



## Formation of the Russian Bank Deposit Insurance Scheme

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### ABSTRACT

The paper presents the outcomes of research that reveals the main objective of formation of the Russian deposit insurance scheme (DIS) is protection of rights and legally protected interests of depositors in banks of the Russian Federation, confidence-building measures to the banking system and attraction of personal savings to banks. The paper has noted that over the last 5 years private deposits were one of the main sources of funding and growth of the Russian banking system. It was largely proved by the fact that the market of private deposits was the only competitive market of passives available to all banks. But now private deposits do not encourage growth of the Russian banking system. Considering the extent of protection, the Russian insurance scheme refers to the DIS that guarantees depositors limited coverage. The paper has also offered to compute premium accounts due to the deposit base risk adjustment.

**Keywords:** Deposit Insurance, Deposit Risk, Bank Deposit-sourcing Mechanism

**JEL Classifications:** G20, G21, E40

### 1. INTRODUCTION

Being the main source of attraction of financial resources for modern banking systems, private deposits are characterized by low costs and demand high banks' reputation in the yeas of depositors. Since the 1980s, the problem of deposit insurance schemes (DIS) was that, on one hand, they stimulated a tendency of banks to increased risks, and on the other hand, degraded depositors' interest in bank investment security assessment. In Russia overcoming of depositors' mistrust to the financial system is caused by common economic instability and numerous losses of savings over the last decade of the XX century. And now, in modern macroeconomic conditions, the decreased level of risks is the most important task that commercial banks have. One of the two main instruments of regulation over attraction of financial resources to the banking system along with the rate of central banks is the deposit insurance mechanism.

### 2. METHODOLOGY OF DEPOSIT INSURANCE IN THE BANK

The main demands which are made to a mechanism of attraction of deposits to commercial banks are preservation

of a mechanism of attraction of deposits, a limited risk that occurs from effects of a moral risk and negative election, the possibility of finer regulation of the risk level in the banking system, formation of depositor's ideas about deposit risks, close to adequate.

Over the last decades, the role of DIS around the world had been strengthened as they already act in 106 countries.

The North American scheme is the oldest and most developed DIS - the Federal Deposit Insurance Corporation.

In 2004, according to the Federal Law on private deposit insurance in banks of the Russian Federation, in Russia there is the system of obligatory private bank deposit insurance that is a special state program in our country and its main task is to protect depositors' private savings. Table 1 presents the main characteristics of the Russian DIS.

The explicit insurance scheme assumes accurately formulated legislative acts which present the order of bank deposit assurance and also have the specially created insurance fund, used for compensation of lost deposits.

**Table 1: Characteristics of the deposit insurance scheme in Russia**

Classification criteria	DIS characteristics
Under the legislative form	Explicit
Under the bank participation in the insurance scheme	With obligatory participation
Under the extent of protection	With limited coverage
Under the pattern of ownership	Statutory
Under the principle of formation of the payment rate to the insurance fund	With the fixed rate
Under the state participation in financial assurance of insurance payments	Without additional statutory guarantees
Under the finance-sourcing mechanism	Ex-ante

DIS: Deposit insurance scheme

Today, more than 80 credit organizations are involved in the insurance scheme, and there is the increasing share of banks which are participants of the DIS.

In Russia unlike the majority of developed countries only private deposits (in rubles and foreign currency) and accumulated interests are the objects of deposit insurance. Being the owners of deposit accounts, legal entities are not included in the scheme (Gorelaya, 2015).

Considering the extent of protection, the Russian insurance scheme refers to the DIS that guarantees depositors limited coverage

Since 1994, Europe uses the Directive of the European Parliament and of the Council on deposit assurance systems. On the basis of this document, all countries of the European Union exert control and supervision over development and official recognition of one or several deposit assurance systems in the territory.

In June 2009, the Basle Committee on Banking Regulations and Supervisory Practices and the International Association of Deposit Insurers have approved a set of fundamental principles for effective DIS that defined a basic set of demands which national DIS should follow. The Russian DIS with its key parameters conforms to these international standards (Nabiullina, 2015).

### 3. SOLUTION OF A PROBLEM BY MEANS OF THE DIS

Over the last 5 years private deposits were one of the main sources of funding and growth of the Russian banking system. It was largely proved by the fact that the market of private deposits was the only competitive market of passives available to all banks. But now private deposits do not encourage growth of the Russian banking system.

Despite the complexity of a situation, which Russian banks face now, there is a number of opportunities which allow many banks not only to survive, but also to strengthen their positions in the market.

The special conditions, included in a contract for deposit, which a client and bank conclude, promote loss prevention when forming

deposits. But a bank should decide what clients conclude the contract. Refusal to a client in early withdrawal of a deposit can be one of the contract terms.

