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Yale Program on Financial Stability

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Russian Bank Capital Support Program

Sean Fulmer

Yale Program on Financial Stability Case Study
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Abstract

At the start of 2014, the Russian Federation had experienced several years of decelerating growth rates as a result of weak investment, poor governance, and failed structural reforms. During 2014, the dual shocks of rapidly declining oil prices and increasingly stringent international sanctions led to significant financial instability, as Russian firms lost access to international markets and net capital outflows accelerated. As part of the response to this crisis, the Russian government unveiled a RUB 1 trillion (US $17.2 billion) bank capital support program, which it later revised down to RUB 838 billion. The program, operated by the Deposit Insurance Agency (DIA), exchanged government bonds (OFZs) for either preferred shares or subordinated debt from large banks, banks affected by the sanctions, or major regional banks. The DIA required banks to increase lending to certain sectors in the real economy by 1% a month for three years, as well as freezing executive compensation and raising private capital of 50% of the amount of support provided by the DIA. The DIA concluded agreements with 34 banks for the exchange of RUB 838 billion in OFZs, with over RUB 628 billion in OFZs still in place at those institutions as of October 2019. Government auditors reported that the program transferred RUB 261.3 billion to the federal budget by the end of 2019, as a result of eleven banks ending their participation in the program, with the four banks merging with others. The Russian government claimed the intervention was a success, noting that lending to the real economy increased by 65%.

Keywords: broad-based capital injection; broad-based, capital injection, Russia, Deposit Insurance Agency, recapitalization

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1 This case study is part of the Yale Program on Financial Stability (YPFS) selection of New Bagehot Project modules considering broad-based capital injection programs. Cases are available from the Journal of Financial Crises at https://elischolar.library.yale.edu/journal-of-financial-crises/.

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At a Glance

In the second half of 2014, Russia faced two significant shocks to its economic system: an extreme decline in oil prices, and international sanctions in response to Russia’s annexation of Crimea. As a result, the Russian ruble faced serious deprecative pressure, causing net capital outflows of 8% of GDP and declining asset prices which generated liquidity issues for Russian banks. The depreciation of the ruble negatively affected the value of Russian banks’ risk-weighted capital, making it harder for Russian banks to operate. The Russian financial sector reported after-tax losses from December 2014-May 2015 (IMF 2015).

According to the International Monetary Fund, the sanctions placed on Russia would decrease real GDP by 1-1.5% in the short term, and possibly cause it to decline by up to 9% in the medium term. Russian companies lost access to international markets—which increased financing costs—and had to turn to Russian banks to finance their external debts—banks which struggled to provide the necessary financing (IMF 2015).

In response to the worsening economic conditions, the Russian government initiated several measures in fiscal and monetary policy measures, including a bank capital support program to help ailing banks. The bank capital support program, announced in December 2014, sought to recapitalize the Russian banking sector with RUB 1 trillion (US $17.2 billion) set aside for

### Summary of Key Terms

| Purpose | The bank capital support program intended to provide capital to systematically important banks affected by declining oil prices and international sanctions, as well as increase lending to select sectors of the real economy. |
| Announcement Date | December 2014 |
| Operational Date | April 27, 2015 |
| Sunset Date | Not applicable |
| Legal Authority | Authorized by Law No. 451-FZ |
| Program Size | Initially one trillion rubles but revised downwards to 838 billion rubles |
| Usage | 34 banks received a total of RUB 838 billion in OFZs |
| Outcomes | RUB 628.6 billion of preferred shares and subordinated debt remain outstanding with the government as of the end of 2020; four banks merged and two lost their banking licenses |
| Key Features | Capital injection exchanged for preferred shares in some cases; maturity for subordinated debt 10-20 years and in some cases could be greater than 50 years |
the program, later revised down to RUB 838 billion (IMF 2015).3 The Deposit Insurance Agency (DIA), a state-run corporation, administered the bank capital support program by exchanging government bonds (OFZs) for the preferred shares and Tier 1 debt of partly state-owned banks and banks facing international sanctions. Additionally, the DIA swapped OFZs for the Tier 2 subordinated debt of the remaining eligible private banks (IMF 2015).

