



# RUSSIAN FEDERATION

## FINANCIAL SECTOR ASSESSMENT PROGRAM

### DETAILED ASSESSMENT OF OBSERVANCE BASEL CORE PRINCIPLES FOR EFFECTIVE BANKING SUPERVISION (BCP)

September 2016

This Detailed Assessment of Observance on the Basel Core Principles for Effective Banking Supervision on the Russian Federation was prepared by a staff team of the International Monetary Fund. It is based on the information available at the time it was completed on September 2016.

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## DETAILED ASSESSMENT OF OBSERVANCE

September 2016

### BASEL CORE PRINCIPLES FOR EFFECTIVE BANKING SUPERVISION (BCP)

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## Glossary

AML/CTF	Anti-Money Laundering/Countering Terrorist Financing
ASFB	Analysis of Financial Condition of Banks
AR	Authorized Representative
BBAL	Federal Law “On Banks and Banking Activity”
BCBS	Basel Committee for Banking Supervision
BCP	Basel Core Principles
BHC	Bank Holding Company
BoD	Board of Directors
BSC	Banking Supervision Committee
BSR	Banking Supervision Report
CBL	Federal Law “On the Central Bank of the Russian Federation (the Bank of Russia/CBR)”
CBR	Central Bank of the Russian Federation/ Bank of Russia
CBRC	Chinese Banking Regulatory Commission
CG	Corporate Governance
CPs	Core Principles
C&RA Plan	Continuity and Recovery of Activities Plan
CRO	Chief Risk Officer
D-SIBs	for Domestic Systemically Important Banks
EC	Essential Criteria (of the Core Principles)
FATF	Financial Action Task Force
FIU	Financial Intelligence Unit
FSAP	Financial Sector Assessment Program
FSB	Financial Stability Board
FX	Foreign Exchange
HQLA	High Quality Liquid Assets
IAS	International Auditing Standards
ICAAP	Internal Capital Adequacy Assessment Process
IFRS	International Financial Reporting Standards
IRB	Internal Ratings Based
KYC/CDD	Know Your Customer/Customer Due Diligence
LCR	Liquidity Coverage Ratio
MER	Mutual Evaluation Report
MoF	Ministry of Finance
MOU	Memorandum of Understanding
NFB	National Financial Board
NPLs	Nonperforming Loans
NSFR	Net Stable Funding Ratio
OR	Operational Risk

## RUSSIAN FEDERATION

PEPs	Politically Exposed Persons
RAS	Risk Assessment System
RCAP	Regulatory Consistency Assessment Program
RM	Risk Management
RP	Related Party
RWA	Risk Weighted Asset
SIBs	Systemically Important Banks
SoCs	Statements of Cooperation
SREP	Supervisory Review and Evaluation Process
SIBSD	Systemically Important Banks Supervision Division
STR	Suspicious Transaction Reports
UBO	Ultimate Beneficial Owner

## INTRODUCTION<sup>1</sup>

**The establishment of the Central Bank of the Russian Federation (CBR) as a unified or “Mega Regulator” in 2013 is an emblem of the far reaching changes to the legal and supervisory landscape in recent years.** In addition to the new regulatory architecture, which has itself facilitated greater cross-sectoral oversight in the financial system, a number of previous limitations have been largely or wholly addressed. These changes have permitted the CBR to make substantive progress which needs to be recognized. Past impediments to cooperation and collaboration based on supervisory information exchange (domestic and cross border) have been eliminated; the scope of application of supervision is enhanced as revisions to the perimeter of regulation, based on definition of banking group and bank holding company, are aligned with international standards, thus facilitating the practice of consolidated supervision; and the CBR is now granted the power to impose standards for the risk management (RM) and internal controls of banks and banking groups.

**The level of compliance with the Basel Core Principles (BCP) reflects the transitional nature of the supervisory practices in Russia at the time of the assessment.** The present report seeks to reflect the considerable regulatory and organizational reforms that the CBR has instituted in the past few years. In considering the current assessment of the BCP, however, it is important to understand that a number of important changes are extremely recent and are at very early stages of being implemented and embedded in revised practices. Track record is not available yet in a number of fields.

**The CBR is in the course of developing and enhancing its Risk Based Approach to supervision.** The risk differentiation of the Russian banking system into different groups, including the establishment of a dedicated division to supervision of systemically important banks, had already been put into place, in the past few years, illustrating the CBR’s increasing risk focus. Utilizing its new powers, though, the CBR has now issued some landmark regulations that focus on the quality of RM and governance within firms. The new regulation will introduce, for example, important new dimensions in risk supervision, for example scrutiny of risk appetite in firms. The active supervision and assessment of the impact of this new regulation process is still a year away, however.

**The regulatory approach in the Russian Federation is highly rules based and this presents some specific challenges to an effective risk based supervisory regime.** The first challenge is moving the supervisory mindset and process from one that primarily focuses on finding and eliminating violations and deficiencies to one that also incorporates a forward looking, early intervention approach that seeks to avoid violations emerging. Although recent legislative changes support the CBR’s risk focus, it may be the case that in some instances the CBR will only be able to recommend that firms change their course of action in order to avoid future deficiencies. The CBR is encouraged to monitor such situations with a view to identifying possible future legislative amendments that will put early intervention actions onto a sounder footing. A second challenge in a

<sup>1</sup> This Detailed Assessment Report has been prepared by Katharine Seal, IMF and Pierre-Laurent Chatain, World Bank.

rules based system is ensuring that the rules remain relevant and appropriate to the prevailing risk environment. While the CBR can be complimented on a very nimble approach in adapting and modifying its regulations, the transition to more risk based practices is a good moment to review the existing regulatory canon for internal consistency and to eliminate elements that may be outdated or overlapping.

**Supervision and Anti-Money Laundering and/Countering Terrorist Financing (AML/CFT) regulations have been improved.** Money laundering/terrorist financing are still a matter of national concern. In that context, the CBR has made significant efforts to ensure proper implantation of integrity standards in the banking industry. The CBR supervision of AML/CFT issues is intensive and intrusive. The most common deficiencies identified by CBR Chief inspectorate are in the following areas (i) Know your Customer/Customer Due Diligence (KYC/CDD); (ii) Identification of the Ultimate Beneficial Owner (UBO); (iii) frequency in updating customer's information; (iv) timely Suspicious Transaction Reports (STRs) reporting to the FIU; AML/CFT internal control rules; and (v) AML training to employees. The CBR has also a good track record in enforcing AML/CFT requirements. Lack of compliance with money laundering standards is the most frequent reason for sanctions, including revocation of licenses. The CBR has also raised awareness in the market on AML/CFT issues. Workshops devoted to the practical application of the AML/CFT Law have been organized with the participation of representatives of professional associations. Lastly, cooperation with other domestic relevant agencies has proved to be successful.

**Effective communication and flow of information has been improving but some limitations still apply.** Some elements of the BCP are not met because there are no requirements for banks or professional service providers, such as external auditors or other experts used by the CBR, to notify the CBR in advance, or at all, of material information that is relevant to the soundness and stability of the supervised bank. In the case of a professional third party, such as an auditor, if information were disclosed there would be no legal protection available for the CBR or the professional service provider. The onus is therefore on the CBR to raise the relevant question at the relevant moment to uncover the information that it needs. The balance of responsibility needs to be shared more evenly with the banks and the external auditors (or professional service providers who may in future carry out inspections on behalf of the CBR). Moreover, there needs to be a clear expectation that the bank and any auditor or professional understands that there is a responsibility to provide the CBR with any relevant information in a timely manner, even if information pertains to a topic that was not specifically defined within the scope of an inspection mandate. Legal protections also need to be put in place as necessary.

**Despite legislative improvements there are several areas where further amendments are needed.** The key areas are noted below.

**The legal framework governing the CBR's relationship and interactions with the external audit profession is materially deficient.** It is important that the supervisor should have powers to reject or rescind the appointment of an external auditor who has inadequate independence or experience or who does not meet professional standards; to ensure rotation of the external auditor of a bank or

banking group; and to meet with the audit firm to discuss matters pertaining to a supervised institution.

**The legal regime applicable to Related Parties (RPs) has been streamlined, particularly since 2015 but deficiencies remain.** From a positive perspective, the law captures not only transactions with persons connected to each other in one way or another but also a person or a group of people connected to the bank. However, the regulatory framework does not require that lending to affiliates be on same terms and conditions as those generally offered to the public. The CBR made recommendations in that regard but they are not binding and thus not enforceable. Additionally, the CBR lacks authority to impose penalties to directors who personally benefited from these favorable conditions. Further, in the appreciation of connectedness, the concept of economic linkages has been introduced in the law but it will not be implemented before 2017.

**There are no specific requirements for management of country risk and transfer risk with the exception of exposures to borrowers residing in off-shores centers.** As a result, minimum requirements for risk policies, processes and limits need to be substantially strengthened particularly in a volatile environment. In the area of major acquisition, the CBR does not establish requirements for banks to seek prior CBR approval when making domestic investments in nonbank institutions. As a result, the CBR is not in a position to measure possible impacts of acquisitions on a bank's condition or if the acquisition will not affect transparency of bank's organizational structures and the ability of the CBR to supervise on a consolidated basis.

**In the area of operational risks (OR), the corpus of norms, while detailed, is made essentially by recommendations from the CBR.** The Ordinance on ICAAP obliges banks to have RM strategies including for OR but this new regime has not been implemented yet. Reporting mechanisms will also need to be improved. Further, the CBR does not have the authority to establish outsourcing requirements for credit organizations.

**The CBR has multiple objectives established in law, and it is important to ensure clarity of purpose for the supervisory function.** Although the decision making process of the CBR is well designed to ensure a good focus on prudential issues, it is not transparent to an external observer whether or not the CBR's decisions might be influenced by its institutional objective for development of the financial sector and also its significant stake in the most systemic banking group of the Russian Federation. For supervisory reputational purposes alone, the authorities could consider a different holding structure for the government interests that do not involve the CBR.

**With respect to combating money laundering/terrorist financing, the CBR has made important progress but further improvements are desirable.** Banks are subject to close scrutiny and the CBR has been forceful against banks and their management which committed grave violations of the AML regime. There are a few areas where improvements could be made; these include the promotion of a more risk based approach to ML/TF issues in both the industry and the CBR; the use of more proportionality when enforcing the law, the need to strengthen the understanding of ML/TF risks in banks, especially in relation to UBO and politically exposed persons



(PEPs) and the inclusion of ML/TF risks into the scope of duties to be performed by external auditors.

## METHODOLOGY

- 1. It should be noted that the ratings assigned during this assessment are not directly comparable to previous assessments.** The current assessment of the CBR was against the BCP methodology issued by the Basel Committee on Banking Supervision (BCBS) in September 2012. The authorities have opted to be assessed on the essential criteria. The last complete BCP assessment in the Russian Federation was conducted in 2007 and a targeted assessment of the BCPs examined 10 of the core principles (CPs) in the course of the 2011 Financial Sector Assessment Program (FSAP) Stability Module. While grades could be compared between the full BCP assessment of 2007 and the targeted assessment of 2011, the revision to the BCP methodology in 2012 has introduced some substantive changes.
- 2. In the 2012 revision of the CPs, the BCBS sought to reflect the lessons from the recent financial sector crisis, to raise the bar for sound supervision reflecting emerging supervisory best practices.** New principles have been added to the methodology along with new essential criteria (EC) for each principle that provide more detail. Altogether, the revised CPs now contain 247 separate essential and also additional criteria against which a supervisory agency may now be assessed. In particular, the revised BCPs strengthen the requirements for supervisors, the approaches to supervision and supervisors' expectations of banks. While the BCP set out the powers that supervisors should have to address safety and soundness concerns, there is a heightened focus on the actual use of the powers, in a forward-looking approach through early intervention.
- 3. The assessment team reviewed the framework of laws, rules, and guidance and held extensive meetings with authorities and market participants.** The assessment team met officials of CBR, and additional meetings were held with the Ministry of Finance (MoF), auditing firms, and banking sector participants. The authorities provided a comprehensive self-assessment of the CPs, as well as detailed responses to additional questionnaires, and facilitated access to staff and to supervisory documents and files on a confidential basis. Owing to time constraints it was not possible to make as full a study of the documents as the assessors would have wished but the authorities did everything that was possible to facilitate access.
- 4. The team appreciated the very high quality of cooperation received from the authorities.** The team extends its warm thanks to staff of the authorities, who provided excellent cooperation, including extensive provision of documentation and technical support, at a time when many other initiatives related to domestic concerns and international regulatory initiatives were in progress.
- 5. The standards were evaluated in the context of the sophistication and complexity of the financial system of the Russian Federation.** The CPs must be capable of application to a wide range of jurisdictions whose banking sectors will inevitably include a broad spectrum of banks. To accommodate this breadth of application, a proportionate approach is adopted within the CP, both

in terms of the expectations on supervisors for the discharge of their own functions and in terms of the standards that supervisors impose on banks. An assessment of a country against the CPs must, therefore, recognize that its supervisory practices should be commensurate with the complexity, interconnectedness, size, and risk profile and cross-border operation of the banks being supervised. In other words, the assessment must consider the context in which the supervisory practices are applied. The concept of proportionality underpins all assessment criteria. For these reasons, an assessment of one jurisdiction will not be directly comparable to that of another.

**6. An assessment of compliance with the BCPs is not, and is not intended to be, an exact science.** Reaching conclusions required judgments by the assessment team. Banking systems differ from one country to another, as do their domestic circumstances. Furthermore, banking activities are undergoing rapid change after the crisis, prompting the evolution of thinking on, and practices for, supervision. Nevertheless, by adhering to a common, agreed methodology, the assessment should provide the Russian authorities with an internationally consistent measure of the quality of their banking supervision in relation to the revised CPs, which are internationally acknowledged as minimum standards.

## INSTITUTIONAL AND MARKET STRUCTURE— OVERVIEW

**7. Banking represents the most significant sector of the Russian financial system, although the role of the nonbank sector has been steadily growing.** Bank assets amounted to 103 percent of GDP at end-2015. Pension funds, insurance, and mutual funds have assets of 3.6, 2.0, and 3.3 percent of GDP, respectively. The financial system also includes microfinance organizations. Russia has the lowest ratio of bank credit-to-GDP among a group of comparator countries composed of Brazil, India, China, and South Africa and it tends to show slightly lower depth in its financial markets. However, Russia shows much greater financial development, reflecting higher access and efficiency than these comparator countries and Russia's overall financial development is higher than the EM average.

**8. The banking system is relatively concentrated at the top but is otherwise fragmented.** In its relatively short history, the banking system has experienced a strong concentration phase, going from 1,311 banks in 2001 to less than half that number by end-2015. The largest 20 banks account for three quarters of system assets. Government-related banks, dominated by Sberbank and VTB Group, accounted for 60 percent of system assets at end-2015. The top 10 private universal banks hold 16 percent of system assets, foreign-owned banks 13 percent, and 11 percent is in specialized and small banks. Lending is also highly concentrated: the top 10 banks by assets accounted for about 70 percent of lending as of January 2016. Notably, Sberbank and VTB Group together account for a similar share as the remaining 700+ banks. Many of the small banks operate in mono-industrial-cities and are often systemically important for their respective regions.

**9. Despite market stresses since 2013, the authorities' policy response has supported the banks' soundness indicators.** Given the slump in oil prices, the slowdown in global growth and the

sanctions the Russian economy experienced challenging times. In response, CBR developed regulatory forbearance measures that positively helped the banking sector and that may mean that indicators have been overstated since end-2014. However, the authorities have been steadily withdrawing these measures with the exception of the FX refinancing operations. The capital adequacy ratio of banks remained broadly unchanged since March 2015 at about 13 percent, in part reflecting a recapitalization program, before declining to about 12 percent in early 2016 as regulatory forbearance was lifted. Capital issuance increased over 2015, offsetting the decline in retained earnings. Nonperforming loans (NPLs) have increased, but remain below their 2008 peak. Liquidity has strengthened, with the loan-to-deposit ratio decreasing to 115 percent by end-2015 (returning to the level of mid-2013), reflecting increased retail deposits and the use of the reserve fund to finance the budget deficit.

**10. Profitability has declined markedly, over the past few years, reflecting demanding market conditions.** Bank profitability has dropped markedly—with the return on assets reaching 0.3 percent at end-2015. The main reasons for the drop in profits are credit losses and declining net interest income. Banks’ profitability is generated largely through fees, other non-lending fees and spreads.

**11. Although representing a smaller segment of the financial sector than the banks, an important role is played by nonbank financial institutions (NFIs).** This sector primarily includes insurance companies, private pension funds, and management companies of various funds.

#### Structure of Nonbank Financial Organizations as of September 30, 2015

Nonbank Organization	Active Organizations	Assets (In billions of rubles)	Capital (In billions of rubles)
Insurance entities	509	1,626.70	429.6
Non-state Pension funds	110	2,822.90	146
Mutual investment fund	1,542	2,560.30	2,303.9
Microfinance organizations	3,500	62.4	48.4
Professional securities market participants	540	753.6	281.4

Source: CBR.

**12. Since 2014, CBR has become the “mega regulator” of financial markets, absorbing regulatory and supervisory powers for all categories of financial institutions.** CBR took the powers of the former Federal Service on Financial Markets and was given an explicit financial stability mandate. Basel III capital ratios entered into force in 2013 and the Basel Liquidity Coverage Ratio is being phased in according to the Basel timetable for the systemically important banks and is on target to meet the 100 percent compliance on January 2019 as required for Basel compliance.

# PRECONDITIONS FOR EFFECTIVE BANKING SUPERVISION

## Sound and Sustainable Macroeconomic and Financial Sector Policies

**13. Russia's institutional framework supporting the conduct of macroeconomic policy is led by CBR and the MoF.** Monetary policy is conducted by CBR and budgetary policy is conducted within a fiscal framework managed by the MoF. In mid-November 2014, CBR switched to a floating exchange rate regime.

**14. CBR is managing ongoing policy normalization.** Since the end of January 2015, CBR started unwinding the emergency rate hike to 17 percent set in December 2014. The current policy rate is set at 11 percent and inflation is expected to continue to decrease. The current inflation target is set at 4 percent, to be achieved by end-2017. In 2015 alone, the Russian currency lost almost 20 percent of its value vis-à-vis the U.S. dollar.

**15. The MoF announced the review of the Federal budget for 2016.** The government is considering reduction of budget expenditures compared to figures set in the budget law for 2016. Also government is looking to sell some of its shares in state-owned companies. The 2015 budget deficit required the use of the Reserve Fund and GDP growth in 2016 is expected to be negative again.<sup>2</sup> Russia's government debt remains low, around 20 percent of GDP.

## The Framework for Financial Stability Policy Formulation

**16. Authorities have strengthened the institutional framework for financial stability.** The inter-agency National Council on Ensuring Financial Stability (FSC) was created as an advisory body for the different authorities to exchange views and coordinate on financial stability matters. The FSC has the authority to provide recommendations and request information. Member agencies have to comply or explain. The FSC's composition is approved by the government. Currently, the FSC is headed by the First Deputy Chairman of the Government of the Russian Federation and comprises the Advisor to the President of the Russian Federation, the Governor and four First Deputy Governors of CBR (monetary policy, financial stability, banking regulation and supervision, financial market regulation and supervision), the Minister of Finance and Deputy Minister of Finance of the Russian Federation, the Minister and Deputy Minister of Economic Development of the Russian Federation, the Managing Director of the State Corporation Deposit Insurance Agency.

**17. CBR has used different tools for macroprudential policy but does not have an ex-ante toolkit.**<sup>3</sup> In the past, CBR has used macroprudential instruments in an *ad hoc* manner with no formal triggers.

<sup>2</sup> CBR, December 2015. Monetary Policy Report. [http://www.cbr.ru/eng/publ/ddcp/2015\\_04\\_ddcp\\_e.pdf](http://www.cbr.ru/eng/publ/ddcp/2015_04_ddcp_e.pdf)

<sup>3</sup> Financial Stability Board, 2015. Peer Review of Russia.