Sometimes, a bank has to estimate the extent of deposit usage which possesses. A coefficient of deposit coherence that must be equal to one is determined for this purpose, namely, all bank deposits are involved in its turn.

A deposit risk is closely interconnected with other bank risks, therefore when a bank carries out a complex of activities for deposit risk minimization the degree of reliability of a bank deposit resource base and the list of conducted activities and services in the long term are increasing.

In our opinion, a coefficient of a sufficient deposit base to estimate responsibility to depositors both by private and legal entities can be used to estimate the extent of deposit stability can be used:

$$Ksd=(DK\div SK)\div Kdr \quad (1)$$

Where  $Ksd$  - is a coefficient of sufficiency of a deposit base;  
 $DK$ - is the sum of the deposit bank capital;  
 $SK$  - is the volume of own bank capital;  
 $Kdr$ : - is a coefficient of a deposit risk.

Beloglazova and Krolivetskaya (2009) determine a deposit risk as a risk of early deposit calling from a bank. So, Russian commercial banks carry an actual risk as, according to the Civil Code of the Russian Federation (Art. 837), a bank is obliged to issue deposits upon the first demand of private depositors.

Thus, the lower a coefficient of deposit risk, the higher a coefficient of sufficiency of a bank deposit base, and on the contrary.

Now, in economic instability, considerable financial means from an account can be withdrawn at any time that can stir up a liquidity crisis. The problems of one bank can cause private depositors' mistrust to other banks also. Along with retail banks, those banks which activity is connected with one or several big customers are subject to a deposit risk. A differentiated balanced approach to attraction of financial means, fixing of interest rates are one of the conditions of successful management over the bank liquidity (On Fixing of the Insurance Premium Payment Rate, 2016).

Therefore, in our opinion, a coefficient of a deposit risk has to include the possibility of deposit insurance coverage.

The purpose of formation of the deposit protection scheme deposits by means of deposit insurance in Russia was protection of the most financially vulnerable segments of the population, regardless of a concrete bank operation. The issue concerning protection of such depositors' interests has a special social context, considering the fact that small depositors, as a rule, make the greatest share in the common structure of bank deposits. Besides, the deposit protection scheme contributes to the financial system stability in the country, stimulates the inflow of means of the population to the

banking system, reduces the cash turnover and increases domestic investment resources.

Participation in the insurance scheme is obligatory for all banks, having the right to work with private deposits. Deposits are insured as from the date of inclusion of a bank to a register of banks which are participants of the scheme.

#### 4. IMPLEMENTATION OF THE DEPOSIT INSURANCE PROGRAM AT FINANCIAL AND CREDIT INSTITUTES

A financial basis of the DIS in the Russian Federation is the obligatory deposit insurance fund (ODIF).

The main sources of the fund formation are:

- Initial deposit of the Russian Federation, amount of which is equivalent to 2 billion rubles;
- Insurance premium bank payments and penalties for their late payment;
- Income on investment of resources of the fund.

The procedure of calculation of insurance premium payments is established by the State Deposit Insurance Agency, in accordance with item 6 of Art. 19 and Art. 36 of the Federal Law On deposit insurance in banks of the Russian Federation, and that is obligatory for banks, which in accordance with Art. 6, should pay insurance premiums (The Federal Law from 23.12.2003 No. 177-FZ, 2003; The Procedure of Calculation of Insurance Premium Payments, 2004).

In our opinion, the premium amount that is subject to payment to the ODIF over the accounting period should be calculated with adjustment to an accounting deposit base by a coefficient of a deposit risk from the formula 2:

$$S = (Ld \div Ksd) \times P \quad (2)$$

Where,  $S$  - is the insurance premium payment amount to the ODIF over the accounting period;

$Ld$  - is an accounting deposit base over the accounting period;

$Ksd$  - is a coefficient of sufficiency of a deposit base, considering a coefficient of a deposit risk;

$P$  - is the rate of insurance premium payments in percentage terms.

Insurance premiums are paid by banks quarterly. The rate of bank insurance premium payments is established by the Report Proceedings of the Court of Directors of the DIA and, now, is 0.10% (basic) of the average deposit amount per quarter (Table 2).

In case of the fund deficiency the rate of insurance premium payments can be increased to 0.25% (basic + additional penalty).

Amendments to the Law on deposit insurance has come into force in 29.12.2014 and legislatively fixed that bank depositors will get insurance payment through the DIA within 1400 thousand rubles instead of the former maximum of 700 thousand rubles that was during 6 years.