The Russian government allowed large banks (those with at least RUB 25 billion in capital), banks facing international sanctions, and major regional banks to participate in the bank capital support program (IMF 2015). The DIA defined a major regional bank as a bank with at least RUB 5 billion in capital, with only the largest bank in each constituent entity of the Russian Federation included in this list (DIA 2015). A bank could receive capital support of up to 25% of its capital if it committed to increase lending in specific sectors by one percent a month, froze executive compensation and payroll, and raised its own capital by an additional 50% of the amount of the government’s capital injection (IMF 2015).

The Board of Directors of the DIA operated the bank capital support program, dependent on Russian government approval, while the Accounts Chamber of the Russian Federation (ACRF) provided frequent audits of the program (DIA 2015; ACRF 2020).

Summary Evaluation

In total, the DIA purchased RUB 838 billion rubles of preferred shares and subordinated debt from 34 banks under the bank capital support program, as of December 31, 2019 (DIA 2020). That total included: (1) RUB 298 billion in subordinated debt with maturity dates in 2025, 2027, 2029, 2032, and 2034, from 27 private banks; (2) RUB 13 billion in subordinated debt with a maturity of at least 50 years from three banks; and (3) RUB 527 billion in preferred shares from four partly state-owned banks (ACRF 2020). The DIA funded all of these purchases by issuing OFZs to the supported banks.

Twelve banks failed to meet the credit growth target at points during the three-year period and paid RUB 771 million in fines to the DIA as a result. Three banks violated the condition to self-raise funds and paid RUB 290 million in resultant fines. Two banks exceeded the payroll restrictions and thus remitted RUB 351 million to the federal budget (ACRF 2020).

Between the start of the program and the end of 2019, 11 banks ended their participation due to various reasons such as reorganizing through merger, exchanging claims for ordinary shares of the banks, and transferring preferred shares to the Treasury of the Russian government (DIA 2020; ACRF 2020). See Figure 1 for the size of the program over time.

As of December 31, 2019, over RUB 628.6 billion in preferred shares and subordinated debt remained outstanding with the Russian government, including the 2.2 billion of subordinated debt to two banks whose licenses were revoked in 2017 and 2018 (these

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3 1 RUB = US$ 0.01723 on December 31, 2014 (Bloomberg).
claims will be satisfied through bankruptcy proceedings) (DIA 2020). The DIA has transferred RUB 261.3 billion to the federal budget as of October 1, 2019, as a result of compensation for lost coupon income, dividends on preferred shares, interest on subordinated loans, and fines due to noncompliance with contractual obligations (ACRF 2020). The Accounts Chamber of the Russian Federation, a government auditor, declared that the bank capital support program was successful because banks made it through the crisis period, while lending to the real economy increased by 65% (compared to only 11% for the overall banking sector) (Vilenovich 2019).

**Figure 1: Assets of Bank Capital Support Program (in RUB billions)**

![Graph showing assets of bank capital support program from 2014 to 2019.](image)

*Sources: Deposit Insurance Agency 2016; Deposit Insurance Agency 2017; Deposit Insurance Agency 2018; Deposit Insurance Agency 2019; Deposit Insurance Agency 2020.*
## Russian Federation Context 2014 - 2015

<table>
<thead>
<tr>
<th>Metric</th>
<th>2014</th>
<th>2015</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>GDP</strong>&lt;br&gt;(SAAR, Nominal GDP in LCU converted to USD)</td>
<td>$2.077 trillion</td>
<td>$1.366 trillion</td>
</tr>
<tr>
<td><strong>GDP per capita</strong>&lt;br&gt;(SAAR, Nominal GDP in LCU converted to USD)</td>
<td>$14,096</td>
<td>$9,313</td>
</tr>
<tr>
<td><strong>Size of banking system</strong></td>
<td>$643 billion</td>
<td>$847 billion</td>
</tr>
<tr>
<td><strong>Size of banking system as a percentage of GDP</strong></td>
<td>30.94%</td>
<td>61.96%</td>
</tr>
<tr>
<td><strong>Size of banking system as a percentage of financial system</strong></td>
<td>93%</td>
<td>96%</td>
</tr>
<tr>
<td><strong>5-bank concentration of banking system</strong></td>
<td>42%</td>
<td>55%</td>
</tr>
<tr>
<td><strong>Foreign involvement in banking system</strong></td>
<td>0%</td>
<td>0%</td>
</tr>
<tr>
<td><strong>Government ownership of banking system</strong></td>
<td>58.5% of assets in state-owned banks in 2014 58.6% of assets in state-owned banks in 2015</td>
<td></td>
</tr>
<tr>
<td><strong>Existence of deposit insurance</strong></td>
<td>100% insurance on deposits up to $21,387 in 2013 (exchange rate volatility complicates this estimate)</td>
<td></td>
</tr>
</tbody>
</table>