## A Well-Developed Public Infrastructure

### *System of business laws*

**18. Business laws in Russia are based on Chapter 4 of the Civil Code, the 208-FZ Federal Law on Joint Stock Companies and the 14-FZ Law on Limited Liabilities Companies.** The latest major amendments to business legislation were introduced with Federal Law 99-FZ and Federal Law 210-FZ, from 2014 and 2015 respectively, which changed the types of companies allowed in the Russian Federation, increased the protection of investors holding Russian local securities and improved the conditions for participation in corporate actions (for example by allowing e-voting and e-proxy voting). The Insolvency Law was amended in 2014 to incorporate changes in the insolvency procedures for credit institutions. Other important Federal Laws to register and conduct business are those related to state registration of legal entities and individual entrepreneurs, fundamental principles of Russian legislation on notaries, trade, consumer rights protection and combating money laundering and the financing of terrorism (AML/CFT), as well as the Land code, the Labor Code and the Tax code. One of the most significant changes in these laws was the introduction of the requirement for financial institutions in 2013 to identify their clients, clients' representatives and beneficial owners and to collect information on their reputation and business purposes. The definition of the "beneficial owner" was also clarified and it currently is consistent with the Financial Action Task Force (FATF) Forty Recommendations Glossary.

### *Efficient and independent judiciary*

**19. The judicial power is formally independent from the legislative and the executive powers.** The judiciary is primarily regulated by the Constitution of Russia, the Code of Criminal Procedure, the Code of Civil Procedure, the Code of Administrative Procedure, the Code of Arbitration Procedure and the 1996 Federal Constitutional Law on the Judicial System of the Russian Federation. According to the Constitution of the Russian Federation, the judiciary should protect all men (and women) and citizen's rights and freedoms. In addition, the Constitution confirms that courts alone can administer justice and requires that all judges shall be independent and obey only the Constitution and the law. The courts are financed solely from the federal budget in order to ensure a complete and independent administration of justice. The judicial power is exercised by means of constitutional, civil, arbitration, administrative and criminal proceedings. As a general rule, examination of cases in all courts is open. Judges adopt the Code of Judicial Ethics which asserts the need to guarantee everyone's right to a fair consideration of a case by a competent, independent and impartial court.

**20. There have been changes to the judicial system.** In February 2014, the Supreme Court of the Russian Federation, which heads the system of courts of general jurisdiction, was merged with the Supreme Arbitration Court of the Russian Federation, which headed the system of arbitration (commercial) courts, to form a new Supreme Court. Consequently, Russia's judicial system is now composed of the Constitutional Court of the Russian Federation, the Supreme Court of the Russian Federation, federal courts, district courts, magistrate courts, military courts and arbitration courts. The World Bank Global Competitiveness Report for 2014–15 ranks Russia as 109 out of 144 in

judicial independence, while a year earlier it was ranked as 119. In terms of the efficiency of the legal framework in settling disputes and in challenging regulations, Russia ranks 110 and 99 respectively and in the area of protection of property rights, Russia ranks 120.

**21. The legal profession is governed by the Constitution, the Law on the Status of Judges, the Law on Attorneys' Practice and the Bar and the Foundations of the Legislation on Notary.**

The main legal professions in Russia are the public prosecutor, investigator, judge, attorney (advokat), and notary.

- The public prosecution service supervises over observance of the legality, law and order in Russia. It consists mainly of the Prosecutor General's Office of the Russian Federation, the prosecutor's offices of the subjects of the Russian Federation, city, district and other territorial prosecutor's offices and military and other specialized prosecutor's offices.
- The Prosecutor General of the Russian Federation must be appointed and removed from office by the Council of the Federation of the Federal Assembly of the Russian Federation by the recommendation of the President of the Russian Federation. The Prosecutor General appoints prosecutors of cities and regional districts' prosecutors' offices. Prosecutors of the prosecutors' offices in the federal subdivisions of the Russian Federation are appointed by the President of Russia upon recommendation of the Prosecutor General and as agreed with the respective subdivision. The term of office of the Prosecutor General is five years.
- The Investigative Committee of Russia is the main federal investigating authority in Russia. From 2011, this committee is not included in the structure of government authorities and only the President of the Russian Federation carries out any control over the Committee. The Chairman is appointed and dismissed by the President without the approval of any body of legislative power and reports annually to the President on its activities.
- Prosecutors and investigators employed in the prosecution bodies should not be members of any elective or other bodies set up by state authorities and local self-government bodies.
- According to the Law of Status of Judges, judicial candidates must have a degree in law and a certain number of years of working experience and are selected on a competitive basis. All judges of the Supreme Court are appointed by the Council of the Federation of the Federal Assembly of the Russian Federation upon recommendation of the President of the Russian Federation. All other judges including of military and arbitration courts are appointed by the President of the Russian Federation.
- Lawyers must have a license to practice law in order to appear in court on criminal matters. Under the 2002 Law "On Attorneys' Practice and the Bar," each of the Russian regions has a single bar body called Bar Chamber. Lawyers need to be a member of one of such Bar Chamber to be recognized as an attorney.

**22. Efficiency of the system in the realization on collateral could be further improved.** It may take two years after a court decision in order for a credit organization to be able to acquire the collateral in the case of a loan default. In the meantime, the collateral may deteriorate in value and banks may be asked to create reserves.

### ***Accounting principles and rules***

**23. The financial reporting framework in Russia is determined and regulated by the state.** The MoF is both the official standard-setting body in accounting and financial reporting and the endorsement body of the International Financial Reporting Standards (IFRS). According to Law 208-FZ, and Government Decree 107, IFRS are to be applied in Russia based on a Russian translation prepared by the MoF. In the case of credit institutions, CBR needs to approve the accounting standards, including the Russian Accounting Standards (RAS). The authorities state that RAS are being brought into compliance with IFRS and will be fully in line by 2017. RAS include the requirement for a balance sheet, statement of results of operations, statement of cash flow and statement of changes in ownership equity.

**24. Currently, both IFRS and Russian Accounting Standards (RAS) are used in the financial sector.** IFRS are required for the consolidated financial statements of the majority of financial entities and those companies whose securities are listed in stock exchanges.<sup>4</sup> Those which do not constitute a group according to IFRS must nevertheless compile stand-alone financial statements in accordance with IFRS. All legal entities, regardless of type, are still required to prepare stand-alone (separate) financial statements based on RAS. The rest of legal entities are not still obliged to apply IFRS nor they have to prepare consolidated aggregated financial statements—therefore they only report standalone financial statements under RAS.

**25. Over the years RAS has been converging with IFRS, but as of today there are still some differences between the two standards.** The most important difference lies in the fact that RAS never adopted International Auditing Standards (IAS) 39 on Financial Instruments.<sup>5</sup> In addition, there are other variations in the calculation of capital and reserves. Other previous differences, such as the impairment testing of fixed assets, has been recommended by CBR since 2013, and in 2016 will become mandatory. The MoF, has not granted any exemptions that apply under IFRS.

### ***System of independent external audits***

**26. According to the Auditing Law, financial companies are required to perform an audit on an annual basis.** In the law, auditing is defined as an independent check of the financial statements of an audited entity for the purposes of expressing an opinion on the reliability of said financial statements. Requirements on the form, content, and procedure for signing and submitting the audit report are established by federal auditing standards. The code of conduct for audits firms

<sup>4</sup> Banks, insurance companies, pension funds, fund management companies, clearing companies, certain state unitary enterprises and state-owned companies.

<sup>5</sup> IAB 39 was replaced in July 2014 by IFRS 9 which will be adopted by 2018.



and auditors is specified in the Code of Professional Ethics of Auditors adopted by the Audit Council, which is the national body that discusses standards and regulations in field of auditing. Audit firms and auditors should be independent of the entity, must comply with audit secrecy, and have to be a member of a self-regulating organization of auditors, which should comply with the rules of the Audit Council. In addition, an audit firm or individual auditor should establish and comply with rules of internal and external quality assurance system based on federal standards.

**27. Broadly, the international firms cover IFRS and smaller, domestic audit firms cover RAS.** In Russia, auditors are required to obtain an auditor qualification certificate issued by self-regulating organizations of auditors.<sup>6</sup> An audit firm is just required to have 50 percent of the collegial executive body as auditors but is allowed to participate in a tender with just 2–3 auditors in its team. Bigger audit firms tend to be international firms equipped with more resources and training capabilities.<sup>7</sup> As of 2014, there are 3,400 certified auditors in Russia.

### ***Payment and clearing systems***

**28. The payment system of the Russian Federation comprises CBR payment system (BRPS) and other payment systems operated mainly by credit institutions.** The BRPS is considered systemic and comprises the system for intraregional electronic payments (VER), the system for interregional electronic payments (MER), the Banking Electronic Speedy Payment system (BESP system), and a payment system based on letters of advice. The other systemically important payment system is the Payment System - National Settlement Depository (PS NKO ZAO National Settlement Depository). The PS NSD is a part of the post-trade infrastructure of OJSC MICEX-RTS Moscow Exchange (the Moscow Exchange) and is used for the open market, repo transactions, and foreign exchange (FX) transactions of CBR. There are four other payment systems which are considered important for consumption: CONTACT, Visa, Golden Crown, and MasterCard.<sup>8</sup> Finally, there are another 25 payment systems in operation.

**29. In 2013, CBR adopted the National Payment System Development Strategy, outlining its key elements and an Action Plan with defined timelines for their implementation.**

Consumer protection issues, automation of government payments and adoption of ISO 20222 standards were some of the areas which were the focus of the strategy. An advisory council headed by the Governor of CBR comprising members of executive authorities of the Russian Federation, professional payment services market participants, banking associations, and other professional associations has been formed as part of the broader NPS development strategy.<sup>9</sup>

<sup>6</sup> In order to obtain the certificate, professional competence of the applicant shall be verified through a qualification examination and the applicant should have a work record of at least three years in auditing or bookkeeping and preparation of the financial statements by the day of the results of the qualification examination.

<sup>7</sup> Some of the firms send the audit reports to their Head Quarter offices for a final quality check.

<sup>8</sup> CBR, 2013. Annual Report. [http://www.cbr.ru/eng/psystem/general/ar\\_2013\\_e.pdf](http://www.cbr.ru/eng/psystem/general/ar_2013_e.pdf)

<sup>9</sup> CBR, 2013. Annual Report. [http://www.cbr.ru/eng/psystem/general/ar\\_2013\\_e.pdf](http://www.cbr.ru/eng/psystem/general/ar_2013_e.pdf)



**30. Furthermore, electronic money is increasingly important and CBR is enhancing regulation and supervision.** Supervision in the national payment system now covers money transfer operators, 33 payment system operators, payment infrastructure service operators, 35 operation centers, 36 payment clearing centers, 32 settlement centers, 97 electronic money operators, and the Federal State Unitary Enterprise Russian Post.

### ***Credit bureaus***

**31. Russia has 21 functioning credit bureaus according to the State Register of Credit Bureaus.** These bureaus process store credit histories and provide credit reports and related services. As of December 2015, credit bureaus kept records of 81.6 million individuals and over 485,000 legal entities. Shares in some credit bureaus are owned by banks.

**32. Credit bureaus are supervised by CBR and have been the subjects of reforms to strengthen the financial and real sector.** In accordance with the Federal Law “On Credit Histories,” CBR supervises the activities of credit bureaus. The Federal Law “On Credit Histories” entitles CBR to keep the central catalogue of credit histories which informs users, subjects of credit histories, and some other persons defined by laws about the location of the credit histories. The Federal Law “On Credit Histories” was amended in 2014 and 2015 introducing, among other developments, the abolishment of the need for borrowers’ consent in order for the credit institutions to send their information to a credit bureau. Additionally, the amendments provided CBR with a power to request and receive credit history reports from credit bureaus.

### ***Public availability of basic economic, financial, and social statistics***

**33. CBR publishes a range of statistics and analysis on the economy and the financial sector.** The Federal State Statistics Service, the government agency for statistics in Russia, publishes social statistics as well. The CBR’ statistics are regularly updated (e.g., financial sector statistics are published on a monthly basis). The Federal State Statistics Service, whose mission is to collect, analyze, and publish data, publishes statistics on labor, living standards, education, public health, offences, industry, agriculture, finance, and investments among others.

### **Framework for Crisis Management, Recovery and Resolution**

**34. CBR and the Deposit Insurance Agency (DIA) have been extensively and increasingly involved in bank resolution and rehabilitation in the past years.** Apart from acting as deposit insurer, the DIA also is the corporate receiver/liquidator of failed banks and is entitled to resolve banks that participate on deposit insurance system. In 2014 and 2015, the DIA was assigned two additional functions: the insurance of funds in non-state pension funds and the injection of capital to banks. During 2015, CBR sent the DIA proposals for participation in bankruptcy preventions of 18 banks. As of February 25, 2016, 30 banks were under bankruptcy prevention measures. CBR revoked the licenses of 86 credit institutions in 2014 and 93 in 2015 and simultaneously provisional administrations were appointed. CBR revoked licenses of 61 Deposit

Insurance System member banks in 2014 and 75 in 2015. As of January 2016, liquidation was pending in 288 credit institutions whose banking licenses had been revoked.

**35. Before any determination on the possibility or desirability of rehabilitation is made, CBR and the DIA can perform a joint inspection of the bank.** If there is evidence that the bankruptcy will create a threat to the depositors or to the stability of the banking system as a whole, CBR can ask the DIA to take part in the prevention of the bankruptcy of a bank. Should a bank's unstable financial position create a threat to the interests of its depositors, CBR can request that the DIA settle the bank's liabilities. In the case of rehabilitation or prevention of bankruptcy, the DIA may refuse participation based on the cost-effectiveness of the rehabilitation measures, and other criteria. At the time of the assessment, the DIA has not decided how to measure the feasibility of participating in measures aimed at preventing bank's bankruptcy. The DIA can use the deposit insurance fund or, as has been done in the majority of cases, ask for a loan from the CBR for bank rehabilitation.

**36. Federal Law 127-FZ on Insolvency was amended in 2014 to improve the legal regulation of financial rehabilitation and liquidation of credit institutions.** The law reformed the insolvency regime for all credit institutions establishing the possibility of bankruptcy prevention at the expense of private investors, without the involvement of the federal budget, CBR and the DIA. Furthermore, the amendments to the Federal Law on Banks and Banking Activities and to the Federal Law on the Central Bank of the Russian Federation established the obligation for Domestic Systemically Important Banks (D-SIBs) to submit their Recovery Plans to CBR and the option for CBR to request Recovery Plans from any other credit institution. CBR is entitled to develop Resolution Plans for D-SIBs. The DIA is currently requesting the amendment of legislation in order to have powers to write down and convert unsecured liabilities (bail-in) and is looking into assuring deposits from legal entities. Currently, the system does not allow the creation of a bridge bank.

***Adequacy of systemic protection (public safety net)***

**37. The DIA was established in 2004 and up to date it has delivered more than 300 deposit pay-outs since its inception.** As of the first of January 2016, the deposit insurance fund had RUB 56.6 billion rubles and covers all credit institutions that attract deposits. In 2014, given the events, the amount of insurance compensation on deposits was raised to RUB 1.4 million for individual deposits per credit institution from RUB 700,000. As of January 1, 2016, the Deposit Insurance System fully covered 99.7 percent of the number of deposit accounts of individuals in Russian banks and 65.1 percent of total amount of individuals' deposits in Russian banks. Deposits are on average RUB 300,000. The Deposit Insurance Fund is funded ex-ante with premium contributions from the credit institutions it covers. Recently, the DIA adopted a risk-adjusted differential premium system. Starting from the third quarter of 2015, premiums have been set according to the riskiness of the institutions.

**Effective market discipline**

**38. Transparency in bank ownership has been a concern but improvements are being made.** In 2014, a requirement for Russian companies to disclose information on their “beneficial owners” in accounting statements was formulated and the definition of beneficial owner was amended to be consistent with FATF requirements. In addition, it was prohibited to maintain accounts in fictitious names as well as to open or maintain accounts with pseudonyms. Furthermore, CBR Regulation 499-P obliges credit institutions to update customer and beneficiary identification information and review the level of risk every time the level of risk changes or at least annually.

**39. Governance standards are being enhanced.** In order to enhance market discipline, Federal Law 334-FZ of 2014 “On Amendments to Article 8 of the Federal Law on Banks and Banking Activity” obliges credit institutions to publicly disclose information on the qualifications and experience of management and the members of the board of directors (BoD). In addition, requirements for goodwill have been established for founders and owners of more than 10 percent of the shares in a credit institution, with a 10-year ban for non-compliance. Changes to the Criminal Code establish criminal liability for falsifying financial documents of accounting and reporting of financial organizations, including credit organizations. However, the Corporate Governance Code is voluntary.

## MAIN FINDINGS

### Responsibility, Objectives, Powers, Independence, Accountability (CPs 1–2)

**40. The legal framework currently in place provides CBR with necessary powers and responsibilities.** CBR has powers to authorize banks, conduct ongoing supervision, oversee compliance with laws and undertake corrective actions to address safety and soundness concerns. Major reforms have been introduced that increase CBR’s duties and powers in many respects, although implementation is not yet tested in all cases. Responsibilities and objectives of CBR are particularly broad and appear to be intertwined, while some functions seem to concur with the objectives related to safety and soundness of the banking system. While many governance, accountability, and transparency measures are in place, there are some issues of concern notably in respect of legal protection for staff and transparency of dismissal procedures. There is also scope for improvements in the arrangements for decision making in order to better support and communicate the objectivity and independence of CBR to external audiences.

### Ownership, Licensing, and Structure (CPs 4–7)

**41. The Russian licensing regime for banks appears exhaustive.** The legal and regulatory framework provides CBR with a set of instruments and tools to ensure that the licensing process is sound. Banks’ management and board members must meet fit and proper qualifications, including the absence of a criminal record. In its licensing process, CBR also informed the mission that all efforts were made to ensure transparency in the ownership structure of applicants. It would be desirable, however, to establish formal procedures to subject the newly established bank to follow

up attentive offsite supervision, and if necessary onsite inspection, to ascertain that the bank is performing according to the terms and conditions of the license.

**42. CBR also has the power to review, reject, and impose prudential conditions on any proposals to transfer significant ownership** or controlling interests held directly or indirectly in existing banks to other parties. In that regard, to address a 2008 FSAP recommendation, CBR vetting threshold for signification transfer of ownership has been lowered from 20 to 10 percent. Further, the Federal Law on the Central Bank of the CBR (CBL) has been amended to empower the central bank to address changes of controls that were not vetted by CBR.

**43. The legal regime for major acquisitions was found to be weak.** While foreign investments by Russian banks require prior approval by CBR, when they lead to the establishment of a subsidiary abroad, the CBL does not establish requirements for banks to seek prior CBR approval when making domestic investments in nonbank financial institutions. Without such requirement CBR is not able to measure or consider in advance the possible impact of acquisitions on a bank's condition or to determine whether the acquisition will affect the transparency of the bank's organizational structure and affect the ability of CBR to supervise it.

#### **Methods of Ongoing Supervision (CPs 8–10)**

**44. CBR has developed its risk based approaches since the last assessment and is in the early phases of introducing the next stage of risk based supervision.** The introduction of the supervisory review and evaluation process (SREP) based on banks' own internal assessments and the integration into the analytical approach of CBR is an important evolution. The first full implementation cycle will begin from 2017. Where CBR is less well advanced is in the field of resolution assessment and planning. It is necessary for CBR to have the legal power to require operational or institutional changes based on an assessment of the bank's ability to recover. From a forward looking perspective, CBR needs to remain alert to the potential for banks to seek to manipulate the regulatory perimeter and CBR must remain assiduous in using all forms of information available to it so that the potential for regulatory arbitrage does not arise.

**45. CBR has reconfigured its organization of on and offsite supervisory functions since the last assessment.** The role of the Chief Inspectorate, supplemented by the authorized representative (AR) where one is appointed, is central to confirming the quality of banks' actual practice. In terms of reinforcing priority messages with the banks, though, CBR could invest in greater direct contact with the boards as recommended by the Financial Stability Board (FSB). More systematic meetings and contact with firms in the context of delivering key findings of inspections should be introduced.

**46. Structurally, CBR has been reorganized to support a risk-based focus and has established a separate division to supervise the systemically important banks.** Institutions that are identified as systemically important banks, according to a methodology based on the Basel standard (Ordinance 3737-U) are supervised directly from Moscow, rather than through the CBR network. The methodology has been in force since July 2015 and the list of systemically important

banks must be assessed and re-issued annually under the terms of the ordinance. Capital buffers, consistent with the Basel approach, are applied to the systemically important banks.

**47. CBR has strong powers and rights of access to information and uses its inspection process to obtain assurance on the substance and quality of information it receives.** Despite the ability to obtain information and data from institutions, there are some missing elements. There is no requirement for banks to notify CBR in advance of any substantive changes or of material adverse developments. Notification requirements are almost all retrospective. Nor does CBR have the right to require the prompt notification of any material issue that has come to the attention of an external expert in the course of that expert's work for CBR on a supervisory matter unless it is specifically within the scope of work that CBR has commissioned, although it should be noted that CBR has not yet commissioned work from external experts at the date of the assessment.