Since 1 July 2015, the DIA applies another procedure of payment accounting to the insurance deposit. In particular, advanced laws specify the formulation of the earlier effective document that calculates the extent of guarantee, provided by the state as proportion of all deposits of a certain private depositor at the same credit institution. In other words, having several accounts in one credit organization, a certain depositor (but not all members of one family, as many assume) has the right to get accelerated insurance payments in an amount equal to not more than 1400000 rubles for all available accounts in general. In case if accounts had more deposits and funds, a client can get the margin, exceeding the insurance, but much later (and perhaps not 100%) and by certain turn of depositors by the results of the bankruptcy procedure (Iskakov, 2006).

The decision on the doubled insured sum together with increasing deposit rates up to values, close to 20% per annum has led increased trust of the population to the domestic banking system. For example, in the MDM Bank only in one its small regional additional office about 500 depositors opened new deposits over one operational day. This event occurred in that day, when amendments to the Law on insurance were signed by the Federation Council.

When choosing a bank for deposits, financial consultants advise to consider not only the sum of insurance guarantee, but also the fact that the fund of the DIA is limited. Especially, in these conditions, when there will be a series of bankruptcies and the DIA guarantee fund because of the doubled insurance sum, will dwindle much quicker, perhaps, without managing to be restructured by the necessary rates. Table 3 presents dynamics of the key DIS financial parameters (The Annual Report of the Deposit Insurance Agency Over 2014, 2015).

Over the 10 years of the Russian insurance scheme operation the maximum deposit indemnity has changed four times, and over the whole period has increased by 14 times - from 100 thousand rubles to 1 million 400 thousand rubles and the last increase was in December 2014.

Since 2015 the interest deductions of banks to the insurance scheme depends on their deposit rates, namely, there is the following principle - the higher the deposit rate for a client, the higher the bank payment to the insurance scheme, and since January 2016, depending on the personal financial stability of each credit organization, the scheme of additional payments to the DIS will start working.

It should be noted that the main characteristic feature of the Russian insurance scheme is connected with a way of formation of the payment rate to the ODIF. Today, there is the fixed payment rate to the insurance fund is 0.1% of the deposit amount on private accounts.

Figure 1 shows the data on the actual amount of finance, channeled to the ODIF.

It is obvious that almost during the whole period of the Russian DIS operation, namely, from 01.01.2005 to 01.01.2013 the amount

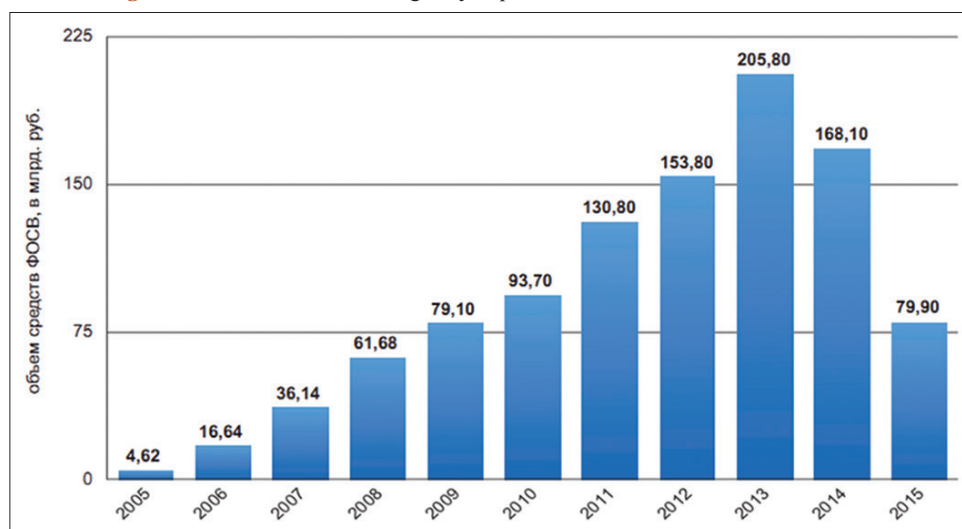
**Table 2: Insurance premium payment rates to the obligatory deposit insurance fund**

Beginning of the rate usage	First accounting period (quarter)	Rate	Rate amount, in percentage terms of an accounting base over the accounting period (quarter)	Decision of the court of directors of the agency
01.07.2004	The third quarter 2004	Common	0.15	Record proceedings from 03.02.2004 No. 3
01.07.2007	The third quarter 2007	Common	0.13	Record proceedings from 06.03.2007 No. 1
01.10.2008	The fourth quarter 2008	Common	0.1	Record proceedings from 23.09.2008 No. 3
01.07.2015	The third quarter 2015	Basic	0.1	Record proceedings from 28.04.2015 No. 6
		Basic+additional	0.12	
		Basic+additional penalty	0.25	

