft policy did not work. The banks ignored the requirements of the Central Bank, most of them continued to conduct their illegal activity. Problems were accumulated further. The market received a signal of no concessions, even for large investors, with calling for operation in accordance with the law.

GROUND FOR REVOCATION OF A LICENSE BY THE BANK OF RUSSIA

In terms of legislation, the Bank of Russia shall revoke the license for banking operations in accordance with Article 20 of the Federal Law On Banks and Banking Activities (Anonymous, 1990) in the following cases:

- If the adequacy of the bank's capital (the actual value of HI standard) is below 2%
- If the amount of the bank's equity is less than the minimum amount of the authorized capital specified by the Bank of Russia as of the date of registration of the bank
- If the bank fails to fulfill within the period prescribed in the Law On Insolvency (Bankruptcy) of Credit Institutions the requirement of the Bank of Russia to adjust the amount of both the authorized capital and equity
- If the bank fails to satisfy the claims of creditors on monetary obligations and/or fulfill tax and other mandatory payments within 14 days after the date of their execution (provided that such claims against the bank make up 1,000 or more minimum wages)

Considering the absence of significant changes in the legislation before the wave of license revocation, we should say that the Bank of Russia set to a more strict control and recovery of the banking system from the "weak" banks.

According to ex-Minister of Finance Aleksei Kudrin, "recovering the banking system is very difficult and sometimes even dangerous work".

The banking sector has accumulated many problems due to a lack of strict supervision, however, the accumulated problems must be solved despite the anxiety. We can not leave this situation with a tinderbox waiting to explode.

We have to agree with the Head of VTB Andrei Kostin having said: "I think the purge is long overdue and I support in this regard the management of the Central Bank who has decisively started to solve this problem concerning supervision of the banking sector and the elimination of those financial institutions, that either do not meet the requirements for capital adequacy, or simply engaged in illegal activity such as money laundering" (Anonymous, 2003). We cannot also exclude a policy point. Revocation of licenses often helps to return money from the high-handed local elite. Do not forget that most banks of 90th were established by criminal structures, although a lot has changed over time, the roots remain the same and it is entirely possible that the relations between crime and government still exists.

Having considered possible reasons for revocation we can conclude that the license revocation is unpleasant procedure that affects everyone. Banks terminate their activities, individuals lose their money exceeding the amount of insurance deposit, DIA spends money from reserves.

There is a law of conservation of energy in physics reformulated by Mikhail Vasilievich Lomonosov as follows: "If something decreases somewhere, it will increase somewhere" (Zubkov, 2007). In other words, someone will win in this situation.

CONSEQUENCES OF WAVE OF BANKING LICENSE REVOCATIONS

Autumn-early winter 2013 might be called further a mini-crisis of banking system. On the one hand, we observe no banking crisis. On the other hand, a number of banks began to stop making payments and returning deposits. There are already quite large credit institutions among them. A key factor of the market situation is a high dependence of banks on such source of funding as deposits of individuals. The "raids" of depositors in combination with insufficient liquidity are the main reason for the suspension of payments by banks. Another factor is the growing activity of the Bank of Russia in anti-money laundering. An active withdrawal of funds by depositors from their deposits and insufficient liquidity are just a consequence of more strict regulation of the banking system by the Central Bank.

Revocation of the Master-Bank license, the most high-profile case for the market, happened on November 20. Master-Bank used to rank among Top-5 of Russian banks by the number of cards issued, Top-100 of Russian banks by financial results and accumulated about 47 billion ruble of private depositors.

We shall assess the changes in the market. For November 2013, according to the Central Bank, the total amount of deposits in Russian banks increased by 1.2% and was 16.26 trillion ruble. The gain was 198.7 billion ruble. The leading banks in the gain on deposits are Sberbank (145.8 billion ruble), VTB 24 (102.9 billion ruble) and Alfa-Bank (15.9 billion ruble). The excess of the total growth of the top three banks over the general growth in deposits in the banking system suggests a significant outflow of deposits from other banks. The average share of individuals in liabilities remained virtually unchanged and was 28.7%.

Total 316 banks had outflow of deposits (totaling 75.5 billion ruble). Leaders in absolute outflow of deposits are "Russian Standard" (minus 6.6 billion ruble), "Vostochnyi Ekspres" (minus 6.5 billion ruble), "Home Credit" (minus 5.5 billion ruble), "Baltiyskiy Bank" (minus 4.2 billion ruble) and "Gazbank" (minus 3.8 billion ruble).

It turns out that the large banks benefit from revocation of licenses (Table 1). We can see a clear dynamic in the RAS financial statement of Sberbank. In December 2013, the household deposits increased by 654 billion ruble or by 9% for a month. This is a record in both absolute and relative terms. For example, deposits increased by 406.6 billion ruble or 6.7% in December 2012, by 402.1 billion ruble or 7.8% in December of 2011 and by 291.3 billion ruble or 6.6% in December 2010.

In November 2013, the household deposits increased only by 145.9 billion ruble or 2%. The increase is primarily due to the growth in balances on current accounts of individuals (+365.9 billion ruble or +32.8%) as well as growth in deposits of individuals (280.6 billion ruble or +4.8%).

Such significant growth cannot be only due the seasonal factor such as the traditional infusion of budgetary funds into the economics at the end of the year. The obvious reason of this record is an outflow of funds of investors, frightened of the bank micro-crisis, from small and medium-sized banks to the largest banks, firstly state and other large banks. Experts note that such a flow of funds from small and medium banks to large ones is the result of a chain of high-profile revocations of banking licenses in 2013.

Table 1: Absolute growth in deposits by months 2013, billion ruble

License No.	Bank	August	September	October	November
1481	Sberbank of Russia	20.8	19.9	48.6	145.8
1623	VTB 24	12.6	0.8	29.0	102.9
354	Gazprombank	6.6	-10.7	-5.6	6.0
3349	Roselkhozbank	4.6	5.0	4.7	8.1
2748	Bank of Moscow	5.0	10.1	3.1	6.4
	Total growth	49.6	25.1	79.8	269.2

Deputy Director of the Deposit Insurance Agency Andrei Melnikov assumes it normal that the deposits in the largest banks grow faster in these situations than in the system in general.

In addition, Sberbank was the agent of the DIA for the payment of insurance to depositors of several banks (Master-Bank, Investbank, Smolenskiy Bank and Commercial Volga Social Bank) which licenses were revoked during the banking micro-crisis. Considerable part of this money could be either left on the current accounts of individuals, or transferred onto deposits of Sberbank; just like money, the customers transfer to another banks too.

CONCLUSION

We can conclude that the revocation of banking licenses is definitely necessary measure to overcome severe consequences that can affect the banking sector in the future. Another result is a tendency towards consolidation of banks and runoff from smaller banks.

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