### **Corrective and Sanctioning Powers of Supervisors (CP 11)**

**48. CBR has a good track record in enforcing the law.** It has a wide range of tools and sanctions to choose from and has applied multiple measures over the past years, including revocation of licenses. Certain decisions on sanctions are made public, which is a good practice. There are a few areas for improvement, however. Lack of clarity and transparency in the way laws and regulations are enforced (especially for AML purposes) has been mentioned by market participants, which in turn creates the sentiment that banks are disciplined even for minor problems. CBR supervisory actions should therefore be in most cases predictable, consistent, and proportionate. The amount of fines for AML breaches is also excessively low and not deterrent enough.

### **Cooperation, Consolidated, and Cross-Border Banking Supervision (CPs 12–13)**

**49. The framework for collaboration and coordination with domestic and cross-border supervisors is satisfactory.** CBR is satisfied with the quality and effectiveness of existing cooperation arrangements, especially with Rosfinmonitoring in the area of AML/CFT and also with the DIA for resolution purposes. Removal of legislative obstacles to the exchange of supervisory information has allowed progress in the field of home and host supervisory cooperation. The legislation governing the CBR (Article 73) contains a potential obstacle to effective home-host practices as a foreign supervisory authority requires written consent to access the premises of a subsidiary established in Russia (foreign-owned branch establishments are not permitted). In practice this has not been an issue, however. Initial moves have also been made in terms of cross-border crisis planning and involvement in recovery and resolution plans for cross-border groups, now that the legal provisions are in place.

**50. The legal and regulatory framework in respect to consolidated supervision has been significantly developed and enhanced since the last assessment.** Notably, the changes include powers to act in the event of violations by the parent of a banking group, an enhanced scope of information exchange, and expanded definitions based on IFRS. The regulatory and legal changes are, nevertheless, still relatively recent and the practical application and supervisory practice based

on the new framework is yet to be substantively demonstrated. The cross-border dimension of consolidated supervision is still mostly undeveloped. Some legal gaps remain and are a hindrance to CBR and relate to the perimeter of the consolidation. First, the supervisor may not require the closure of a foreign branch of a Russian bank. Secondly, the supervisor may not prevent the acquisition of a nonbank financial entity by a banking group.

### **Corporate Governance (CP 14)**

**51. Russia has taken several initiatives over the past years to improve governance in banks.** The introduction in 2013 of Articles 11.1 and 11-1-1 in the banking law is an important step forward as it provides a clear articulation of what the role of the BoD should entail especially with regard to the promotion of Corporate Governance (CG) principles within each credit institution. In 2014, the profound revision of the Corporate Governance Code was also an important step forward, even though it is still a non-binding instrument. New regulations and ordinances have provided more leverage to CBR to monitor and enforce CG related issues. The current regime for CG is governed by piecemeal regulations, which makes it difficult to understand. Moreover, the current norms are different in nature: some of them are binding, others are just optional (CG Code, CBR Letters) and as such not enforceable. Several important regulations pertinent to CG were issued in 2015, and some of them will not be enforceable before 2017. Thus, the current mission is not in a position to assess their effective implementation. Also, the deficiencies in governance policies are largely influenced by problems found in other areas, for example deficiencies in related party transactions and lending to affiliates on more preferable terms than those applied to non-affiliated parties.

### **Prudential Requirements, Regulatory Framework, Accounting and Disclosure (CPs 15–29)**

**52. Russia has made significant progress in improving the RM supervisory and operational framework.** In the past, the RM regime was not deemed to be sufficiently robust. To address the situation, CBR initiated and completed several reforms aimed at improving the RM regulatory regime. The most significant changes were made by the Federal Law 146-FZ of July 2, 2013 that included new provisions in both the CBL and the law on banks and banking. The overarching objective was to increase CBR's powers in relation to RM on the one hand and fostering RM processes in banks on the other. Also, Ordinance 3624-U on risk and capital management is a major step forward as it defines more clearly the responsibilities of the BoD for developing and overseeing management of banks' entire risk profile and the policies supporting the participation of (independent) directors in overseeing RM decision-making. Equally important, this ordinance empowers the CBR to impose Pillar II measures, including capital add-on. Further, Ordinance 3223-U of April 1, 2014 obligates banks to notify CBR when the head of RM has been appointed and sets the qualification requirements for head of RM, internal control, and internal audit functions, in particular the conditions to be met by the applicants in terms of academic background and professional expertise in relevant fields. There is, however, a lack of perspective on the effective implementation of this new regime in banks owing to the fact that key aspects have not been implemented yet.

**53. The capital adequacy regime is consistent with international standards.** The Russian framework for capital adequacy has been periodically updated to include Basel 2.5 and Basel III standards and was further amended by a series of reforms introduced in December 2015, most of which became effective in January 2016. All Russian banks are subject to Basel capital regulation on both standalone and consolidated levels. Capital adequacy standards applied on a consolidated basis are broadly consistent with those established on a solo level. Also, the implementation of the capital buffers has been assessed by the Regulatory Consistency Assessment Program (RCAP) as compliant with the Basel standard. CBR has implemented the capital conservation buffer, countercyclical buffer, and a systemic risk buffer from January 1, 2016, in line with the Basel standard. The effectiveness of the new Internal Capital Adequacy Assessment Process (ICAAP)/SREP regime remains to be assessed however. Pillar 2 has not been yet fully and thoroughly implemented. The ICAAP process is under way and CBR is still in the process of completing the first SREP cycle which will take some time before being fully operational. According to the timetable set by CBR, systemically important banks (SIBs) will have to submit their ICAAP by the end of 2016 and CBR will start reviewing their quality in 2017.

**54. RM standards around credit risk, as with the other risk areas, are still in the process of being fully implemented.** However, work in the field of credit risk, based on the activities of the Chief Inspectorate, coupled with the analysis of the curators and the work carried out on stress testing, puts the supervision of credit risk in a more advanced and developed position than that of other risks. CBR performs its own stress tests on the portfolios, monitors regional and sectoral trends, and performs considerable cross checking of information on major exposures.

**55. Loan classification and provisioning are under close scrutiny but the level of NPLs remains a concern.** Asset quality has deteriorated over the past months. NPLs have grown at a fast pace (especially in the household sector) and the depreciation of the ruble led CBR to take forbearance measures through the issuance of three letters of a temporary nature. These measures were introduced in December 2014 to help banks weather problems stemming from the decline in global oil prices, the Western sanctions over the Ukraine conflict, and the depreciation of the ruble. Some of these measures aimed to allow banks to restructure loans without making provisions or not to re-qualify borrowers in a lower category, under certain conditions (for example, if the problem of servicing the debt arose from the deterioration of macroeconomic conditions). These regulatory concessions expired in December 2015. However, in 2016 credit institutions were given the opportunity not to reclassify the borrower until the borrower has paid back the entire amount of the loan. In that context, it seems realistic to assume that a certain portion of rescheduled loans currently sits in a lower loan category. Only an Asset Quality Review would permit a clear assessment of the current NPL situation. Poor practices have been detected and led to enforcement action. CBR inspections reveal an important number of violations during assessments of asset quality, including lending to shell companies, overvaluation of collateral, misreporting and unreliable financial statements. Collateral valuation is another challenge. According to the discussion with both CBR and market participants, the valuation of certain collateral in particular, real estate is a difficult task in Russia. Appraisals are not reliable and external appraisers have not been trustworthy for many years.



**56. The regulatory regime for concentration risk and large exposure limits has been improved.**

CBR has a wide range of powers to address situations where banks are taking excessive concentration risk, including the power to instruct the bank to mitigate the risk exposure when the concentration is deemed excessive. However, much of the progress made will not be measurable before 2017. For RM purposes, for example, SIBs have begun to include the impact of significant risks—including risk concentrations—into their stress testing programs since January 1, 2016 only and for non-SIBs, this approach is set to start on January 1, 2017. The definition of economic linkages is not implemented yet, which undermines CBR's ability to oversee the entire spectrum of concentration. The problem stems from the fact that the determination by CBR—and banks alike—of relatedness between customers connected economically will start to be implemented in 2017. In the same vein, the new regime concerning exposures arising from transactions of person(s) connected to the credit institutions itself will not be implemented before January 2017. It is noteworthy that according to discussions with market participants, the issue of large exposures is a matter of concern. Statistics from CBR on shareholder and insider credit risks confirm the general sentiment. In 2014, the large loan exposure of the banking sector grew by 34.9 percent to RUB 19.5 trillion. The share of large loans in the banking sector assets remained unchanged over the year and stood at 25.1 percent.

**57. There are no specific requirements for management of country risk and transfer risk.**

The general RM and internal control regulations apply. Country risk is assessed on an ad hoc basis as there are no specific guidelines or regulations for country or transfer risk outside of the general BCBS principles. As a result, the minimum requirements for risk policies, processes, and limits are uncertain. Several improvements are desirable in order to bring Russia to a higher degree of conformity, especially in the current context of ruble depreciation.

**58. The framework for transactions with RPs is still weak despite recent progress.**

Important amendments have been introduced since 2015 to the CBL that streamline the legal regime applicable to RPs, particularly through a clearer and broader definition of RP. The role allocated to the Banking Supervisory Committee of CBR in deciding about the relatedness of the persons or a group of persons to the credit institution is another hallmark of progress. There are, however, a series of issues that have not been addressed or are not yet implemented and enforced. The definition of RPs arises from a "patchwork" of different legal sources, as opposed to being founded on a single non-ambiguous one. Further, the new regime concerning exposures arising from transactions of person(s) connected to the credit institutions will not be implemented before January 2017. Lastly, the regulatory framework for related party transactions does not require that lending to RPs be on same terms and conditions as those generally offered to the public. CBR made recommendations in that regard but they are not binding and thus not enforceable. Additionally, CBR lacks authority to impose penalties on directors who personally benefited from these favorable conditions.

**59. Bank activities giving rise to market risk are not highly developed, and CBR's powers to enforce RM and control standards are very new.** Historically, the volumes of tradable securities have been low and complex structured products do not feature. Although banks are not authorized



to use models for Pillar 1 regulatory capital calculations, they may use economic capital models in the context of their internal capital adequacy assessment. Until 2014, CBR did not have the legal powers to enforce RM and control standards. Implementation of the new RM standards is at a very early stage, and a track record is not yet available.

**60. The regulatory framework around Interest Rate Risk in the Banking Book—has been enhanced but many of the new provisions, including a greater emphasis on stress testing, are not yet fully in force.** There are, at present, limited options available to banks in terms of instruments to hedge interest rate risk. In this context, it becomes even more important for banks to develop meaningful stress scenarios and build management strategies to allow the banks to withstand any future shocks that might manifest.

**61. CBR liquidity metrics and RM standards are well developed for systemic banks.** The criterion for the definition of systemic banks includes international activity. At the time of the assessment, quantitative and qualitative standards and CBR's scrutiny of banks with respect to liquidity was transitioning to the new standards. At this early stage, it is hard to determine the extent to which the new framework is fully in force and actively monitored. The full LCR metrics and management standards will not apply to the non-systemic banks, and for this sector it is not clear that CBR will have clear grounds to act if the supervisor is concerned by the RM standards of the banks, notably in respect to funding risks.

**62. Regarding supervision of OR, there are several aspects that would merit improvement.** The corpus of norms that govern OR is detailed, but with the exception of Ordinance 3624-U and Regulation 242-P on internal controls, the rest of the relevant norms essentially consists of recommendations from CBR, which by their very nature are not binding. This is the case of Letter 76-T on the organization of OR at lending institutions and Letter 92-T on the organization of Legal Risk and Reputational Risk. CBR has also recommended that the industry adopt the BCBS Principles for sound management of OR, but these recommendations are not enforceable. It is advisable to convert CBR recommendations on OR into binding instruments with a view to establishing a general OR management framework that is comprehensive and mandatory.

**63. There are significant differences between the supervisor's powers in relation to internal and external control functions.** The regulatory framework for the internal control environment has been refreshed within the past two years based on important new powers, which permit CBR to apply RM and internal control standards. By contrast, there are material deficiencies in the legal framework, restricting the CBR's ability to act and be effective in relation to the external auditor function. Current weaknesses in the regulatory framework mean that the supervisor may not: reject or rescind the appointment of an external auditor who has inadequate independence or experience or who does not meet professional standards; ensure rotation of the external auditor; or meet with the audit firm to discuss matters pertaining to a supervised institution. Likewise, the auditor may not notify the supervisor of serious matters that come to the auditor's attention. Furthermore, it is unclear whether CBR has powers to ensure or directly require that the board and management are held accountable for ensuring that financial statements are properly prepared and subject to an independent external auditor's opinion according to international standards. In

general, and reflecting the weaknesses of the legal framework, CBR's relationship with the auditing community is restricted. It is not, currently, CBR's practice to meet with the audit community, except on general matters.

**64. CBR attaches importance to disclosure and transparency.** CBR is entitled to and has exercised its powers to take measures in the event of non-disclosure of information, partial disclosure or unreliable information, a failure to conduct a required audit, or non-disclosure of the consolidated statements and the auditor's report on them. CBR has exercised its powers under the law when assessing disclosure by banks and banking groups. Some of the disclosure standards are at early phases of implementation, but the Basel disclosure framework (Pillar 3, Market Discipline) is now in force.

**65. With respect to combating money laundering/terrorism financing, CBR has made important progress but further improvements are needed.** Banks are subject to close scrutiny, and CBR has been forceful against banks and their management which have committed grave violations of the AML regime. There are a few areas where improvements could be made; these include the promotion of a more risk based approach to ML/TF issues in both the industry and CBR; the use of more proportionality when enforcing the law; and the need to raise the level of compliance in banks regarding the verification of the ultimate beneficial owner and the inclusion of ML/TF risks into the scope of duties to be performed by external auditors.

## DETAILED ASSESSMENT

<b>A. Supervisory Powers, Responsibilities and Functions</b>	
<b>Principle 1</b>	<b>Responsibilities, objectives and powers.</b> An effective system of banking supervision has clear responsibilities and objectives for each authority involved in the supervision of banks and banking groups. <sup>10</sup> A suitable legal framework for banking supervision is in place to provide each responsible authority with the necessary legal powers to authorize banks, conduct ongoing supervision, address compliance with laws and undertake timely corrective actions to address safety and soundness concerns. <sup>11</sup>
<b>Essential criteria</b>	
<b>EC1</b>	The responsibilities and objectives of each of the authorities involved in banking supervision <sup>12</sup> are clearly defined in legislation and publicly disclosed. Where more than one authority is responsible for supervising the banking system, a credible and publicly available framework is in place to avoid regulatory and supervisory gaps.
Description and findings re EC1	<p>The status, objectives, responsibilities and powers of the authority involved in banking supervision are spelled out in the Constitution of the Russian Federation, the Federal Law 86-FZ of July 10 2002 on the Central Bank of the Russian Federation (here after the CBL) and the Federal Law on “banks and banking activity” (hereafter the banking law) that governs the activity of financial institutions.</p> <p>Pursuant to Article 4 of the CBL, the CBR (CBR) <i>exercises supervision over the activities of credit institutions and banking groups</i>. Along the same line, Article 41 of the banking law stipulates that “<i>the supervision of the activities of a credit institution shall be undertaken by the CBR in compliance with federal laws.</i>” As a result, the CBR has sole responsibility for banking supervision in accordance with the laws mentioned above.</p> <p>Article 56 of the CBL also states that CBR is the “<i>body of banking regulation and banking supervision.</i>” It exercises ongoing supervision over the compliance by credit institutions and banking groups of Russian legislation and CBR regulations. The CBR competencies extend to the analysis of the activity of bank holding companies. In virtue of the same article, the regulatory and supervisory functions of the CBR are implemented through the Banking Supervision Committee, a permanent body uniting the heads of the CBR units responsible for supervision.</p> <p>Both the CBL and the banking law, through various articles, empower the CBR with the authority to carry out virtually all supervisory functions, such as regulating the industry, conducting onsite</p>

<sup>10</sup> In this document, “banking group” includes the holding company, the bank and its offices, subsidiaries, affiliates and joint ventures, both domestic and foreign. Risks from other entities in the wider group, for example non-bank (including nonfinancial) entities, may also be relevant. This group-wide approach to supervision goes beyond accounting consolidation.

<sup>11</sup> The activities of authorising banks, ongoing supervision and corrective actions are elaborated in the subsequent Principles.

<sup>12</sup> Such authority is called “the supervisor” throughout this paper, except where the longer form “the banking supervisor” has been necessary for clarification.

	<p>examinations, licensing banks, collecting information for supervisory purposes and enforcing the law and relevant regulations.</p> <p>It is also noteworthy that CBR's supervisory role goes well beyond the oversight of the banking system. In effect, since the enactment of the Federal Law 251-FZ of July 23, 2013<sup>13</sup> that came into effect on September 1, 2013, the CBR took over the supervisory powers from the Federal Financial Market Services (FFMS). This extension of CBR's remit has transformed CBR into a "mega-regulator" overseeing and supervising the Russian banking system, securities markets, private pension funds, insurance business as well as micro-finance institutions. For these purposes, all functions and authorities of the FFMS and certain regulatory powers of the Russian MoF and Russian Government were transferred to the CBR.</p> <p>Other authorities are involved in overseeing the financial system as part of their general functions, i.e., the Federal Service for Financial Monitoring (the Russian Financial Intelligence Unit—FIU) whose role is to prevent and combat money laundering and terrorist financing. This body exercises several competencies (see CP 29 for more details); however, the oversight of conformity with AML/CFT rules in the banking sector is the exclusive responsibilities of the CBR. There is also the state corporation, DIA, which is responsible for deposit insurance. This agency is also vested with certain powers in relation to banks but none of these has something to do with supervision. There are cases where CBR and DIA staff perform joint reviews of banks to ascertain the financial conditions of the institution that exhibit signs of possible bankruptcy. For that particular instance, the Federal Law 177-FZ establishes clearly the conditions of such cooperation (see CP 3 for details) and the distribution of responsibilities of each authority.</p> <p>To sum up, CBR is the sole supervisor for both banks and nonbanks financial institutions. The responsibilities and objectives of the CBR are also clearly disclosed on the CBR website; for example, it is indicated that the CBR supervises the activities of credit institutions and banking groups. In addition, most of the relevant legislation and regulations that set out the duties of the CBR are available on line.</p> <p>On the other hand, the normative acts of the CBR, which are binding for financial institutions (see Article 57 of the CBL) are published on the official website of the CBR or in the Official Bulletin of the CBR and come into force in 10 days after their publication, unless another date is specified by the regulation.</p>
<b>EC 2</b>	The primary objective of banking supervision is to promote the safety and soundness of banks and the banking system. If the banking supervisor is assigned broader responsibilities, these are subordinate to the primary objective and do not conflict with it.
Description and findings re EC2	<p>According to Article 3 of the CBL, the purpose of the CBR is to:</p> <ul style="list-style-type: none"> <li>- protect the Ruble and ensure its stability;</li> <li>- develop and strengthen the banking system of the Russian Federation;</li> <li>- ensure stability of and develop the national payment system;</li> <li>- develop the financial market of the Russian Federation (since 2013); and</li> <li>- ensure stability of the financial market of the Russian Federation (since 2013).</li> </ul>

<sup>13</sup> On Amendments to Certain Legislative Acts of the Russian Federation connected with Transfer of Authorities to Exercise Regulation, Control and Supervision of Financial Markets to the Central Bank of the Russian Federation.