**Table 3: Dynamics of the key DIS financial parameters**

Figures	01.01.2012	01.01.2013	01.01.2014	01.01.2015
Total amount of insured deposits, million rub.	11849632.5	13999730.6	16590994	18
Agency insurance responsibility (potential payments), million rub.	8027378.1	9401174.4	10874457	12
Relation of the Agency insurance responsibility to the total amount of insured deposits (%)	67.7	67.2	65.5	69.4
Maximum deposit indemnity to one depositor in one bank, thousand rub.	700	700	700	1 400
Amount of completely insured deposits of one depositor in one bank, thousand rub.	700	700	700	1 400
Decreasing insurance payment (franchise) for partially insured deposits (%)	0	0	0	0
Insurance payment rate per quarter (%)	0.10	0.10	0.10	0.10
ODIF level, million rub.	0.5	205767.1	168127.4	83599.5
Relation of the fund level to the agency insurance responsibility (incl., without the Sberbank of Russia) (%)	1.92 (4.51)	2.19 (4.93)	1.55 (3.52)	0.66 (1.34)

DIS: Deposit insurance scheme, ODIF: Obligatory deposit insurance fund

**Figure 1: Formation of the obligatory deposit insurance fund from 2005 to 2015**

of finance, channeled to the ODIF, has steadily grown, and during 2013 the fund volume had been reduced to 168.1 billion rubles, and for 1 January 2015 the ODIF level was 79.9 billion rubles that is by 88.2 billion rubles lesser the same figure for 2014.

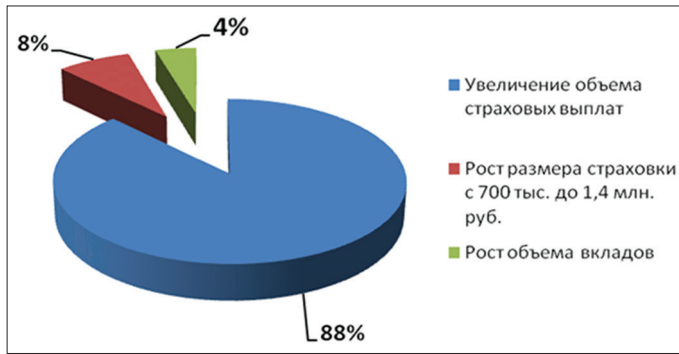
Over the year the participants of the DIS have been changed. For the beginning of 2014 the DIS included 873 banks, and as of 1 January 2015 there were 860 banks, including 162 banks which are in the process of competitive production (elimination) and 8 operating banks, which, being a part of the DIS, have lost the right to close new accounts and to take private deposits.

By the end of the financial year, the total amount of insured deposits has reached 18.3 trillion rub, having increased by 9% for 2014.

For the end of the year, the extent of the Agency insurance responsibility (potential payments) was 12.7 trillion rub (in the previous year - 10.8 trillion rub). In relative terms (to the total amount of insured deposits) it had been also generally increased in connection with the doubled amount of insurance indemnity) and was 69.4% (at the end of 2013 - 65.5%).

The significant decrease in the fund finance in 2014 is certainly connected with payments for liabilities of banks, being the

**Figure 2:** Contribution of various factors to the decreased figure the obligatory deposit insurance fund sufficiency



participants of the insurance scheme who have been withdrawn their licenses (Figure 2).

Following the results of 2014, a figure of the Fund sufficiency (the relation of the Fund volume minus a reserve for current insured events to the total Agency insurance responsibility) had been decreased from 1.3 to 0.5% (without the Sberbank of Russia - from 2.9 to 1.1%).

Now, the DIS operates this way that many private investors are guided by the high rates (which present more real inflation), but not by a credit organization's authoritative name. Besides, there are the measures, undertaken by the state and which really increase the financial system safety. So, in case of the problems concerning the liquidity from stabilization funds of the state financial means for the increased capital of several tens systemically of significant banks will be allocated.

## 5. CONCLUSION

The Russian DIS still lags behind foreign analogs. The indemnity amount for deposits in Russia in rubles is almost by 10 times lower

than in the USA, by 5 times lower than in Germany, and by 3.36 lower than in Japan.

Thus, the research has showed that since 2016 banks have to consider the interest rates and the bank financial condition, and also other parameters, capable to have significant impact on its reliability. Respectively, the riskier policy will be conducted by a bank, much more money will have to be deposited to the insurance deposit by a bank. In this regard, the paper has offered to calculate the sum of insurance premium payments taking into account the deposit base adjustment by a coefficient of a deposit risk. The purpose of the Russian DIS is both stabilization of the banking sector in national economy and protection of certain depositors' interests.

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