*Sources: Bloomberg; World Bank Global Financial Development Database; World Bank Deposit Insurance Dataset.*
Key Design Decisions

1. **Part of a Package:** The Russian government provided additional capital support through separate targeted programs; it also provided temporary regulatory forbearance with respect to loan loss provisions and asset valuation.

Two additional provisions intended to stabilize the Russian banking sector accompanied the bank capital support program. Up to 10% of the assets of the National Wealth Fund (0.5% of GDP) could be used to finance large infrastructure projects through banks (IMF 2015). Additionally, the legislation permitted the Central Bank of Russia to inject capital into the largest state-owned bank, Sberbank, which was thus made ineligible for the bank capital support program and held approximately 30% of the system’s assets at the time. The government also replaced subordinated loans it had provided to three state-owned banks during the Global Financial Crisis with preferred shares of up to 0.4% of GDP (IMF 2016).

The Russian government implemented several temporary regulatory forbearance measures, affecting the valuation of securities and foreign exchange assets. Additionally, there were measures designed to provide flexibility for loan loss provisioning related to armed conflict and international sanctions (IMF 2016).

2. **Legal Authority:** Law No. 451-FZ authorized the Deposit Insurance Agency to recapitalize the banking sector through the exchange of government bonds for subordinated debt and preferred shares on December 25, 2014.

The lower house of the Russian Federal Assembly, the State Duma, passed Law No. 451-FZ on December 19, 2014, and the upper house, the Federation Council, approved the measure on December 25, 2014. This law allowed the Deposit Insurance Agency (DIA) to recapitalize Russian banks by transferring government bonds (OFZ) for subordinated loans and bonds (Federation Council 2014).

3. **Communication:** The DIA released annual reports, as well as timely announcements of specific recapitalizations.

The DIA released annual reports that provided updates on the progress of the bank capital support program. Additionally, the regulation of the DIA required it to publicly announce on its website any transfer of government bonds within five working days. This announcement included the total par value of the transferred government bonds, the term of the subordinated debt, and the interest rate on the subordinated debt (DIA 2015).
4. **Governance/Administration: The DIA required monthly reports from the participating banks to ensure compliance with the conditions in the contracts.**

The DIA required banks that received capital support from the DIA to submit monthly reports to the DIA on their required credit growth targets, with quarterly reports on the other conditions included in the capital support agreements (DIA 2015).

The Accounts Chamber of the Russian Federation (ACRF), an audit institution within the Russian government, released quarterly reports on the progress of the bank capital support program (ACRF 2020). The ACRF did not approve of the DIA’s handling of reports, raising concerns of inaccurate or incorrect data in their reports. In response, the DIA devised a new methodology for report preparation in December 2016 (ACRF 2017a). However, these forms were not approved by the Central Bank of Russia and the ACRF requested that the DIA implement sanctions on banks that provided inaccurate data. Altogether in 2016-17, the DIA (by its Board’s decisions) implemented financial sanctions (fines) on banks that did not comply with the conditions in the contracts for the total amount of 822.9 million RUB. The fines paid by the banks were transferred by the DIA to the federal budget (DIA 2018).

5. **Governance/Administration: The Board of Directors of the DIA operated the bank capital support program, subject to government approval.**

The DIA operated the bank capital support program (IMF 2016). The Board of Directors of the DIA determined eligibility of banks to participate in the program, pending approval from the government of the Russian Federation, which consists of the Prime Minister and their deputies (DIA 2015). It appears that the vast majority of decisions approved by the Board of Directors required governmental authorization. The Board of Directors is comprised of seven representatives from the federal government, five representatives of the Central Bank of Russia, and the director general of the DIA (IMF 2016).