	<p>Article 4 of the same law defines thirty three functions assigned to the CBR, including inter alia, the conduct of monetary policy in collaboration with the government, the management of budget account, the management of international reserves and the supervision over the activities of credit institutions and banking group (paragraph 9), in addition to the supervision of non-credit financial institutions. Article 56 of the same law stipulates that the <b>principal</b> objectives of banking regulation and banking supervision is to <i>"maintain the stability of the Russian banking system and protect the interests of depositors and creditors."</i></p> <p>Considering the broad mandate assigned to the CBR and the multiple functions deriving from it, the question as to whether the broader responsibilities of the CBR are subordinate to the primary objective of banking supervision is not clearly established. In fact, some of these objectives (in particular the development and strengthening of the banking system, the conduct of monetary policy) may not be compatible with the supervisory mandate. During the mission, the CBR representatives did not raise any concern in relation to possible overlapping objectives and to any risks of conflict of interest in that regard.</p> <p>On the other hand, CBR is not only a banking supervisor but an integrated supervisor that is also mandated to undertake insurance, securities, non-State pension funds, rating agencies, professional stock-market operators (brokers, dealers), clearing companies and micro-finance supervision. During the discussion with the CBR, the mission was told that the expansion of CBR functions has not been made to the detriment of banking supervision. In analyzing the structure of the CBR, its budget and resources allocation for both bank and non-bank entities, the assessors did not find any fact that would lead them to conclude otherwise (see CP2).</p> <p>In effect, the execution of banking supervision does not seem to be hindered by these additional new activities. First, within the CBR, these other tasks are organizationally separated from the banking supervision duties and are entrusted to separate departments responsible for each function, namely insurance companies (Insurance Market Department), pension funds, investment and management funds (Collective Investments and Trust Management Department), as well as securities market participants (Securities Market and Commodities Market Department). Second, a separate inspection planning and resourcing process exists for banking supervision which ensures a sufficient prioritizing towards banking supervision.</p>
<b>EC3</b>	Laws and regulations provide a framework for the supervisor to set and enforce minimum prudential standards for banks and banking groups. The supervisor has the power to increase the prudential requirements for individual banks and banking groups based on their risk profile <sup>14</sup> and systemic importance. <sup>15</sup>
Description and findings re EC3	In Russia, both the CBL and the banking law provide a framework for the CBR to set minimum prudential standards for banks and banking groups. For example, Articles 57, 62, and 64 of the CBL empower CBR to set norms for banks and banking groups relative to capital, assets, liquidity, large exposure limits, provisioning, disclosure obligations and other prudential standards.

<sup>14</sup> In this document, "risk profile" refers to the nature and scale of the risk exposures undertaken by a bank.

<sup>15</sup> In this document, "systemic importance" is determined by the size, interconnectedness, substitutability, global or cross-jurisdictional activity (if any), and complexity of the bank, as set out in the BCBS paper on *Global systemically important banks: assessment methodology and the additional loss absorbency requirement*, November 2011.

	<p>The law also provides a framework for the CBR to enforce the minimum prudential standards mentioned above. Articles 73 and 74 of the CBL grants enforcement powers to CBR, including remedial measures and sanctions. As stipulated in the law, <i>“to fulfill its functions (...) the CBR shall conduct inspections of credit institutions, give them instructions (...) to eliminate violations (...) and use sanctions against violators as stipulated by this Federal Law”</i> (for further details, please see CP 11).</p> <p>In the previous FSAPs in 2008 and 2011, it was observed that the legal framework did not explicitly grant the CBR power to increase the prudential requirements for individual banks based on their risk profile and systemic importance. This was an important limitation to the CBR powers. With the adoption on April 15, 2015 of the CBR Ordinance 3624-U on risk and capital management, the CBR is now entitled to use Pillar 2 instruments to require a bank to increase its CAR if the outcomes of the ICAAP reveal, for example, important flaws in the bank’s RM system. This new power however has not been used yet.</p>
<b>EC4</b>	<p>Banking laws, regulations and prudential standards are updated as necessary to ensure that they remain effective and relevant to changing industry and regulatory practices. These are subject to public consultation, as appropriate.</p>
Description and findings re EC4	<p>The legal and regulatory framework for banking supervision has been updated multiple times over the past years. Some of these reforms were introduced to address the 2011 FSAP’s recommendations. As mentioned by the authorities, the CBL has been amended more than 51 times since 2002, while the banking law from 1990 has been revised more than 83 times. For 2015 only, several key reforms and updates were introduced. The most salient laws or regulations establish:</p> <ul style="list-style-type: none"> <li>• requirements to the risk and capital management systems of credit institutions and banking groups, including requirements to implement internal capital adequacy assessment process;</li> <li>• new processes in the area of CG including fairness of compensation for bank’s top management;</li> <li>• CBR vetting for acquisition of equity interest in banks reaching or exceeding the thresholds of 10 percent of the shares;</li> <li>• new fit and proper requirements for shareholders, senior managers, members of executive and supervisory committees, chief accountants, and internal control officers;</li> <li>• definition of possible signs of relatedness of legal entities and (or) individuals to the credit institution and (or) its affiliates and the role of the Banking Supervision Committee of the CBR in this determination.</li> </ul> <p>According to Article 104 of the Constitution of the Russian Federation, the CBR does not have the power to initiate legislation. However, draft laws and legal acts of federal bodies of executive power regulating the performance by the CBR of its functions must be submitted to the CBR for consideration and approval (Article 7 of the CBL). Further, Article 21 governing the relations between CBR and bodies of State Power stipulates that CBR chairman—or one of his deputies—may participate in State Duma and Government sessions discussing draft laws on issues relating to the economic, financial, credit, and banking policies.</p> <p>According to Article 5 of the CBL, the CBR has the right to issue binding acts in the form of regulations, instructions, and directions on matters related to its competencies. Such acts are compulsory for all entities licensed by the CBR. The CBR can also issue non-regulatory acts on administrative related issues in the form of orders. These acts are equally binding.</p>

	<p>Draft banking Laws and CBR's draft regulations are subject to public consultation. In fact, the CBR is by law (Article 77 of the CBR Act) required to co-operate with credit institutions, non-credit financial institutions, their associations and unions and self-regulatory organizations, and should hold consultations with them before taking the most important decisions relating to legislation. While this process is essential to permit more transparency and predictability in banking regulations, the process can be lengthy. The draft is made public on the official websites of the government and the CBR for 14 days for discussion as part of the regulatory impact assessment. Comments are analyzed within 21 days after the end of public discussion. The report on public discussion and the revised version of the draft are prepared and sometimes another round of public consultation is needed. Draft regulations related to the banking regulation and supervision are approved by the Banking Supervisory Committee and those that affect third parties' rights sent to the Ministry of Justice that will make sure that any new act is not creating pre-conditions for corruption.</p> <p>In Russia, the public is informed about the latest developments in the banking sector. The CBR publishes two annual reports, the Banking Supervision Report (BSR) and the CBR Annual Report. Both reports provide details on the most recent legal and regulatory changes. The 2014 BSR contains a chapter on banking activity regulation and supervision, including the latest amendments to the CBR and banking laws. These reports also provide a fair picture of problems identified by the supervisors and enforcement measures taken to correct the main deficiencies. The information is published on the official website of the CBR.</p>
<b>EC5</b>	<p>The supervisor has the power to:</p> <ul style="list-style-type: none"> <li>(a) have full access to banks' and banking groups' boards, management, staff and records in order to review compliance with internal rules and limits as well as external laws and regulations;</li> <li>(b) review the overall activities of a banking group, both domestic and cross-border; and</li> <li>(c) supervise the activities of foreign banks incorporated in its jurisdiction.</li> </ul>
Description and findings re EC5	<p>The ability of the CBR to have access to bank's information is governed by a number of articles the CBL and CBR instructions and regulations.</p> <p>a) The CBR has the power to have full access to banks and banking group's information for supervisory purposes. In effect, pursuant to the CBL (Articles 57, 73) and CBR Instruction 147-I of December 5, 2013, CBR staff is empowered to have access to information on banks' and banking groups' activities. In addition, in consonance with Regulation 310-P of September 7, 2007, CBR's curators assigned to a particular bank or banking groups are empowered to enter any bank's premises and receive all relevant information pertaining to the activity of such institution. The CBL also stipulates that CBR employees have the right to receive and examine accounting reports and other documents of credit institutions (or their branches) and, if necessary, make copies of the corresponding documents.</p> <p>It is also noteworthy that for its supervisory duties, the CBR also resorts to the so-called "ARs" who are assigned to a particular D-SIB (one for each entity). These resident examiners enjoy wide autonomy and can request any kind of information. For example, they are allowed to collect information and documents related to the bank's lending activity, including volumes of loans granted and planned to be granted, the terms of their extension, the issuance of guarantees, the amount of remuneration paid to the board members or chief executive officer, and other information related to the assessment of financial stability of the credit institution, its corporate</p>



	<p>and RM quality. They can also attend, without voting power, meetings of the bank's management bodies. The BCP assessors were told that in practice, ARs participate not only in board meetings but also in all relevant committees, including risk committees and audit committees.</p> <p>Also, according to Article 73 of the CBL, the CBR has the right to review activity of credit organizations located abroad if such organizations form part of a banking group or a bank holding company. Such inspections can be carried out on the basis of MOU, and in the case of the absence of a MOU, these questions are regulated in an individual order in coordination between Bank of Russia and the foreign supervision authority.</p> <p>b) The CBL also entitles the CBR to review overall activities of a banking group, both domestic and cross-border. CBR Instruction 147-I of December 5, 2013 provides this power.</p> <p>c) For foreign banks members of banking groups operating in Russia, the CBL stipulates that the supervisory authority of a foreign state (i.e., the home authority) may gain access to the premises of the said credit institutions and get access to the relevant information if the credit institutions has given a written consent (see comments below).</p>
<b>EC6</b>	<p>When, in a supervisor's judgment, a bank is not complying with laws or regulations, or it is or is likely to be engaging in unsafe or unsound practices or actions that have the potential to jeopardize the bank or the banking system, the supervisor has the power to:</p> <ul style="list-style-type: none"> <li>(a) take (and/or require a bank to take) timely corrective action;</li> <li>(b) impose a range of sanctions;</li> <li>(c) revoke the bank's license; and</li> <li>(d) cooperate and collaborate with relevant authorities to achieve an orderly resolution of the bank, including triggering resolution where appropriate.</li> </ul>
Description and findings re EC6	<p>Enforcement powers are governed by the CBL (for more details, see CP 11). According to Article 74, the CBR can take corrective actions, impose sanctions and revoke a bank's license in the most extreme scenario. More specifically, the following actions can be taken:</p> <p>The CBR can instruct any credit institution to correct any violations of the law or CBR normative acts, impose a penalty (up to 0.1 percent of bank's minimal capital), or restrict the credit institution from conducting certain operations (for up to six months), including with the parent company, in case of banking groups.</p> <p>In most serious instances, for example when a credit institution did not comply with a CBR order to address a particular violation or if the bank endangers the interests of depositors, the CBR can impose a range of sanctions, including, but not limited to, charging a fine of up to 1 percent of the bank's paid-up capital, prohibiting certain operations for one year, instructing "financial rehabilitation measures," including appointing a provisional administrator.</p> <p>Revocation of the license is also an important tool at the disposal of the authorities that has been used extensively over the past three years. Multiples licences have been revoked across Russia for various, and often multiple, infringements of Russian law and CBR norms (see CP 11 and CP 29 for details). These range from unsatisfactory financial standards (such as insufficient equity and unreliable reporting data) to violations of AML/CFT legislation. These actions have noticeably increased under the current Governor of the CBR, who was appointed in June 2013. In the first six</p>



	<p>months of her tenure, 35 licenses were revoked, in contrast to the three revoked in the first half on 2013 under her predecessor.</p> <p>CBR's enforcement power also extends to banking groups. In case of violations of laws or prudential norms, several measures can be imposed on the parent company, including fines and restrictions of activities within the group (Article 74).</p> <p>The CBR also cooperates closely with the Deposit Insurance Agency to achieve orderly resolution of banks (see CP 11 for further details).</p>
<b>EC7</b>	The supervisor has the power to review the activities of parent companies and of companies affiliated with parent companies to determine their impact on the safety and soundness of the bank and the banking group.
Description and findings re EC7	The CBR is empowered to carry out supervision on a consolidated basis over banks and banking groups (CBL Articles 4 and 56). The supervisor enjoys free access to all relevant information. When the parent company of the group is a non-bank institution, CBR is also empowered to request information from the Holding Company.
<b>Assessment of Principle 1</b>	<b>Largely Compliant</b>
Comments	<p>The legal framework currently in place reasonably provides the necessary powers to authorize banks, conduct ongoing supervision, oversee compliance with laws and undertake corrective actions to address safety and soundness concerns. However, responsibilities and objectives of the CBR are particularly broad and appear to be intertwined, while some functions seem to concur with the objectives related to safety and soundness of the banking system. It is important to ensure clarity of purpose for the supervisory function. Although the decision making process of the CBR is well designed to ensure a good focus on prudential issues, it is not transparent to an external observer whether or not the CBR's decisions might be influenced by its institutional objective for development of the financial sector and also its significant stake in the most systemic banking group of the Russian Federation.</p> <p>There are also a few issues that limit CBR powers. One first example is that the inspected period cannot be more than five years before a year of inspection (but the CBR can obtain data from banks older than five years to confirm whether laws were violated during that period). The CBR told the assessors that this has no practical implications because banks are subject to a two-year inspection cycle. Further, this limitation applies to certain accounting documents only (e.g., data on payment). In addition, according to Article 29 of the Federal law 402-FZ "About accounting," primary registration documents, registers of accounting, accounting (financial) reports, audit reports on it are subject to storage for not less than five years after the financial year.</p> <p>Other limitations on CBR enforcement powers include the situation where a gross violation older than one year has been committed by a shareholder having qualifying interest in a bank. Also, the CBR cannot act if five years have passed since a violation has been committed (see CP 11 for more details).</p> <p>On the other hand, major reforms have been introduced that increase CBR duties and powers in many respects. The "mega-regulator" reform is seen as a major step forward, allowing the CBR to</p>

	<p>issue prudential and accounting standards for all entities and as a result to set a unified supervisory regime. It also provides the supervisor with a broader perspective on risks across the entire financial industry. These reforms have been introduced very recently and the present mission is not in a position to evaluate their effective implementation nor to assess the use of new enforcement powers granted to the supervisor.</p> <p>In effect, the capacity of the CBR to use its power to increase the prudential requirements for individual banks and banking groups based on their risk profile and systemic importance remains to be tested. As observed in 2011 during the last update FSAP, the CBR did not have the legal foundation to inquire additional capital based on the risk profile of an institution. With the adoption of Ordinance 3624-U on risk and capital management, the CBR can instruct a bank to increase its CAR if the outcomes of the ICAAP reveal, for example, important flaws in the RM systems of the institution. This new arsenal will not be enforced before 2017.<sup>16</sup></p> <p><b>Recommendations:</b></p> <ul style="list-style-type: none"> <li>• Include language in the CBL that would clearly segregate CBR’s safety and soundness duties from other assigned objectives.</li> <li>• Allow the CBR to get access to banking data older than five years.</li> </ul>
<b>Principle 2</b>	<b>Independence, accountability, resourcing, and legal protection for supervisors.</b> The supervisor possesses operational independence, transparent processes, sound governance, budgetary processes that do not undermine autonomy and adequate resources, and is accountable for the discharge of its duties and use of its resources. The legal framework for banking supervision includes legal protection for the supervisor.
<b>Essential criteria</b>	
<b>EC1</b>	The operational independence, accountability and governance of the supervisor are prescribed in legislation and publicly disclosed. There is no government or industry interference that compromises the operational independence of the supervisor. The supervisor has full discretion to take any supervisory actions or decisions on banks and banking groups under its supervision.
Description and findings re EC1	<p><b>Independence</b></p> <p>The independence of the CBR is formally stipulated under Article 1 of the CBL. Article 1, states that “the status, purposes, functions and powers” of the Central Bank of the Russian Federation (CBR) are as set out in the Constitution of the Russian Federation. More particularly, the CBR is to fulfill its functions and exercise its powers “independently from other federal bodies of state power, the bodies of state power of the constituent entities of the Russian Federation and bodies of local government.”</p> <p><b>Accountability</b></p> <p>The CBR’s accountability is to the State Duma of the Federal Council of the Russian Federation (Article 5, CBL). Moreover, the State Duma has the power to appoint and dismiss the CBR</p>

<sup>16</sup>(i) Credit institutions with assets of RUB 500 billion or more shall bring the risk and capital management procedures into compliance with Ordinance 3624 at the individual level by December 31, 2015, and at the level of the banking group by December 31, 2016; (ii) credit institutions with assets of less than RUB 500 billion shall bring the risk and capital management procedures into conformity at the individual level by December 31, 2016, and at the level of the banking group—by December 31, 2017.

Chairman, on the proposal of the President of the Russian Federation, as well as to appoint and dismiss the members of the Board of Directors—at the proposal of the CBR Chairman as agreed with the President. (Articles 5 and 15 CBL). The State Duma can also take decisions on audit inspections of the CBR, by the Audit Chamber of the Russian Federation, and can conduct parliamentary hearings on the CBR’s activities. The CBR must supply information to the State Duma and President of the Russian Federation according to the procedures established in the federal law.

### ***Governance***

The CBR has two governing bodies established by the CBL (Chapter III): The Board of Directors of the CBR (executive members) and the National Financial Board (NFB) of the CBR (non-executive members). The NFB was formerly titled the “National Bank Council” until the legislative amendments of 2013. The CBL (Chapter III) sets out the composition and powers of the governing bodies of the CBR. Please see EC2 for more detail on composition and appointment/dismissal of these bodies.

The Role of NFB includes considering reports from the BoD on supervision and regulation, making decisions on issues relating to CBR participation in capital of credit institutions; and approving the budget proposals put forward by the BoD. The BoD has a wide ranging set of executive functions set out in the CBL (Article 18). As noted below, however in EC4, direct supervisory decisions are taken by the Banking Supervisory Committee and notified to the board. The competence of the BSC and the board do not overlap except insofar as the board has the responsibility for taking decisions on issuance of the regulations, instructions, and ordinances of the CBR (CBL, Article 18).

As an over-arching point, the CBR is required (CBL, Article 4) to articulate and enact policies to avoid conflicts of interest when performing its legal functions.

### ***Relationship with government***

The Government cannot issue operational instructions to the CBR, but under the CBL (Article 21) the CBR and the Government of the Russian Federation must inform each other about their plans of action of national importance, coordinate their policy and hold regular consultations.

Two government ministers, or their representatives—the MoF and the Ministry of Economic Development—have the right to attend the BoD in an advisory capacity and “shall participate in the BoD’ meetings with the right of a consultative vote” (CBL, Article 21). While the decisions of the board belong to the CBR, the ministers (or their representatives) have the ability to express a view on the matters under discussion.

### ***Supervisory independence and discretion***

As noted above, and also below in EC4, supervisory decisions are taken—at their highest level—at the Banking Supervision Committee. Also there is a delegation of powers within the CBR to enable supervisory decisions to be taken at an appropriate level and as efficiently as possible. There are

	<p>no legal constraints in respect of the CBR in exercising supervisory discretion, provided that it is acting within its legal <i>vires</i>.</p> <p>The CBR has an equity participation in Sberbank (the Savings Bank of the Russian Federation). The CBR operates “Chinese walls” in respect of discharging its governance/ ownership rights and obligations and its supervisory responsibilities. Voting rights and dividend receipts from Sberbank are disclosed.</p>
<b>EC2</b>	<p>The process for the appointment and removal of the head(s) of the supervisory authority and members of its governing body is transparent. The head(s) of the supervisory authority is (are) appointed for a minimum term and is removed from office during his/her term only for reasons specified in law or if (s)he is not physically or mentally capable of carrying out the role or has been found guilty of misconduct. The reason(s) for removal is publicly disclosed.</p>
Description and findings re EC2	<p>The process for the appointment and dismissal of the Chairman of the CBR, members of the BoD and the NFB is reflected in Articles 14, 15, and 12 of the CBL.</p> <p>The Chairman of the CBR is appointed by the State Duma for a five-year term, with a maximum of three consecutive terms, and may be dismissed only for reasons laid out in the law (CBL, Article 15), including expiry of term, resignation, medical condition preventing exercise of duty, violation of the law, including failures in relation to managing conflicts of interest appropriately. The dismissal may only be carried out by the State Duma on the proposal of the President of the Russian Federation. The law does not state that the reasons for the dismissal must be made public. (Article 14, CBL). The decision of the Duma is public, but the published decision will not necessarily be detailed. There are no obligations to disclose the reason for removal.</p> <p>The BoD of the CBR is composed of the CBR Chairman and 14 executive members whose term of appointment is 5 years. Appointments are made to the BoD by the State Duma at the proposal of the chairman and with the agreement of the President of the Russian Federation. Dismissal of a member of the board, other than for expiry of term, is by the State Duma at the proposal of the Chairman of the CBR. The reasons for which a proposal for dismissal may be made are not specified with the exception of a failure in relation to managing conflicts of interest. (Article 15, CBL). As noted in EC1, two government ministers, or their representatives—the MoF and the Ministry of Economic Development—have the right to attend the BoD in an advisory capacity “with the right of a consultative vote” (Article 21, paragraph 2, CBL).</p> <p>The NFB is composed of 12 members. One is the CBR Chairman, two are delegated by the Federal Council of the Federal Assembly of the Russian Federation, three are delegated by the State Duma, three by the Russian Federation President, and three by the Russian Federation Government. The members of the NFB may only be dismissed or recalled by the body responsible for appointing them. Reasons for a recall are not specified in the law. The Chairman of the NFB is elected by the members of the NFB on a majority vote. The decisions of the NFB are made on the basis of a simple majority, with a quorum of seven members. Only the Chairman of the CBR may work for the CBR on a full-time basis and is the only member to be remunerated. (Article 12, CBL).</p>
<b>EC3</b>	<p>The supervisor publishes its objectives and is accountable through a transparent framework for the discharge of its duties in relation to those objectives.<sup>17</sup></p>

<sup>17</sup> Please refer to Principle 1, Essential Criterion 1.

<p>Description and findings re EC3</p>	<p>The CBR’s functions and objectives in respect to the supervision of credit institutions are clearly stated in the CBL (Articles 4 and 56).</p> <p>The annual report of the CBR contains, inter alia, information on supervisory and regulatory developments. Additionally, and separately, the CBR also publishes an annual report on the development of banking sector and banking supervision.</p> <p>As noted in EC1, the CBL (Article 5) sets out the manner in which the CBR is accountable to the State Duma. This includes appointment of the Chairman, BoD, delegates to the NFB, consideration of the CBR’s annual reports (and decisions made on the basis of such reports). The Duma can hold hearings and hear reports by the CBR Chairman on the CBR’s activities.</p> <p>Duma hearings are public, though of course only members of the Duma can ask questions. It is common for members of the Duma to ask questions and hearings are held annually at a minimum, with the Duma having the right to call more frequent hearings. Such hearings are sometimes broadcast and reports of the hearings are available afterwards.</p>
<p><b>EC4</b></p>	<p>The supervisor has effective internal governance and communication processes that enable supervisory decisions to be taken at a level appropriate to the significance of the issue and timely decisions to be taken in the case of an emergency. The governing body is structured to avoid any real or perceived conflicts of interest.</p>
<p>Description and findings re EC4</p>	<p>There are various internal regulations that stipulate internal procedures and decision-making process depending on seniority and significance of the issues to be resolved.</p> <p>The regulatory and supervisory functions of the CBR, as required by the CBL (Article 56), are implemented through the Banking Supervision Committee. The head of the Banking Supervision Committee is appointed by the CBR Chairman from among the members of the BoD. The CBR’s BoD also is required to approve the CBR regulation on the Banking Supervision Committee while the structure is approved by the CBR Chairman (item 4 of the Regulation on BSC). All key supervisory decisions (licensing, revocation, sanctioning, and restrictions) must be made by the Banking Supervision Committee of the CBR and equally all decisions are reported to the Board of the CBR and the NFB. The decisions of the Banking Supervision Committee cannot be amended or overturned by the board or the NFB.</p> <p>According to the regulation, the Committee meets, in any case, at least monthly and is composed of fifteen members—including heads of the supervisory, regulatory, licensing departments as well as of the Chief Inspectorate but not solely limited to the fields of banking supervision—and the regulation establishes the quorum (minimum 50 percent attendance) and rules for voting (decision made by majority, with the Chairman of the Committee having the casting vote). The Banking Supervision Committee is chaired, at present, by the First Deputy Governor for banking supervision. When taking a major decision, the dossiers are compiled using information gathered by curators, inspectors, and ARs (see CP9 for a discussion of these functions) and reviewed by the legal department before being submitted to the Committee. There are internal protocols governing how much time can be spent preparing the information, and this varies depending on the gravity of the issue. The assessors were able to review some submissions to and orders issued by the BSC and found them to be of high quality.</p>

	<p>There is also a cascade of delegated powers so that, for minor violations, the Territorial Office responsible for supervision of an institution may make a decision. For larger institutions (such as regionally systemic banks identified in the “second line” of supervision), decisions are made jointly between the Territorial Office of the CBR and the main office of the CBR. In any case, and as indicated above, major supervisory decisions are reserved to the Banking Supervision Committee.</p> <p>The requirements on avoidance of conflict of interest are discussed below in EC5. In addition, CBL Article 83.1 requires separation of responsibilities between deputy heads of the CBR, heads of separate structural subdivisions, including during implementation of monetary policy, foreign-exchange reserves management, banking regulation and supervision, financial markets control and supervision in order to prevent, detect or manage any conflict of interest during fulfillment of its functions.</p>
<b>EC5</b>	<p>The supervisor and its staff have credibility based on their professionalism and integrity. There are rules on how to avoid conflicts of interest and on the appropriate use of information obtained through work, with sanctions in place if these are not followed.</p>
Description and findings re EC5	<p>Issues related to conflict of interest are considered in a number of laws and directions. General rules around conflict of interest issues are established by the Federal Law 273-FZ. At an overarching level, and as noted above, the CBL (Article 4.1) establishes that the CBR is obliged to prepare and implement policy on combating, identification and management of conflicts of interest when performing its functions.</p> <p>There are also a number of provisions in the CBL treating potential conflicts. Hence employees of the CBR (CBL Article 90) are subject to a range of restrictions, such as holding the securities of supervised institutions, being employed by such institutions, or accepting gifts. Cooling off periods are also stipulated, as certain restrictions apply for two years after employment at the CBR has ceased and restrictions on disclosure of information are perpetual.</p> <p>The CBR has issued an Ordinance (3414-U) containing rules on how to avoid conflicts of interests, and sanctions for their violation. Supervisors participating in onsite reviews must disclose relevant personal information to avoid conflicts of interest, or be disbarred from the review (see Instruction 149-I).</p> <p>There are numerous internal regulations on proper usage of information obtained through work, such as Regulation 235-P that, among other issues, sets a list of employees who after resignation are prohibited to disclose and use the information they received while serving at the CBR. Furthermore, employees are prohibited from disclosure of information obtained through work without approval of the CBR BoD (CBL Article 92). In practical terms, the CBR has not had experience of breaches of confidentiality.</p> <p>The assessors noted, in their contact with market participants and professionals, that the CBR was held in high regard for its professionalism and is perceived as an authoritative institution. The caliber and responsiveness of staff in the departments in the head office of the CBR was particularly commented upon. The increasing levels of transparency and efforts at communicating forward looking priorities in recent years were appreciated by a number of the contacts with whom the assessors met, although it was considered that there was scope for even further improvement.</p>

<b>EC6</b>	<p>The supervisor has adequate resources for the conduct of effective supervision and oversight. It is financed in a manner that does not undermine its autonomy or operational independence. This includes:</p> <ul style="list-style-type: none"> <li>(a) a budget that provides for staff in sufficient numbers and with skills commensurate with the risk profile and systemic importance of the banks and banking groups supervised;</li> <li>(b) salary scales that allow it to attract and retain qualified staff;</li> <li>(c) the ability to commission external experts with the necessary professional skills and independence, and subject to necessary confidentiality restrictions to conduct supervisory tasks;</li> <li>(d) a budget and program for the regular training of staff;</li> <li>(e) a technology budget sufficient to equip its staff with the tools needed to supervise the banking industry and assess individual banks and banking groups; and</li> <li>(f) a travel budget that allows appropriate onsite work, effective cross-border cooperation and participation in domestic and international meetings of significant relevance (e.g., supervisory colleges).</li> </ul>
Description and findings re EC6	<p>The CBR funds its expenses from its own revenues, as prescribed by law, but the law does not prescribe how budgeting and resource allocation should be decided within this parameter (CBL, Article 2). The CBR and the state are, on a reciprocal basis, not responsible for the liabilities of the other unless a specific agreement and obligation has been entered into. The purpose of the CBR is not to generate profit (Article 3). The CBR must submit its budget to the board and to the NFB. The CBR does not, therefore have independent control over the allocation of its funds to its departments. The CBR has control over the disposition of its net revenues. Additionally, the compensation of the governor and deputy governors must be disclosed and this disclosure is made annually online.</p> <p>According to the CBL (Article 26), 75 percent of the CBR's post tax profit shall be transferred to the federal budget and under an amendment to the CBL (Federal Law FZ-334) for the period of January 1, 2014 to January 1, 2015, (profit for 2015 to be paid in 2016) Article 26 shall be suspended and 90 percent of the CBR's post-tax profit will be transferred to the federal budget. All the assets of the CBR belong to the state.</p> <p>The CBR's internal budgeting process is managed by the Financial Department and is subject to approval by the CBR's BoD and NFB. Hence if any department within the CBR, including the supervisory functions, required additional resources, the BoD would have to discuss and agree to this.</p> <p>Retention rates of staff for the CBR as a whole are very high (approximately 2–3 percent annual turnover). However, some areas, including supervision, can be subject to higher attrition. In common with other jurisdictions, the CBR has found it easier to attract specialist skills when the market is undergoing periods of stress.</p> <p>The CBR has the legal power (e.g., CBL Article 73) to hire audit firms to conduct bank reviews. Legal and accounting firms may also be hired but not to conduct reviews of banks. Of course, the external firms have no participation in any CBR decision. Restrictions on information, and hiring procedures which are performed on a tender basis, are set forth in Regulation 442-P and Ordinance 3463-U.</p>



	<p>The training budget and planning is conducted annually a year in advance. IT systems were last given a major upgrade upon the creation of the mega regulator in 2013, but there is continuous development. During 2016, the data analysis system in supervision (see CPs 8 and 9) will be further enhanced to support a “single view” of all aspects of a credit institution.</p> <p>No constraints on travel for international or domestic purposes were identified.</p>
<b>EC7</b>	As part of their annual resource planning exercise, supervisors regularly take stock of existing skills and projected requirements over the short- and medium-term, taking into account relevant emerging supervisory practices. Supervisors review and implement measures to bridge any gaps in numbers and/or skill-sets identified.
Description and findings re EC7	<p>The CBR prepares a rolling training plan for 3 years on the basis of proposals received from departments and sub-divisions with due account to strategic development plans for each types of activity. Departments and sub-divisions are expected to take into consideration best domestic and international practices when preparing their proposals.</p> <p>In terms of developing individual staff’s skills, the annual appraisal process is used to identify training and development needs that are fed into the various divisions’ training plans. At a more strategic level, the CBR also considers the nature and extent of specific skill sets available within its staff. For example, in the past few years there have been programs to train staff in IFRS and also specialist training made available for Basel 2 implementation.</p> <p>CBR staff noted that it was possible to self nominate for training, and indeed some training is mandatory. There are certification processes to meet in order to transfer to some of the supervisory divisions (such as the Inspectorate) and training is made available to support these needs.</p>
<b>EC8</b>	In determining supervisory programs and allocating resources, supervisors take into account the risk profile and systemic importance of individual banks and banking groups, and the different mitigation approaches available.
Description and findings re EC8	<p>Structurally, the CBR has been reorganized to support a risk based focus and has established a separate division to supervise the systemically important banks: the systemically important banking supervision division (SIBSD). Institutions are identified as systemically important banks under the terms of Ordinance 3737-U, whose methodology is based on the Basel standard. SIBSD operates its own budget. The methodology has been in force since July 2015, and the list of systemically important banks must be assessed and re-issued annually under the terms of the ordinance. See CP16 (EC4) for details on the capital buffer applied to systemically important banks.</p> <p>The appointment of curators and ARs, as well as the frequency and scope of inspections, also reflects risk based allocations. A major or more complex institution will be allocated a team of staff. Systemic institutions and institutions which are in the weaker grading categories are subject to more intensive attention, not least the appointment of an AR. The Chief Inspectorate is going through a process of merging some of its regional offices given declining numbers of institutions in the affected regions.</p>
<b>EC9</b>	Laws provide protection to the supervisor and its staff against lawsuits for actions taken and/or omissions made while discharging their duties in good faith. The supervisor and its staff are adequately protected against the costs of defending their actions and/or omissions made while discharging their duties in good faith.



Description and findings re EC9	<p>There are no special provisions in Russian law regarding protection of the CBR and its staff against lawsuits for actions taken and/or omissions made while discharging their duties in good faith.</p> <p>The CBR noted that, if a suit were brought, the institution itself would act as the defendant and further explained that in instances, for example, of revocation or restrictions, decisions are made collectively by the Banking Supervision Committee. It seemed, therefore, less likely that a lawsuit would be brought against a specific individual.</p> <p>In principle, however, an aggrieved party is able to bring a lawsuit for gross negligence against an individual employee of the CBR. The CBR explained that in such circumstances, it would enter the legal proceedings on the side of the employee and ask the court to exclude the employee from the defendants. The legal fees can be borne by the CBR based on approval by the board. No case of such a suit has ever arisen.</p> <p>In the case of criminal proceedings, an aggrieved party can bring a criminal lawsuit against an employee of the CBR in respect of a criminal act perpetrated against the bank (e.g., bribery, corruption, theft). The order and basis for filing such a claim are stated in the Criminal Procedure Code of the Russian Federation (Articles 140 and 141). There is neither obligation nor prohibition on the CBR to cover the legal fees of its employee in such circumstances, and it would be a board decision to bear the legal costs (if, for example, the CBR believed the case to be frivolous or an attempt to intimidate the CBR or a staff member).</p>
<b>Assessment of Principle 2</b>	<b>Largely Compliant</b>
Comments	<p>The CBR is a respected and authoritative institution. While many governance, accountability, and transparency measures are in place, there are some issues of concern notably in respect of legal protection for staff and transparency of dismissal procedures. There is also scope for improvements in the arrangements of decision making in order to better support and communicate the objectivity and independence of the CBR to external audiences.</p> <p>There is scope for two important enhancements in particular. The first issue is that legal protection for staff carrying out their functions in good faith is not fully in place. Although the assessors appreciate and understand the explanations of the CBR on this issue, it remains the case that there is a legal vulnerability that in future might possibly be exploited maliciously.</p> <p>There is no legal requirement for the reasons for the dismissal of the Governor of the CBR (or of the first deputy governor in charge of supervision) to be disclosed. While it is normal practice for the CBR to issue press releases on the occasion of their departure, it is not mandatory and there is no history of early dismissal. Transparency measures are part of a guard against abuses in any system, and it would be important and fitting for the CBR to benefit from such transparency requirements.</p> <p>There is a governmental and parliamentary role in the appointment of the Chairman and the BoD and two ministers or their representatives may attend the board. There appears to be no operational impact of the appointment process and composition of board and NFB in terms of the supervisory decision making processes, not least because of the delegation of powers to the Banking Supervisory Committee. However, the role of the governing bodies in budget approval and regulatory decision making opens the possibility for an impact on the CBR's supervisory</p>

	<p>function even though, to date, there is no history of any restriction being placed on the CBR. It may be noted that the CBR has only one voice on the NFB as all other representatives come from other institutions or bodies.</p> <p>In terms of achieving an overall balance for the purposes of accountability and for the CBR to fulfill its mandate for developing the financial sector, the presence of the ministries on the CBR Board can be understood. However, with specific respect to regulation on supervisory issues, the authorities may wish to consider arrangements so that there is no ministry participation or observation on regulatory topics.</p> <p>The CBR's stake in Sberbank presents a particular challenge for the CBR in its supervisory capacity as it is important that Sberbank, which in any case is the dominant financial institution in the jurisdiction, is supervised, and seen to be supervised, to the same standards as any other institution. To external observers, however, it is not necessarily easy, or even possible, to distinguish the CBR's broad role in supporting the development of the financial sector, which might be thought to favor Sberbank particularly in the light of the ownership structure, and the CBR's supervisory role. The assessors stress that they have no findings to suggest that there is any question mark over the CBR's exercise of supervision or the governance of Sberbank and the internal separation of the two roles. Nevertheless, while the assessors have no evidence to suggest that the CBR would make or has made regulatory or supervisory decisions that would create preferential treatment for Sberbank, this objective treatment is, by its nature, very hard to demonstrate, particularly to outside observers. The authorities may wish to consider a separate form or structure of state ownership for Sberbank, rather than having the holding rest with the CBR, in order to remove the potential for reputational risk and to provide greater confidence that the supervisory function is not and cannot be inappropriately influenced. Please also see the discussion and recommendations in CP1 related to the objectives of the CBR as this would also assist in diluting any reputational risk to the CBR.</p>
<b>Principle 3</b>	<b>Cooperation and collaboration.</b> Laws, regulations or other arrangements provide a framework for cooperation and collaboration with relevant domestic authorities and foreign supervisors. These arrangements reflect the need to protect confidential information. <sup>18</sup>
<b>Essential criteria</b>	
<b>EC1</b>	Arrangements, formal or informal, are in place for cooperation, including analysis and sharing of information, and undertaking collaborative work, with all domestic authorities with responsibility for the safety and soundness of banks, other financial institutions and/or the stability of the financial system. There is evidence that these arrangements work in practice, where necessary.
Description and findings re EC1	Federal laws, legislative acts and CBR regulations contain several provisions governing the cooperation and collaboration among supervisors and agencies with responsibilities for the stability of the financial system. In practice, cooperation arrangements are determined on the basis of bilateral agreements between the Central CBR and the Federal Service for Financial Monitoring ( <i>Rosfinmonitoring</i> , the Russian FIU), Federal State Statistics Service, the Federal Service for Financial Markets, the Federal Tax Service, the Deposit Insurance Agency, the Federal Service for Financial and Budgetary Supervision (External auditors oversight), the Federal Customs Service, the Federal

<sup>18</sup> Principle 3 is developed further in the Principles dealing with "Consolidated supervision" (12), "Home-host relationships" (13), and "Abuse of financial services" (29).