6. **Size, Timing: The Russian government initially allocated RUB 1 trillion to the bank capital support program, although it later decreased the total to RUB 830 billion.**

At the time of announcement, the Russian government allocated RUB 1 trillion (1.2% of GDP) to the bank capital support program, although it would later reduce the allocation to RUB 838 billion as a result of lower capital need estimates (IMF 2015). The other RUB 162 billion went instead to nonfinancial enterprises (IMF 2016).

Eligible banks, excluding regional banks, had until June 1, 2015, to accept the capital injection offer from the DIA, and the process should have been finalized by November 1, 2015. Regional banks had until April 1, 2016, to finalize their participation in the bank capital support program (DIA 2015). Some banks received more than one capital injection throughout the existence of the program.
7. **Source of the Injections:** The Russian government issued new bonds (OFZs) and exchanged them for the securities held by banks.

The funding for the bank capital support program came in the form of government bonds (OFZs) included in the 2014 federal budget (IMF 2015).

8. **Eligible Institutions:** The Russian government made large banks, banks affected by international sanctions, and main regional banks eligible for the voluntary bank capital support program, dependent on compliance with certain conditions.

There were three main categories of banks eligible to participate in the bank capital support program:

- Banks with at least RUB 25 billion in capital (27 banks applicable, 43% of system assets)
- Banks that were directly or indirectly affected by the economic sanctions (four banks)
- main regional lenders (10 banks), which the DIA defines as having at least RUB 5 billion in capital with only the largest bank in each constituent entity of the Russian Federation included in this list (IMF 2015; DIA 2015).

Despite Sberbank being technically eligible under the first category, the bank capital support program excluded it, since it was majority-owned by the Central Bank of Russia. Partly state-owned banks could participate in the program with eight of the 27 banks in the first category falling under this classification and holding 64% of the capital in the entire category (IMF 2015).

Beyond the categorization of eligible institutions, all banks needed to be in full compliance with the prudential regulations of the Central Bank of Russia at the time of the capital injection. Furthermore, consumer loans had to be below 40% of total assets, although legislation raised this limit to 50% in July 2015 (IMF 2016).

On February 2, 2015, the Russian government approved the 27 banks in the first category for participation in the program. The government approved four banks affected by economic sanctions on May 13, 2015. Lastly, the government authorized ten regional banks to participate in the program on August 10, 2015, with RUB 8.47 billion in government bonds allocated to the regional banks (DIA 2016). In total, the DIA preliminarily designated over RUB 856 billion to the banks approved for participation. However, only 34 banks would conclude agreements with the DIA to receive capital support (DIA 2020).
9. **Individual Participation Limits:** Banks could not receive more than 25% of their own capital as of January 1, 2015.

The capital injection to an individual bank could not exceed 25% of the bank's own capital as of January 1, 2015, unless otherwise established by the Board of Directors. In cases when participants of the recapitalization program belonged to the same banking group, the mother bank of the group determined the amount of funds/bonds that were provided to each, within the limits established by the government for each bank. The DIA regulated that every bank would receive the same percentage of its own capital in support, which the Board of Directors would determine (DIA 2015).

The International Monetary Fund (IMF) noted that every bank would be receiving a capital injection equal to 25% of the bank's capital and criticized this condition as not well targeted to individual bank's needs (IMF 2015). However, the documentation from the DIA stated that the capital support could not exceed 25% of the pre-existing capital, rather than a set 25% injection (DIA 2015).

10. **Capital Characteristics:** The DIA exchanged government bonds for preferred shares (for partly state-owned banks and banks facing international sanctions) and subordinated debt (for other private banks).