	<p>Antimonopoly Service, the Federal Registration Service, the Ministry of Internal Affairs, the Prosecutor General's Office of the Russian Federation and the Federal Treasury.</p> <p>Some of the most useful exchanges of information done for supervisory purposes with domestic authorities are with the FIU and the Tax Authority for the purpose of exchanging information on AML/CFT. The CBR is, inter alia, an aggregator of data that are made available to the FIU. The cooperation among the two agencies takes different forms (see CP29). There is also multi-level cooperation among judicial, law enforcement, and financial regulatory authorities in AML/CFT. An example of this is the Interagency Working Group on Combating Illegal Financial Transactions, established by the president of the Russian Federation, and the Interagency Commission for Combating Money Laundering and Terrorist Financing, established by the Russian FIU. These coordinating bodies were created in order to promote effective cooperation and concerted action by all Russian anti-money laundering system participants, including through the involvement of the private sector.</p> <p>Close cooperation has also been established by law with the State Corporation Deposit Insurance Agency for issues relating to crisis prevention, bank resolution, and liquidation. The Federal Financial and Budget Supervision Service of the Minister of Finance provides the CBR with the information on external auditing companies, and the Minister of Internal Affairs assists the CBR in the domain of AML/CFT (data base of lost or fake IDs).</p>
<b>EC2</b>	<p>Arrangements, formal or informal, are in place for cooperation, including analysis and sharing of information, and undertaking collaborative work, with relevant foreign supervisors of banks and banking groups. There is evidence that these arrangements work in practice, where necessary.</p>
Description and findings re EC2	<p>The legal basis for formal cooperation and for information sharing by the CBR with other supervisory authorities is found in Article 51 of the CBL. These provisions set the general conditions under which the CBR is authorized to exchange confidential information.</p> <p>The CBR has concluded 38 formal bilateral arrangements with supervisory authorities of foreign countries in the form of cooperation agreements, memoranda of understanding (MoUs), and statements of cooperation (SoCs) for information exchange. Most close cooperation links are established with supervisory authorities of the following countries: Austria, China, Cyprus, CIS countries (especially countries of the Eurasian Economic Union—Belarus, Kazakhstan, Kyrgyzstan), Germany, Hungary, Latvia. MoUs have also been signed with Italy, Sweden, Finland, and Norway. No MoU has been signed with France however while the country has an important presence through the Société Générale. Between 2012–15, there were around 1–2 visits a year from representatives of the main supervisors of banking groups and foreign banks with subsidiaries of credit institutions in the Russian Federation: Austria, Hungary, Germany, China, Kazakhstan, Latvia, and the Netherlands. There were also visits by representatives of banking supervisory authorities of Korea. These visits can be regular high-level meetings or meetings of experts.</p> <p>In addition, cooperation with the British supervisory agency and the U.S. Office of the Comptroller of the Currency (OCC) was arranged on the basis of the exchange of letters in 2007 and 2009 (these letters are not public). Also, cooperation with some European countries is carried out on an ad hoc basis given previous concerns of some European countries regarding the legal ability of CBR to protect confidential information. The CBL was amended in 2013 to address these concerns and the</p>

	<p>CBR informed about these amendments the Basel Committee on Banking Supervision and the European Banking Authority in due time.</p> <p>Furthermore, during 2014 the CBR continued its cooperation in staff training with foreign partners including the Deutsche Bundesbank, the Bank of France, the Bank of Finland, the Bank of Spain, the Central Bank of Brazil, the Financial Technology Transfer Agency (Luxembourg), the Financial Stability Institute of the Bank for International Settlements (Basel), and others.</p> <p>CBR inspections abroad have been extremely limited so far. In 2014 the CBR carried out an inspection of the Cyprian branch of a Russian credit institution. The representatives of the mission were informed in 2016 on the positive experience of the organization and the inspection itself.</p>
<b>EC3</b>	<p>The supervisor may provide confidential information to another domestic authority or foreign supervisor but must take reasonable steps to determine that any confidential information so released will be used only for bank-specific or system-wide supervisory purposes and will be treated as confidential by the receiving party.</p>
Description and findings re EC3	<p><b><i>Conditions for exchanging confidential information with domestic authorities</i></b></p> <p>Article 26 of the banking law sets the general principle on Bank secrecy. The CBR has no right to disclose or provide to third parties data obtained while performing functions defined by federal laws unless stated in federal laws. Article 57 of the CR law stipulates states that information on specific operations received from legal entities shall not be disclosed without the consent of the corresponding legal entity except for those cases stipulated by federal laws. According to these laws, the CBR is allowed to provide information, including confidential information, to courts and arbitration courts, to the Accounting Chamber of the Russian Federation, to tax and customs authorities, to law enforcement agencies, preliminary investigation bodies, FX control authorities, the Pension Fund, the Social Insurance Fund of the Russian Federation, and other institutions in cases specified by the legislation. Article 57 of the CBL also includes a reciprocal obligation of the CBR to keep confidential any information it receives in the context of these information exchange arrangements.</p> <p><b><i>Conditions for exchanging confidential information with foreign authorities</i></b></p> <p>The conditions for sharing confidential information with banking supervisors of foreign states are laid out in Article 51 of the CBL and Article 26 of the Law on Banks. The CBR has the right to provide to the central bank and (or) other supervisory authority of a foreign state in charge of banking supervision information and (or) documents that they need to exercise supervision, including those that contain bank secrecy data,<sup>19</sup> received from credit institutions, banking groups, bank holdings, and other associations with participation of credit institutions. This covers information collected both during both offsite and onsite supervision. This general principle, however, does not apply for any information or data protected by State secrecy.</p>

<sup>19</sup> "Data Constituting Bank Secrecy" is defined by the Russian Federation in Article 26 of the Banking Activities Law as data on specific transactions and operations of credit institutions and also on transactions and operations of their customers and correspondents received from credit institutions, banking groups and bank holdings and other associations with participation of credit institutions in the course of the discharge of the supervisory functions, including onsite inspections carried out by the CBR.

	<p>Similar information exchange is also permitted by Article 26 of the banking law in the context of cross-border mechanisms for bank resolution. For example, the CBR can provide to home supervisors information contained in financial stability restoration plans for credit institutions that are part of a banking groups.</p> <p>The CBR provides such information and (or) documents to foreign authorities on the condition of reciprocity whereby the recipient country's legal regime should provide equal protection to the information received from Russia and that the transmission to third parties cannot be permitted without the preliminary consent in writing of the CBR, except for cases when such information is provided to a court in a criminal case.</p> <p>The mission received a copy of a cooperation agreement signed with a foreign authority. It was observed that the arrangements include information in connection with the authorization and licensing process, cooperation on ownership control structure, cooperation on offsite supervision of parent institutions and cross-border establishments, information exchange for cross-border resolution, onsite inspections including mutual ones, AML/CFT, etc.</p>
<b>EC4</b>	<p>The supervisor receiving confidential information from other supervisors uses the confidential information for bank-specific or system-wide supervisory purposes only. The supervisor does not disclose confidential information received to third parties without the permission of the supervisor providing the information and is able to deny any demand (other than a court order or mandate from a legislative body) for confidential information in its possession. In the event that the supervisor is legally compelled to disclose confidential information it has received from another supervisor, the supervisor promptly notifies the originating supervisor, indicating what information it is compelled to release and the circumstances surrounding the release. Where consent to passing on confidential information is not given, the supervisor uses all reasonable means to resist such a demand or protect the confidentiality of the information.</p>
Description and findings re EC4	<p>CBR staff is bound by professional secrecy (CBL) and is not allowed to disclose confidential information received from domestic or foreign supervisory bodies, except in the condition stipulated by law. Further, the information received either by domestic or foreign entities should only be used for the performance of the CBR supervisory responsibilities.</p> <p>The information and/or documents received by the CBR from the foreign supervisory authorities may be provided to third persons, for instance law-enforcement bodies, only with the consent of the authority which provided this information, except for providing such information by court order for the proceedings of criminal cases.</p> <p>Requirements to confidentiality protection of information and documents set in cooperation agreements and MoUs also provide for non-disclosure of the received information to third parties without the prior written consent of the originating supervisor. It is also set that confidential information and documents should not be used without the prior written consent of the supervisory authority that provided it for purposes other than those for which it was requested and provided.</p>
<b>EC5</b>	<p>Processes are in place for the supervisor to support resolution authorities (e.g., central banks and finance ministries as appropriate) to undertake recovery and resolution planning and actions.</p>

Description and findings re EC5	<p><b><i>Cooperation with domestic resolution authorities</i></b></p> <p>The fundamentals of interaction between the State Corporation DIA and the CBR are established by Article 27 of Federal Law 177-FZ of December 23, 2003, “On Insurance of Household Deposits in Russian Banks.” This article also states that for the purposes of informational support of the deposit insurance system’s operation, the CBR shall send to the DIA banks’ reports and other necessary information. The framework within CBR and the Agency for information exchange and coordination of actions is defined by an agreement signed in 2014 that covers, inter alia, the insolvency (bankruptcy) of credit institutions.</p> <p>In addition, the Agency is entitled to propose that the CBR inspects a bank or takes measures against a bank. The CBR must reply to the DIA within 15 days on the decision to inspect a bank. Joint inspections by the CBR and DIA are allowed under direction 1542-U of the CBR of January 13, 2005 and Articles 27 and 32 of Law 177-FZ.<sup>20</sup> These inspections are done in respect of matters concerning the extent and structure of these banks’ commitments with regard to depositors, insurance premiums’ payment, as well as these banks’ discharging of other duties established by this Federal Law and are conducted on a regular basis (scheduled) and unscheduled. When a bank exhibits serious sign of distress or constitutes a threat to the stability of the system or to the interest of depositors and creditors the CBR and DIA are authorized to implement rehabilitation measures to prevent the bank’s failure. The CBR can either submit a proposal calling for DIA’s participation in the bank or a proposal for the DIA’s participation in the settlement of a bank’s liabilities.<sup>21</sup> The Plan has to be approved by the BSC. Moreover, during the implementation of the plan, the DIA sends to the CBR monthly reports. In 2014–15 27 banks underwent a resolution process. 45 were subject to a joint DIA—CBR review.</p> <p><b><i>Cooperation with foreign resolution authorities</i></b></p> <p>Pursuant to Article 51 of the Federal Law of the Central CBR and Article 26 of the banking law, CBR can provide the central bank and (or) another authority of a foreign state information contained in the financial stability recovery plans of parent banks or associations, except for the data constituting state secrecy. This process is done on the condition that the legislation of the foreign state stipulates the level of confidentiality for CBR’s documents at least matching the level envisaged by the Russian Federation or in compliance with the international treaties that may regulate these exchanges. This information cannot be shared with third parties without CBR’s consent, except for providing such information to court for criminal case proceedings.</p> <p>Supervisory colleges are also a conduit for cooperation with foreign supervisors. The CBR’s SIBS Department participated in the supervisory college organized by the home supervisor in 2014. The</p>
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<sup>20</sup> These representatives are authorized to enter any premises of the bank, access any documents, records and information systems of the bank as well as to request and receive from the bank employees any information and documents.

<sup>21</sup> When reviewing any of these two types of proposals, the Agency has the right to request additional information regarding the bank’s financial position from the CBR, to make a proposal to CBR or other entities for bankruptcy prevention and to negotiate with management bodies of the bank, its founders (members), and other entities which have contractual relations with the bank on taking measures aimed at preventing bankruptcy or settling the bank’s liabilities.

	frequency of supervisory college meetings where CBR takes part as a host-member is defined by the home supervisory authority. The usual frequency is once a year or two.
<b>Assessment of Principle 3</b>	<b>Compliant</b>
Comments	<p>The CBR is in a position to exchange information and to cooperate with home supervisors over Russian-based subsidiaries of foreign banks through a number of bilateral MOUs. Adequate information sharing arrangements are also in place with all relevant domestic authorities. As indicated above, the CBR has concluded 38 formal bilateral arrangements with supervisory authorities of foreign countries in the form of cooperation agreements, memoranda of understanding (MoUs), and SoCs for information exchange. It is noteworthy however that no MoU has been signed with France while in fact the country has an important presence through the Société Générale.</p> <p>During interviews, assessors were told that the authorities are satisfied with the quality and effectiveness of existing cooperation arrangements. One example of successful inter-agency cooperation is in the area of AML/CFT. As indicated under CP29, the cooperation between the CBR and the FIU led to the closure of Siberia's largest illegal encashment center, carried out by the local law enforcement agencies, the main department of the CBR in the Kemerovo region and Rosfinmonitoring's SFD Directorate. In 2014, the CBR revoked the licenses of two credit institutions of the Kemerovo region. The criminal investigation resulted in criminal charges being brought against one of these credit institution directors and the seizure of approximately RUB 3 billion worth of assets.<sup>22</sup> Cooperation between the CBR and the DIA is also very good.</p> <p>On the international front, the previous 2008 FSAP observed that the text on information exchange with foreign supervisors as contained in the then Article 51 of the CBL prohibited provision of information on individual client transactions to foreign financial sector supervisor. This inability under Article 51 to exchange institution specific and client information left a large gap to be closed. A change in legislation has been made to achieve this. The Federal law 146-FZ of July 2, 2013 has introduced new language in Article 51 that lifted these restrictions. According to the new provision, the CBR is entitled to provide to foreign counterparts information or documents "including those that contain data constituting bank secrecy" provided that the authority receiving such information treats it with the same level of confidentiality as the Russian authorities and that the information does not constitute a state secret. Another legislative reform was made to explicitly empower the CBR to exchange information contained in financial recovery plans (except state secrets) with foreign resolution authorities.</p> <p>Considering the progress made by the Russian authorities in addressing previous flaws in the legal regime for cooperation and collaboration, the rating assigned in 2008 to this CP has been improved from "Largely Compliant" to "Compliant."</p> <p><b>Recommendation:</b></p> <ul style="list-style-type: none"> <li>• Establish a formal mechanism of cooperation with the French Supervisory and Resolution Prudential Authority.</li> </ul>
<b>Principle 4</b>	<b>Permissible activities.</b> The permissible activities of institutions that are licensed and subject to supervision as banks are clearly defined and the use of the word "bank" in names is controlled.

<sup>22</sup> See Rosfinmonitoring activity report 2014.



Essential criteria	
<b>EC1</b>	The term “bank” is clearly defined in laws or regulations.
Description and findings re EC1	<p>The Russian regime as spelled out in the banking law defines a credit institution as a legal entity authorized to carry out banking operations to generate profit as the main goal of its activities, on the basis of a special permit (license) granted by the Central Bank of the Russian Federation. Under this law, all credit institutions fall into the following categories: (i) banks; (ii) nonbanking credit institutions; (iii) nonbanking credit institutions for money transferring without opening of account and (iv) nonbanking credit institutions—central counterparty.</p> <p>A <b>bank</b> is a lending institution that has the exclusive right to perform all of following banking operations:</p> <ul style="list-style-type: none"> <li>• the drawing of deposits from individuals and legal entities</li> <li>• the granting of loans; and</li> <li>• the opening and operation of bank accounts for individuals and legal entities.</li> </ul> <p>Pursuant to Articles 5 and 13 of the banking law, attraction of deposits is permitted only for lending institutions with a bank status.</p> <p>A nonbank lending institution is a lending institution that has the right to perform certain operations only (stipulated by law), e.g., maintenance of bank accounts, money transfers services, cash services). They may also make loans to, and invest in natural persons and their activities. These institutions are licensed and supervised by the CBR.</p>
<b>EC2</b>	The permissible activities of institutions that are licensed and subject to supervision as banks are clearly defined either by supervisors, or in laws or regulations.
Description and findings re EC2	<p>Permissible activities of institutions that are licensed and subject to supervision as banks are defined under the banking law, Article 5 and include the following:</p> <ul style="list-style-type: none"> <li>• attraction of funds for deposit from individuals and legal entities;</li> <li>• placement of the attracted funds referred to under item 1;</li> <li>• opening and maintenance of bank accounts for individuals and legal entities;</li> <li>• performance of money transfers services, including correspondent banking;</li> <li>• cash servicing for individuals and legal entities;</li> <li>• purchase and sale of FX in cash and noncash forms;</li> <li>• attraction of precious metals for deposit and the placement of precious metals;</li> <li>• issuance of bank guarantees; and</li> <li>• performance of money transfers services without the opening of bank accounts, including electronic funds (with the exception of postal money orders).</li> </ul> <p>In addition to banking operations, a lending institution has the right to perform the following transactions: (a) the issuing of sureties for third parties; (b) fiduciary management of funds and other property under a contractual arrangement with individuals and legal entities; (c) operations with precious metals and precious stones in accordance with the legislation of the Russian Federation; (d) leasing operations; and (e) provision of consulting and information services. A bank has also the right to engage in operations involving the issue, purchase, sale, discounting, and safekeeping of securities.</p> <p>Credit institutions are prohibited from engaging in production, trade and insurance activities, although these activities can be conducted by a sister-corporation under a common holding.</p>



	Banking operations are performed solely on the basis of a license issued by the CBR following the procedure established by the banking law (see CP 5 for details).
<b>EC3</b>	The use of the word “bank” and any derivations such as “banking” in a name, including domain names, is limited to licensed and supervised institutions in all circumstances where the general public might otherwise be misled.
Description and findings re EC3	<p>Article 7 of the banking law stipulates that “no legal entity in the Russian Federation, except for those who received a banking license from the CBR may use the word ‘bank’ or ‘credit organization’ in its name or indicate in any other way that the legal entity may carry out banking operations. Exceptions are the CBR and the Bank for Development and Foreign Economic Activity.</p> <p>As observed in the 2008 BCP report, there is no established system to monitor the illegitimate use of the word ‘bank.’ The CBR relies on external sources for media, and other sources. The CBR also regularly receives information about registered credit institutions and other legal entities from the Unified State Register of Legal Entities maintained by the Federal Tax Service.</p>
<b>EC4</b>	The taking of deposits from the public is reserved for institutions that are licensed and subject to supervision as banks. <sup>23</sup>
Description and findings re EC4	In accordance with Articles 1 and 36 of the banking law, the Law on Deposit Insurance, and Chapters 8 and 14 of CBR Instruction 135-I of April 2, 2010, <sup>24</sup> (referred to hereinafter as Instruction 135-I), a bank is granted the exclusive right to accept deposits from the public. A nonbank lending institution is not qualified to attract funds for deposit from individuals.
<b>EC5</b>	The supervisor or licensing authority publishes or otherwise makes available a current list of licensed banks, including branches of foreign banks, operating within its jurisdiction in a way that is easily accessible to the public.
Description and findings re EC5	In accordance with Article 13 of the banking Law and Instruction 135-I, licenses issued by the CBR are recorded in a register. Licenses granted by the CBR are made public by the CBR in an official publication ( <i>Bulletin of the CBR</i> ) at least once a year. Changes and additions to said register are published by the CBR within one month of the date they are made and are posted on a daily basis on the CBR’s website. An announcement of a lending institution’s state registration is also published in the <i>Bulletin</i> above mentioned.
<b>Assessment of Principle 4</b>	<b>Compliant</b>
Comments	There have been several cases of Ponzi schemes in Russia in recent years. According to the data from the Ministry of Internal Affairs of the Russian Federation, there were in 2014 more than 160 organizations that contained certain features of financial pyramids that caused harm to more than nine thousand people. The amount of loss suffered was estimated at RUB 1.7 billion. According the CBR, in none of these cases the perpetrators have used in one way or another, the word “bank,” “banking” to attract and defraud the customers.

<sup>23</sup> The committee recognizes the presence in some countries of nonbanking financial institutions that take deposits but may be regulated differently from banks. These institutions should be subject to a form of regulation commensurate to the type and size of their business and, collectively, should not hold a significant proportion of deposits in the financial system.

<sup>24</sup> On the Procedure for the Adoption of a Decision by the CBR on the State Registration of Lending Institutions and the Issuing of Banking Licenses.

<b>Principle 5</b>	<b>Licensing criteria.</b> The licensing authority has the power to set criteria and reject applications for establishments that do not meet the criteria. At a minimum, the licensing process consists of an assessment of the ownership structure and governance (including the fitness and propriety of board members and senior management) <sup>25</sup> of the bank and its wider group, and its strategic and operating plan, internal controls, RM, and projected financial condition-(including capital base). Where the proposed owner or parent organization is a foreign bank, the prior consent of its home supervisor is obtained.
<b>Essential criteria</b>	
<b>EC1</b>	The law identifies the authority responsible for granting and withdrawing a banking license. The licensing authority could be the banking supervisor or another competent authority. If the licensing authority and the supervisor are not the same, the supervisor has the right to have its views on each application considered, and its concerns addressed. In addition, the licensing authority provides the supervisor with any information that may be material to the supervision of the licensed bank. The supervisor imposes prudential conditions or limitations on the newly licensed bank, where appropriate.
Description and findings re EC1	<p>Articles 56 and 59 of the law on the CBR establish that the CBR is the authority responsible for both licensing banks, and for regulating and supervising them. Article 59 provides the statutory requirements for the licensing of a bank. The CBR has the exclusive right for the issuance of bank licenses and no person shall engage in financial activities without a license issued by the CBR. Foreign banks wishing to establish a subsidiary on the territory of Federation of Russia need also to receive a license from the central bank.</p> <p>The same Article 59 grants to the CBR the power to suspend or reject an application. Article 74 of the same law that complements Article 59 stipulates that <i>“the CBR shall be entitled to revoke the banking license of a credit institution on the grounds established by the Federal Law on “banks and banking activities.”</i> The procedure for revoking a banking license shall be established by CBR normative acts.”</p> <p>It is noteworthy that according to the CBL, the Banking Supervisory Committee of the CBR is exclusively authorized to make decisions on banking license revocation. Under its supervisory capacity, the CBR has the power to impose limitations or additional requirements.</p> <p>The licensing process is under the responsibility of the licensing department, which focuses on two areas, licensing delivery as well as the authorization of major acquisitions and significant transfers of ownership on the one hand, and financial rehabilitation on the other. The department is also responsible for the maintenance of the State Registry of Legal entities. About 70 people—out of 135—are assigned to licensing activities.</p>

<sup>25</sup> This document refers to a governance structure composed of a board and senior management. The committee recognizes that there are significant differences in the legislative and regulatory frameworks across countries regarding these functions. Some countries use a two-tier board structure, where the supervisory function of the board is performed by a separate entity known as a supervisory board, which has no executive functions. Other countries, in contrast, use a one-tier board structure in which the board has a broader role. Owing to these differences, this document does not advocate a specific board structure. Consequently, in this document, the terms “board” and “senior management” are only used as a way to refer to the oversight function and the management function in general and should be interpreted throughout the document in accordance with the applicable law within each jurisdiction.

	<p>In practice, the licensing process is organized as follows. A prospective owner will submit a petition to the CBR territorial branch where the bank will be registered. The local CBR office does the primary vetting, including due diligence in relation to the business qualification, financial soundness, and integrity of the applicants. If the findings are positive, the petition will be forwarded to the CBR head office accompanied by a formal opinion from the head of the territorial branch. The final decision to grant a license rest with the BSC, and the Committee relies on the opinion issued by both the head of the local branch and the head of the licensing department; other departments can also voice their opinion.</p> <p>Once the final decision is made by the BCS, the file is submitted to the tax registration that will confirm the registration of the entity in the State Registration of Legal Entities and Individual Entrepreneurs (Article 12 of the banking law). The applicant has one month to pay the charter capital after which the formal licensing process will begin. The license is signed by one of the Heads of the CBR and forwarded to the head of the competent territorial branch who will formally hand over the license to the bank, which then will acquire the right to operate. Licenses issued to credit institutions are published by the CBR in its official publication (CBR Bulletin) at least once a year.</p> <p>It is directly prohibited for banks to exercise any other kind of activity besides the banking business. However, this prohibition does not apply to operations with financial derivatives – for example, clearing and factoring.</p>
<b>EC2</b>	<p>Laws or regulations give the licensing authority the power to set criteria for licensing banks. If the criteria are not fulfilled, or if the information provided is inadequate, the licensing authority has the power to reject an application. If the licensing authority or-supervisor determines that the license was based on false information, the license can be revoked.</p>
Description and findings re EC2	<p>Criteria for licensing banks are prescribed by the banking law (Articles 10, 11, 11.1, 14, 15, 16, 17, 18, and 23), in the CBL (Articles 4 and 56) and in the CBR Instruction 135-I (Chapters 2–8, 13, 14, 22, 23–28). They set the requirements to be met in order to obtain authorization for banking business. The most relevant information to be provided by the applicants are:</p> <ul style="list-style-type: none"> <li>• article of association;</li> <li>• appropriate information about fitness and propriety of the founders;</li> <li>• documents containing information on the paid in capital of the bank;</li> <li>• documents confirming the sources of funds contributed by individual founders;</li> <li>• a business plan with exhaustive description of the activities to be performed, objectives, policy and strategy of the bank, financial forecast of development over a two-year period;</li> <li>• a questionnaire of candidates to key positions (e.g., chief executive officer and chief accountant) to be filled personally by the candidates providing details about their professional backgrounds, education, lack of criminal records;</li> <li>• description of the managing and organizational structure;</li> <li>• auditor’s conclusions on the authenticity of the financial reports of the founders; and</li> <li>• details on the lay-out of the premises of the future bank, etc.</li> </ul> <p>Based on the information mentioned above (the list is not exhaustive), CBR staff will do its due diligence prior to delivering a license. It will conduct a review of the validity and accuracy of the</p>

materials provided by the applicant. Attention will be paid to the professional qualification and reputation of the prospective founders. Their financial position will be reviewed carefully.<sup>26</sup>

The conditions for refusing (or revoking) a license are clearly stipulated in the law, for example if the applicants submitted false information (Article 16 of the banking law), or if the nominees proposed for senior management positions do not meet the professional requirements set in the law or fail to meet the fit-and-proper requirements (e.g., conviction for *intentional crimes*).

There are other situations where a banking license can be refused. For example, if a nominee has committed more than three times within the year preceding the day of submitting the application<sup>27</sup> an administrative offence in the area of finances, taxes and duties, insurance, securities market, or business activity. Another example is the case where the nominee has been found guilty of bankruptcy of a legal entity in the five years preceding the day of the submission of the applications.

During the interview, the assessors asked whether an unrealistic business plan could lead the CBR to reject an application since such a circumstance is not explicitly contemplated in Article 16 of the banking law. It was indicated that the CBR could base its decision on paragraph 3 of Article 16 according to which a license should be denied in case of "*non-compliance of the documents filed with the CBR*" for obtaining a license.

The founders of a lending institution are notified in writing of a decision to refuse to proceed with the state registration of the lending institution and to issue a banking license to the lending institution. The reasons for the decision must be provided.

In practice, the due diligence process is performed as follows. The CBR will review fit and proper requirements as well as the professional qualifications that have to be met on an ongoing basis (Article 16 of the banking law). These checks will apply to both individuals as well as to the beneficial owners of a legal entity owning more than 10 percent of the capital. If the applicants/founders are found not to be fit anymore, the CBR can require their replacement. To verify that the applicants do not have any criminal records or have no previous disqualification, the CBR has the power to consult the Tax administration, the Ministry of Interior affairs, and request any specific information to external parties including foreign counterparts (e.g., bank supervisors, Interpol). While it is usual practice to meet the applicants at the branch office, such meetings are rarer at the Head office.

Over the past five years, 49 applications for commercial banking licenses have been received by the CBR from domestic entities. The CBR refused state registration to 25 credit institutions (four of them twice), because of the founders' unsatisfactory financial standing and the non-compliance of documents. Also, eight applications for commercial banking licenses have been received from foreign entities and all have been processed. There have been, however, multiple revocations of licenses (see CP 11 for details).

<sup>26</sup> Corporate founders should be registered in accordance with the procedure established by applicable legislation, be in business for at least three years, have a satisfactory financial standing and fulfill obligations to the federal, regional and local budgets during the past three years.

<sup>27</sup> For a registration and license.

<b>EC3</b>	The criteria for issuing licenses are consistent with those applied in ongoing supervision.
Description and findings re EC3	<p>Licensing criteria are consistent with ongoing supervision and need to be met throughout the life of the bank. Criteria include complying with executives to meet fit and proper criteria, the entity to meet prudential standards, have adequate internal control and RM systems in place, adequate human resources, etc.</p> <p>It is also noteworthy that pursuant to Article 44 of the law on deposit insurance, a bank petitioning for a permit of the CBR, shall be deemed to satisfy the requirements with regard to the participation in the deposit insurance system. Permission will be given if (i) the bank's recording and reporting is deemed reliable by the CBR; (ii) the bank adheres to the obligatory normative standards established by the CBR; and (iii) if the bank's financial stability is deemed sufficient by the CBR.</p>
<b>EC4</b>	The licensing authority determines that the proposed legal, managerial, operational and ownership structures of the bank and its wider group will not hinder effective supervision on both a solo and a consolidated basis. <sup>28</sup> The licensing authority also determines, where appropriate, that these structures will not hinder effective implementation of corrective measures in the future.
Description and findings re EC4	<p>Pursuant to the banking law and the CBR Instruction 135-I, a candidate for a license has to submit a set of materials, including but not limited to, the charter and/or founding agreement of the aspiring lending institution, its business plan, and documents concerning candidates for the lending institution's senior management positions. The bank's charter must contain, among others, (i) the company name; (ii) an indication of its organizational-legal form; (iii) information about the address (location) of the management bodies and separate subdivisions; (iv) a list of banking operations and transactions to be performed; (v) a business plan; and (vi) information about the system of management.</p> <p>In light of the information provided by the applicant, the organizational structure of the bank is vetted both in terms of the management structure of the organization and the capacity of the structure to facilitate sound RM and internal control systems. The CBR reviews all relevant data comprising, inter alia, a description of the managing and organizational structure including the activities of individual organizational units, distribution of responsibilities among managing directors and other administrators, organization and management of the bank's information system, etc. The CBR process also entails the analysis of the business plan with a focus on the activities to be performed, customer and product structure, objectives, policy and strategy of the bank, and financial forecast.</p> <p>During this process, attention will also be given to information about the bank's participation in banking groups and bank holding companies, as well as information about the founders (partners) and their groups, with the view to identify persons who are not founders (partners) of the lending institution but who have the ability, directly or indirectly, to exert a significant influence on the decision-making process of the institution's management bodies (see CBR Directive 1176-U).</p> <p>In conclusion, the CBR has the power to determine whether the ownership structure of the bank can hinder effective supervision or hinder effective implementation of corrective measures in the future. Both the banking law and other regulations provide sound legal basis for the CBR to exercise judgment of whether proposed structures will inhibit effective supervision.</p>

<sup>28</sup> Therefore, shell banks shall not be licensed. (Reference document: BCBS paper on shell banks, January 2003.)

<b>EC5</b>	The licensing authority identifies and determines the suitability of the bank's major shareholders, including the ultimate beneficial owners, and others that may exert significant influence. It also assesses the transparency of the ownership structure, the sources of initial capital and the ability of shareholders to provide additional financial support, where needed.
Description and findings re EC5	<p>The requirement for assessing the suitability of banks' major shareholders and others that may exert significant influence can be found in different norms, the banking law (Articles 11, 16), the Ordinance 2005-U, the CBR Regulation 354-P and CRB Regulation 408-P.</p> <p>Based on the current regulation, only shareholders with stakes higher than 10 percent should be vetted. This threshold has been lowered from 20 to 10 since the last BCP update in 2011. Shareholders with interests of more than 1 percent are required to inform the CBR of their acquisition. Holders of 10 percent or more of stock in a credit institution need to obtain permission from the CBR to obtain these shares. Criteria include a stable financial situation and business activity for at least three years. In accordance with the regulation, a founder or shareholder with more than 10 percent of the shares of a credit institution shall also have sufficient own resources to contribute to the charter capital of the credit organization and have a stable financial position. Grounds on which permission can be refused by the CBR include an unsatisfactory financial position, violation of anti-monopoly rules, conviction of fraudulent bankruptcy, or having caused damage to a credit institution where the acquirer of the shares had been employed earlier.</p> <p>Financial suitability (financial condition) of shareholders is assessed also on the basis of the Regulation 415-P of February 18, 2014<sup>29</sup> that sets the condition of banks to join the Deposit Insurance System. In accordance with Article 44 of this law, banks that are participating in the safety net mechanism must meet the requirements imposed by the CBR for transparency of the ownership structure and also comply with the procedure established by the CBR on disclosure of persons having control or exercising a significant influence over the bank.</p> <p>Moreover, a recent directive issued in 2014 by the CBR 3277-U<sup>30</sup> provides further guidance on the evaluation to be made by CBR staff of a set of indicators or indices of transparency in ownership structure. These indicators relate to the following: (i) sufficiency of the information disclosed about the bank's ownership structure in accordance with federal laws and regulatory acts of the CBR (indicator PU1); (ii) availability of information about persons controlling the bank or with a significant influence (PU2); and (iii) significance of the influence of residents of offshore zones on the bank's management (PU3). The evaluation of these indices is performed on the basis of the method presented in Annex 9 to CBR Ordinance 2005-U. While these indicators among others are used for determining bank's financial position, there are also relevant for licensing purposes, according to the CBR.</p> <p>The mission was informed that sources of funds to be used as capital is verified by the CBR. As stipulated in the banking law (Article14, Section 7), in order to obtain a state registration and a</p>

<sup>29</sup> On the Procedure and Criteria for Evaluating the Financial Condition of Individuals Who Are Founders (Partners) of a Lending Institution and Individuals Performing Transactions Aimed at Acquisition of Stock (Shares) of a Lending Institution and/or at Establishing Control over a Lending Institution's Stockholders (Partners).

<sup>30</sup> Of June 11, 2014, on Methods for Evaluating a Bank's Financial Stability for the Purposes of Finding it Sufficient for Participation in the Deposit Insurance System.

	<p>banking license, the applicant must submit to the CBR a document (according to a list established in CBR regulatory acts) confirming the origin of funds contributed by its founders to its authorized capital. Besides, onsite inspection can be carried for control of legitimacy of payment by acquirers of shares of credit institution as stipulated in Item 17.6 of Instruction 135-I.</p> <p>It is required by law that banks should disclose on their website information about the persons which exercise control or exercise significantly influence on the bank.</p>
<b>EC6</b>	A minimum initial capital amount is stipulated for all banks.
Description and findings re EC6	The law stipulates that banks must have a minimum initial capital of at least RUB 300 million. To obtain the right to attract individuals' funds on deposit, a newly registered bank (bank for which less than two years have passed since its date of state registration) must have authorized capital (equity/capital) of at least RUB 3.6 billion.
<b>EC7</b>	<p>The licensing authority, at authorization, evaluates the bank's proposed board members and senior management as to expertise and integrity (fit and proper test), and any potential for conflicts of interest. The fit and proper criteria include: (i) skills and experience in relevant financial operations commensurate with the intended activities of the bank; and (ii) no record of criminal activities or adverse regulatory judgments that make a person unfit to uphold important positions in a bank.<sup>31</sup></p> <p>The licensing authority determines whether the bank's board has collective sound knowledge of the material activities the bank intends to pursue, and the associated risks.</p>
Description and findings re EC7	<p>The persons performing administrative, managerial or control functions (which include board members, senior managers, chief accountants and their deputies) according to Article 60 of the CBL must satisfy the experience and integrity requirements established by Article 60 of the CBL, Article 16 of the banking law (that was introduced in 2013) and CBR Regulation 408-P.<sup>32</sup> These requirements are also applied to the managers and chief accountant of branches.</p> <p>It is also important to note that, in accordance with the requirements established under the new Article 11<sup>1-2</sup> of the Banking law (introduced in 2013), persons holding the position of manager of the RM function, manager of the internal audit function, or manager of the internal control function must meet the business reputation requirements established by the banking law as well as the qualifications requirements established by CBR Directive 3223-U of April 1, 2014<sup>33</sup> (e.g., a higher education in law, economics or in relevant fields, and qualifications in the area of RM/internal control, and/or auditing, as well as professional experience).</p> <p>The banking law stipulates in its Article 14 (8) the different steps to be followed to assess conformity with fit and proper requisites. A questionnaire needs to be filled out by candidates for the positions mentioned above. The questionnaire requires information about education and experience in relevant fields, as well the absence of a criminal record. For CBR's review, supporting documents will be submitted, including the original of a statement of the existence (absence) of a conviction issued</p>

<sup>31</sup> Please refer to Principle 14, Essential Criterion 8.

<sup>32</sup> Of October 25, 2013 «On the Procedure for Assessment of Compliance with Qualification and Reputational Requirements of Persons Cited in Article 11.1 of the Federal Law on Banks and Banking Activities and Article 60 of the Federal Law on the Central Bank of the Russian Federation (CBR) and on the Procedure for Maintenance of the Database Envisaged by Article 75 of the Federal Law on the Central Bank of the Russian Federation.

<sup>33</sup> On Requirements for Managers of the Risk Management Function, Internal Control Function, and Internal Audit Function of a Lending Institution.



	<p>by the Russian Federation Ministry of Internal Affairs and any other supporting documents proving the level of education of the applicants (university degree, advanced training certificate).</p> <p>According to Article 16 of the banking law, the license can be denied if the nominees lack a university educational level in law, economics, or finance, or does not have senior banking experience, or have been convicted of an economic crime or administrative offence, has been dismissed from a previous position within two years prior to the nomination from a position in bank management, and lacks sufficient business reputation. The CBR evaluates the applications and may conduct its own investigation. The assessment of expertise and integrity obligations is performed according to the requirements of the Chapter 2 of the Regulation 408-P. If the requirements are not satisfied by the applicants, the CBR should deny the license.</p> <p>The quality of members of the executive bodies and other key corporate officers (e.g., chief accountant and its deputies) is evaluated by the CBR not only on the basis of the information provided by aspiring banks but also in light of other sources of information available, including external sources. Article 60 of the CBL empowers the CBR to contact and solicit information to the “federal bodies of executive powers” (see EC 2).</p> <p>In accordance with Article 75 of CBL and Regulation 408-P (Chapter 5) CBR (regional CBR offices) keep a database on the persons who occupy the positions specified in Article 60 of CBL (nominees for said positions), the other employees of credit institution, and the other persons whose activities are conducive to the deterioration of the financial state of a credit institution or to the breach of the legislation of the Russian Federation and normative acts of the CBR. For the purposes of keeping the database, the Bank of Russia is entitled to request information from federal executive governmental bodies, the territorial bodies thereof, and from legal entities.</p> <p>The CBR keeps track of the identities of senior managers and board members that have been proven unsuitable.</p> <p>Ordinance 3624-U of April 15, 2015 setting the requirements for risk and capital management defines the expectations in terms of a board member’s duties. The latter should understand the material activities that the bank intends to pursue, and the associated risks and set appropriate limits and policies commensurate of the bank’s business (see CP 15 more details).</p>
<b>EC8</b>	<p>The licensing authority reviews the proposed strategic and operating plans of the bank. This includes determining that an appropriate system of CG, RM, and internal controls, including those related to the detection and prevention of criminal activities, as well as the oversight of proposed outsourced functions, will be in place. The operational structure is required to reflect the scope and degree of sophistication of the proposed activities of the bank.<sup>34</sup></p>
Description and findings re EC8	<p>In the banking law, Article 14, prospective banks should submit to the CBR a set of documents to support their request for a license. The procedure for the preparation of a business plan and the criteria for its evaluation are established by regulatory acts of the CBR (Directive 1176-U). This includes (i) a business plan with exhaustive description of the activities to be performed, customer and product structure, objectives, policy, and strategy of the bank, financial forecast of development</p>

<sup>34</sup> Please refer to Principle 29.



	<p>over a three-year period; (ii) the organizational structure; and (iii) information on the internal audit function and risk management functions.</p> <p>A business plan is the document to be approved by a general meeting of a lending institution's founders (partners) for the next two years, at a minimum, and should contain the proposed program of action for the prospective bank, including the parameters (indicators) and expected results that will enable the CBR to evaluate bank's ability to ensure financial stability and profitability, among other things.</p> <p>To this end, the applicants are required to submit the following information:</p> <ul style="list-style-type: none"> <li>• estimated balance sheet;</li> <li>• structure of assets and liabilities;</li> <li>• expected financial forecast;</li> <li>• estimated profitability; and</li> <li>• projection of compliance with required ratios and reserve requirements.</li> </ul> <p>At its own discretion, a bank may also present projected indicators for a longer period than two calendar years.</p> <p>On the basis of these estimated indicators, an analysis is performed by CBR staff about the business operations, the sectors of activity, operations, and services in which the bank intends to engage in. Particular attention is given to the volume and structure of projected income, expenses, and profit.</p> <p>In addition to financial information, the process requires submission of policies and procedures for CG, RM, and internal controls. The CBR seeks to ensure that the CG, RM, and internal controls are commensurate with the planned scale and complexity of the proposed banking activities.</p>
<b>EC9</b>	The licensing authority reviews pro forma financial statements and projections of the proposed bank. This includes an assessment of the adequacy of the financial strength to support the proposed strategic plan as well as financial information on the principal shareholders of the bank.
Description and findings re EC9	As indicated above, the CBR requires applicants to provide financial forecasts and calculations of capital adequacy. Part of this involves assessing the bank's ability to reach and maintain profitability and to comply with the prudential rules during the start-up of operations. The CBR assesses the viability and sustainability of the proposed business plan, having regard to the strategy, organizational structure and volumes of business that the bank proposes to achieve and the expected outturn.
<b>EC10</b>	In the case of foreign banks establishing a branch or subsidiary, before issuing a license, the host supervisor establishes that no objection (or a statement of no objection) from the home supervisor has been received. For cross-border banking operations in its country, the host supervisor determines whether the home supervisor practices global consolidated supervision.
Description and findings re EC10	The procedure for the registration of lending institutions with foreign investments is established by CBR Regulation 437 of April 23, 1997. <sup>35</sup> In accordance with the provisions of Chapter 2 of this regulation, the set of documents submitted to the CBR by prospective applicants includes written consent from the relevant home supervisor of the foreign legal entity for the participation in the initial capital of a lending institution located in the Russian Federation.

<sup>35</sup> On Specific Aspects of the Registration of Lending Institutions with Foreign Investments.