Initially, the DIA only offered to swap OFZs for subordinated debt of the same maturity. However, most banks did not show interest in participating in the bank capital support program based on that offer (Vilenovich 2015). In response, the DIA, after the special law amendments, allowed two additional procedures for recapitalization in April 2015: exchanging OFZs for subordinated debt with a maturity of more than 50 years, eligible for extensions, and swapping OFZs for the preferred shares of banks. While these two options were more attractive to the banks, they posed additional risks to the federal budget due to irregular receipts and shortfalls in budget revenues compared to what was initially proposed (Vilenovich 2015). The vast majority of banks ended up utilizing the original capital injection design.

For partly state-owned banks and banks affected by sanctions, the DIA exchanged OFZs for preferred shares (Tier 1 capital), while the remainder of the banks swapped subordinated debt (Tier 2 capital). Over 60% of the funds in the bank capital support program went to partly state-owned banks (IMF 2016).

11. **Dividends/Interest Rates:** The Board of Directors of the DIA determined the interest rate for subordinated debt.

The interest rate on the subordinated debt exchanged for OFZs was set at one percent per year greater than the interest rate on the OFZs themselves (IMF 2016). For the banks swapping subordinated debt with a maturity of at least 50 years, the Board of Directors of the DIA would determine the interest rate on the subordinated debt within three months of the maturity of the OFZs (DIA 2015). This date has not occurred yet for any of the banks participating in the bank capital support program, so the specific process for this rate determination is unclear as of this writing.
12. **Allocation of losses for existing stakeholders: The bank capital support program did not seem to directly allocate losses to specific stakeholders.**

Research into the Russian bank capital support program did not find any provisions for the allocation of losses for existing stakeholders, beyond the generally dilutive effects of the government injections.

13. **Debt Restructuring Plan: The bank capital support program did not require any special debt restructuring plans.**

The bank capital support program did not include any debt restructuring conditions.

14. **Fate of Existing Board and Management: Participating banks faced limits on executive compensation and overall wages.**

A bank could not increase the compensation of its executives or raise its overall wage bill for the first three years after recapitalization. The DIA Board of Directors decided the size of the fine (DIA 2015).

Two banks exceeded the payroll restrictions and thus remitted RUB 351 million to the federal budget (ACRF 2020).

15. **Other Conditions: The capital support provided by the DIA included required credit growth targets in certain sectors, as well as the bank’s commitment to increase its own capital by 50% of the capital support.**

The bank capital support program imposed some conditions on recipients of OFZs. First, banks had to commit to increase the total amount of lending in select sectors by at least one percent per month in the first three years after the recapitalization. These sectors included housing, small- and medium-sized businesses, agriculture, manufacturing, construction, and others (DIA 2015). The IMF criticized this provision, stating that specific credit growth targets would increase credit risks and cause poor credit allocation (IMF 2015).

A participating bank also needed to pledge to increase its own capital by at least 50% of the capital injection over the duration of the subordinated loans. The DIA noted that this could be accomplished by issuing new shares and/or by retaining at least 75% of the bank’s profits. This did not apply to partly state-owned banks. Violations of any conditions of the program could result in an annual fine of up to 2% of the capital support (DIA 2015).

Twelve banks failed to meet the credit growth target at points during the three-year period and paid RUB 771 million in fines to the DIA as a result. Three banks violated the condition to privately raise funds and thus paid RUB 290 million in fines (ACRF 2020).
16. **Exit Strategy:** The DIA did not announce a predetermined exit strategy for the bank capital support program.

The original legislation and announcement of the bank capital support program did not indicate a set deadline or exit strategy. However, the required DIA disclosures of capital injections did report the maturities of the subordinated debt being purchased. The most recent capital injection took place in May 2017 (DIA 2018).

17. **Amendments to relevant regulation:** The bank capital support program did not appear to include any significant amendments to relevant regulation.

Research into the bank capital support program did not find any important amendments to relevant regulation.

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**References and Key Program Documents**

**Implementation Documents**


*Rules and regulations operating the bank capital supporting program.*


*Law establishing the bank capital support program.*


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Media Stories


Reports/Assessments


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Report from the IMF that provides updates to the bank capital support program.

Report from an auditor with the Accounts Chamber on the delayed implementation of the bank capital support program.

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Report from the Accounts Chamber on the bank capital support program’s success.
https://ypfs.som.yale.edu/library/additional-capitalization-banks-through-dia-was-successful.

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