	<p>It is worthwhile noting that credit institutions with a general license may set up branches or subsidiaries in a foreign state after obtaining permission from the CBR, and representative offices after notifying the CBR. The CBR shall inform the applicant in writing, no later than within three months from the moment of receiving the respective request, of its consent or refusal. The refusal shall be well-grounded. If the CBR fails to inform of the decision within the specified term, the respective permission of the CBR shall be considered obtained. (Article 35 of the banking law).</p> <p>The mission could not confirm whether, in the course of the licensing process, the CBR determines if the home supervisor practices global consolidated supervision.</p>
<b>EC11</b>	The licensing authority or supervisor has policies and processes to monitor the progress of new entrants in meeting their business and strategic goals, and to determine that supervisory requirements outlined in the license approval are being met.
Description and findings re EC11	Based on the discussion with the CBR, it was not clear whether the CBR has established policies and processes to monitor the progress of new entrants in meeting their business and strategic goals, and to determine that supervisory requirements outlined in the license approval are being met.
<b>Assessment of Principle 5</b>	<b>Largely Compliant</b>
Comments	<p>The Russian licensing regime for banks appears to be exhaustive. The legal and regulatory framework provides the CBR a set of instruments and tools to ensure that the licensing process is sound. The CBR retains adequate powers to require applicants and potential shareholders to submit all information required. In particular, the CBR makes sure that applicants submit, among other things, financial and business reputation information on the founders of the bank, the ownership structure of the bank, including information on the group, as appropriate. Further, the mechanisms for evaluating the business reputation of persons serving in the management bodies of lending institutions, including major owners of lending institutions is done at the licensing stage but also during the life cycle of the bank. Applicants must be fully current in any tax payments.</p> <p>Management and board members must meet fit and proper qualifications, including the absence of a criminal record. In that regard, in past FATF mutual evaluations, the Russian Federation was criticized for being vulnerable to criminal ownership of financial institutions.<sup>36</sup> In 2013, amendments to the law were made to tighten the requirements for the senior managers, board members, and the founders (shareholders) of credit institutions. The threshold for approval of shareholders has therefore been lowered from 20 percent to 10 percent, improving the conditions to verify transparency in ownership structure.</p> <p>In its licensing process, the CBR also informed the mission that all efforts were made to ensure transparency in ownership structure of applicants. Over the past 5 years, the CBR registered 31 newly established credit institutions, of which 7 with the participation of foreign capital. In all cases, the CBR did not encounter problems in identifying the UBO.</p> <p>Nevertheless, there are a few aspects described below that would merit attention or further consideration from the authorities.</p>

<sup>36</sup> FATF, 2008 MER, pages 115–116, paragraphs 508–511.

The persons performing administrative and managerial functions (which include board members and senior managers) must satisfy the experience and integrity requirements established by Article 16 of the banking law. However, the mission observed the following aspects:

- The professional qualifications required for applicants could be strengthened. According to the banking law, Article 16, a prospective candidate for a banking license must have proper education background (e.g., a university degree in relevant fields) as well as at least one-year working experience in managing a credit institution and, in the absence of a “special education,” at least two-year working experience. It is a fact that there is no particular standard when it comes to the minimum qualification required for such positions and there are countries where the law does not require anything. But there are also instances where the minimum years of previous experience is higher than one year.<sup>37</sup> Even though longer professional exposure does not necessarily guarantee the true suitability of a candidate, a threshold of one year may send a wrong signal that fit-and-proper requirements are not so important. Assessors are of the view that the high number of licenses revoked in Russia for mismanagement over the past years militates in favor of stricter requirements in that regard. The authorities are encouraged to reconsider the minimum legal requirement.
- In the same vein, according to the banking law, a nominee who has been found guilty of mismanagement (e.g., for causing the bankruptcy of a legal entity) in the five years preceding the day of submitting a petition for a license does not meet the criteria for business reputation. This seems to suggest that conversely, a person who mismanaged a company six years before petitioning is eligible for a bank license. The same holds true for nominees having committed no less than three times within the year preceding the day of submission an administrative offense in the area of finances, taxes, insurance, and securities market. In that regard, the mission welcomes the proposed revision of Federal Law 779566–6 to expand the term of prohibition to take a position of senior managers specified in Article 60 of CBL for persons found guilty of misconduct causing bankruptcy of legal entity, revocation of license of the credit institution, appointment of temporary administration, and other law violations from five to ten years.
- While the licensing procedures are thorough, in the case of incoming branches or subsidiaries of cross-border banking groups, the mission was not able to determine that the CBR routinely establishes whether the home supervisor practices global consolidated supervision (please see also CP12). The mission recognizes, however, that, at present, there are restrictions on foreign establishments in the Russian Federation.

Once the license has been issued, there is no specific mechanism to monitor the progress of new entrants in meeting their business and strategic goals, and to determine that supervisory requirements outlined in the license approval are being met.

<sup>37</sup> Minimum required experience in Italy is three years (five years for the chairman) for banks. In Germany, “a person shall normally be assumed to have the professional qualifications if he can demonstrate three years’ managerial experience at an institution of comparable size and type of business.” In Spain, suitable professional experience requires at least five years’ experience in banking activities in senior/managerial positions.

	<p><b>Recommendations:</b></p> <p>The Russian authorities may wish to consider the following:</p> <ul style="list-style-type: none"> <li>• amend the banking law to establish a life ban from the banking industry of people who have committed gross and recurrent violations;<sup>38</sup></li> <li>• establish formal procedures to subject the newly established bank to follow up close offsite supervision and if necessary onsite inspection to ascertain that the bank is performing according to the terms and conditions of the license;</li> <li>• establish formal mechanism at the CBR head office level for interviewing applicants. The content and objective of these interviews should also be specified;</li> <li>• when a new bank belongs to a group, ensure that controlling/parent entity closely follow the performance of the new entrant.</li> </ul>
<b>Principle 6</b>	<b>Transfer of significant ownership.</b> The supervisor <sup>39</sup> has the power to review, reject and impose prudential conditions on any proposals to transfer significant ownership or controlling interests held directly or indirectly in existing banks to other parties.
<b>Essential criteria</b>	
<b>EC1</b>	Laws or regulations contain clear definitions of “significant ownership” and “controlling interest.”
Description and findings re EC1	<p>The regime regarding transfer of significant ownership is governed by several provisions of the CBL, the banking law and CBR instruction 146-I of October 25, 2013 on “the procedure for receiving the CBR’s consent to acquisition of credit institutions’ shares”. Other relevant norms include CBR Regulation 2005-U and Regulation 345-P. These provisions empower CBR to (i) approve such transactions; (ii) lay out the criteria for approval of the transfer; (iii) stipulate the grounds for rejection of the transaction; and (iv) describe the possible sanction of an ownership interest gained without going through the regulatory process (Article 11 of the banking law).</p> <p>There is no specific definition of “qualifying interest” in the Russian law but it is understood that any acquisition of voting rights above 10 percent provides such qualification. A controlling interest is not defined either but it is also understood as a relationship in which a shareholder owns directly or indirectly the majority of voting rights (more than 50 percent), and de facto determines the policies or practices of the institution, or exercises control over it. CBR Instruction 146-I and other relevant norms<sup>40</sup> refer in fact to the notions of control and significant influence as defined by the</p>

<sup>38</sup> This proposal is recognized in draft Federal Law 779566-6 “On Amending Certain Laws of the Russian Federation with Regard to Improvement of Mandatory Requirements for Founders (Participants), Governing Bodies and Officials of Financial Institutions” (hereafter draft of Federal Law 770566-6).

<sup>39</sup> While the term “supervisor” is used throughout Principle 6, the Committee recognizes that in a few countries these issues might be addressed by a separate licensing authority.

<sup>40</sup> CBR Regulation 345-P of 10/27/2009, “On Procedures for Banks’ Disclosure of Information About Persons/ Entities Having Control of or Material Influence on Bank Members of the System for the Mandatory Insurance of Individuals’ Deposits in Russian Federation Banks” (hereinafter, “Regulation 345-P”) and CBR Directive 2005-U of 4/30/2008, “On Assessment of Banks’ Economic Condition” (hereinafter, “Directive 2005-U”) establish that control and material influence with respect to a lending institution exerted by an investor singly or as a member of a group of persons/

	<p>International Financial Reporting Standard (IFRS) 10 on Consolidated Financial Statements and IAS 28 on Investments in Associates and Joint Ventures. As indicated by the CBR, these criteria are dominant in deciding whether an investor is exercising control and/ or material influence. However, other evidence may also be taken into consideration to demonstrate the materiality of significant ownership.</p> <p>The concept of a group of persons/ entities is established in Article 9 of the Federal Law On Protection of Competition.</p>
<b>EC2</b>	<p>There are requirements to obtain supervisory approval or provide immediate notification of proposed changes that would result in a change in ownership, including beneficial ownership, or the exercise of voting rights over a particular threshold or change in controlling interest.</p>
Description and findings re EC2	<p>The regime contains provisions whereby changes in ownership or the exercise of voting rights over a certain threshold require CBR intervention. Such changes are made upon the written approval of the CBR issued in accordance with the Instruction 146-I, which gives the CBR to power to enforce the “fit and proper” requirement in case significant transfer of ownership has not been vetted by the CBR (Chapter 3 of the Instruction).</p> <p>As set forth in CBR Instruction 146-I and Article 11 of the banking law, a preliminary consent of the CBR is needed when the holdings of a natural or legal person are reaching or exceeding the thresholds of 10 percent of the shares. The same approval is required when holdings of the same persons mentioned above are becoming “qualifying.” In effect, as detailed below, the CBR’s preliminary consent is required when a buyer (legal entity or an individual) or a group of persons<sup>41</sup> intend to acquire:</p> <ul style="list-style-type: none"> <li>• more than 10 percent but not more than 25 percent of the stock of a lending institution;</li> <li>• more than 10 percent but not more than one-third of the shares of a lending institution;</li> <li>• more than 25 percent but not more than 50 percent of the stock of a lending institution;</li> <li>• more than one-third but not more than 50 percent of the shares of a lending institution;</li> <li>• more than 50 percent but not more than 75 percent of the stock of a lending institution;</li> <li>• more than 50 percent but not more than two-thirds of the shares of a lending institution;</li> <li>• more than 75 percent of the stock of a lending institution;</li> <li>• more than two-thirds of the shares of a lending institution.</li> </ul> <p>For changes not exceeding 10 percent of holdings, a simple notification to the CBR is required.</p> <p>Instruction 146-I also defines circumstances for which a prior consent of the CBR will be needed. This includes entry of the credit institution’s shares into the authorized capital of legal entities which are not credit institutions (Section 1.1.7—see CP 7) or the acquisition of ownership by way of legal succession, as a result of reorganization of the credit institutions’ shareholders (partners) in the form of affiliation, branching off, division or merger.</p>

entities shall be determined in accordance International Financial Reporting Standard (IFRS) 10, “Consolidated Financial Statements,” and IAS 28, “Investments in Associates and Joint Ventures.”

<sup>41</sup> Recognized as such in accordance with Federal Law 135-FZ of July 26, 2006, on the Protection of Competition (referred to hereinafter as the Law on the Protection of Competition).

	<p>There are also cases for which subsequent consent from the CBR are necessary. It is the case for example where the establishment of control over the credit institution's shareholders is effected in case of the public placement of shares.</p> <p>The petition for obtaining CBR prior consent should be submitted to the competent department at the CBR's territorial institution that will perform the primary diligences and vetting process. A petition for CBR's preliminary or subsequent consent for acquisition of shares by a non-resident legal or natural person shall be filed directly to the Licensing department of the CBR.</p>
<b>EC3</b>	<p>The supervisor has the power to reject any proposal for a change in significant ownership, including beneficial ownership, or controlling interest, or prevent the exercise of voting rights in respect of such investments to ensure that any change in significant ownership meets criteria comparable to those used for licensing banks. If the supervisor determines that the change in significant ownership was based on false information, the supervisor has the power to reject, modify or reverse the change in significant ownership.</p>
Description and findings re EC3	<p>As a result of the quality assessment of the proposed acquirer, the CBR will issue or refuse to issue the permission. Clearance will be given only if the CBR is assured of the suitability and adequacy of the quality of the proposed acquirer, including its financial strength and qualified experience. In that respect, CBR due diligence will be comparable to those applied for licensing.</p> <p>Pursuant to Regulation 146-I, the CBR assesses the petition and makes a determination based on a set of materials to be produced by the petitioner. The CBR staff pays due consideration to the financial position of the acquirer and to its business reputation (Chapter 3; also Article 11 of the banking law). The CBR will complete its evaluation of the project within ten calendar days from the day of obtaining the above enquiry.</p> <p>According to Article 11 of the banking law, as well as item 8.1 of Instruction 146-I, the CBR has the right to reject any proposal for a change in significant ownership or controlling interest in cases stipulated in the regulation: for example, if the financial standing of the acquirer is found to be unsatisfactory or if he has an unsatisfactory business reputation. The refusal can also be made in case of violation of antimonopoly rules and if the petitioner has been found guilty of causing losses to any lending institution in the performance of his duties as a member of the BoD, as the chief executive officer or a deputy chief executive officer, and/or as a member of a collegial executive body (executive board, senior management).</p> <p>The regulation also states that there are other grounds provided for by federal laws and regulatory acts of the CBR on which a rejection can be made. It can be inferred from this that the CBR can exercise its prudential judgment for assessing the project and rejecting a petition that may weaken bank's depositors' interest. This point was confirmed to the assessors during the mission.</p> <p>No later than 30 days after the receipt of a petition, the CBR is obliged to notify the applicant in writing of its consent or refusal. Should the CBR fail to make its decision known within the period indicated above, the corresponding transaction is deemed to be approved.</p> <p>As stipulated in the banking law (Article 11), the CBR is empowered to reverse a change that was based on false information. There are two ways to go about it (see EC 4 below).</p>

	In 2015, territorial branches of the CBR issued 337 decisions in relation to transfers of ownership, of which 141 were rejected. The decisions (authorization or refusal) are captured in a registry along with the reasons for rejecting the petition. There is also a weekly reporting of all major transfers to CBR senior management.
<b>EC4</b>	The supervisor obtains from banks, through periodic reporting or onsite examinations, the names and holdings of all significant shareholders or those that exert controlling influence, including the identities of beneficial owners of shares being held by nominees, custodians and through vehicles that might be used to disguise ownership.
Description and findings re EC4	<p>The reporting mechanism to the CBR is spelled out in Instruction 135-I that establishes the procedure for submitting information on shareholders to a regional office of the CBR.</p> <p>For a credit organization having the form of a joint-stock company, the reporting should include a list of participants in the bank. Any change that has occurred in the composition of the shareholders accounting for over 1 percent of the credit organization's charter capital has to be reported within ten calendar days after the end of the quarter. All shareholders with a stake of more than 1 percent must be included, as well as beneficial owners.</p> <p>For a lending institution operating as a limited liability company, the report to the regional office of the CBR should include a list of participants. If a change has occurred in the composition of participants in the credit organization and/or the amounts of their stakes has changed, the information has to be reported within 10 calendar days after the time of the change, together with properly attested copies of documents confirming the acquisition of shares in the charter capital of the credit organization.</p> <p>In addition, the Law on Deposit Insurance,<sup>42</sup> which regulates the transparency of ownership of insured institutions, is an important step forward in promoting greater transparency in banks' ownership. CBR is entitled to obtain from banks that are participants in the deposit insurance system information about their ownership structure, including the ultimate beneficiaries, and to monitor on an ongoing basis the transparency of the ownership structure of these banks. Also, through the Directive 3277-U, the CBR has developed indicators for assessing transparency of the ownership structure and the methodology for their evaluation.</p>
<b>EC5</b>	The supervisor has the power to take appropriate action to modify, reverse or otherwise address a change of control that has taken place without the necessary notification to or approval from the supervisor.
Description and findings re EC5	The banking law (Article 11-3 introduced in 2013) contains some enforcement provisions that allow the CBR to address changes of control above 10 percent that were not vetted by the CBR. In that case, the CBR can issue an order requesting the acquirer to submit a formal request to the CBR. This order will be sent to the interested parties no later than 30 days from the date on which the violation is discovered. The acquirer is required to correct the situation within 90 days of the date such a document is received. In the meantime, the acquirer has the right to vote only on the credit institution's shares that do not exceed 10 percent. The remaining shares that have been wrongly acquired are not voting shares and are not taken into account in determining a quorum at the general assembly's meeting.

<sup>42</sup> Federal Law 177-FZ of December 23, 2003, On Insuring the Deposits of Individuals in Russian Federation Banks (hereinafter, "Law on Deposit Insurance").



	<p>If the CBR order is ignored or not observed within the established deadline, the supervisor is entitled to turn to the court to nullify or rescind the voting rights in question. In that regard, it is important to note that Article 168 Civil Code (CC) provides that a transaction that does not meet the requirements of the law or other legal acts is null and void.</p> <p>During the discussion with the authorities, the mission was told that all CBR's orders were followed in one way or another.</p>
<b>EC6</b>	Laws or regulations or the supervisor require banks to notify the supervisor as soon as they become aware of any material information which may negatively affect the suitability of a major shareholder or a party that has a controlling interest.
Description and findings re EC6	There is no such requirement in the Russian law. However, as indicated by the authorities, within the context of the disclosure of information by lending institutions about the ownership structure, the CBR monitors changes in the composition of the stockholders of lending institutions and their ultimate owners.
<b>Assessment of principle 6</b>	<b>Compliant</b>
Comments	<p>As described above, Regulation 146-I sets the procedure for preliminary approval by the CBR for the purchase of qualified holdings of credit institutions (over 10 percent) and establishment of direct or indirect control in respect to shareholders. On the basis of this law amended in 2013, if more than 1 percent of the shares of a credit institution is acquired, the CBR will need to be notified. If more than 10 percent is acquired, the CBR needs to give prior consent (Article 1). Prior consent is again required when 25 percent, 33 percent, 50 percent, 66 percent, and 75 percent are acquired. The Law also lays out the grounds for refusal, which are very broad and contain references to business reputation, previous convictions, lack of relevant education or experience. These same grounds can also be used to refuse a managerial or board position, or other controlling positions.</p> <p>Another important norm is provision 415 of February 2014 that establishes the procedure and criteria of financial standing of legal entities, individual shareholders, and individuals who enter into transactions aimed at acquiring qualifying interest and/or control. The possibility to reverse changes that were not approved by the CBR has also been introduced in the law.</p> <p>According to the CBR, in evaluating the project leading to the transfer of significant ownership or controlling interests, the competent CBR department applies the same requirements as required for licensing. In particular, the mission was told that attention is paid to the financial condition of the petitioner. The latter is required to demonstrate that his financial position is strong and that he has enough funds to acquire the intended qualifying interests.</p> <p>In the 2008 BCP report, several recommendations were made to streamline the vetting regime for transfer of significant ownership. In particular, it was suggested that, although the system for vetting of shareholders was reasonably effective, the rules could be made more clear, and the threshold of 20 percent should be lowered to at least 10 percent. As discussed under EC1, this threshold has been lowered to 10 percent.</p> <p>It was also observed at that time that the power to take appropriate action to modify, reverse, or otherwise address a change of control that had taken place without the necessary notification of the supervisor was based on some general provisions in the Civil code that did not provide a strong</p>



	<p>legal basis.<sup>43</sup> This deficiency has also been addressed. A new provision has been included in Article 11 of the banking law in 2013 that empowers the supervisor to address changes of controls that were not vetted by the CBR.</p> <p>In light of the above improvements, this CP is rated “compliant.”</p> <p><b>Recommendation:</b></p> <ul style="list-style-type: none"> <li>• Include an explicit requirement obliging banks to notify the supervisor as soon as they become aware of any material information which may negatively affect the suitability of a major shareholder or a party that has a controlling interest.</li> </ul>
<b>Principle 7</b>	<b>Major acquisitions.</b> The supervisor has the power to approve or reject (or recommend to the responsible authority the approval or rejection of), and impose prudential conditions on, major acquisitions or investments by a bank, against prescribed criteria, including the establishment of cross-border operations, and to determine that corporate affiliations or structures do not expose the bank to undue risks or hinder effective supervision.
<b>Essential criteria</b>	
<b>EC1</b>	<p>Laws or regulations clearly define:</p> <ul style="list-style-type: none"> <li>(a) what types and amounts (absolute and/or in relation to a bank’s capital) of acquisitions and investments need prior supervisory approval; and</li> <li>(b) cases for which notification after the acquisition or investment is sufficient. Such cases are primarily activities closely related to banking and where the investment is small relative to the bank’s capital.</li> </ul>
Description and findings re EC1	<p>The rules governing the conditions to approve or reject major acquisitions or investments by a bank can be found in the banking law (Article 11) as well as in CBR Regulation 290-P.</p> <p>According to Article 11 mentioned above, a prospective investor (e.g., a bank) should obtain prior consent of the CBR before acquiring more than 10 percent of shares in a credit institution and (or) establishing control over the shareholders. A notification of the CBR is required if the acquisition is between more than 1 percent and less than 10 percent of shares. CBR’s consent to a transaction aimed at acquiring more than 10 percent of capital in a credit institution may be obtained after the transaction if the acquisition of shares or controlling stakes are made through a public offering.</p> <p>However, there is no requirement that banks seek approval for significant acquisitions of <b>nonbank financial institutions</b><sup>44</sup> and the CBR is therefore unable to analyze impact of nonbank investments on the bank’s financial position.</p> <p>The conditions for investing in foreign banks and for establishing subsidiaries within foreign states are stipulated in detail in Article 35 of the banking law and the Regulation 290-P. A bank is required to report to the CBR on acquisition of shares in a foreign subsidiary within two months from the date of the acquisition. A bank is required to notify the CBR within 15 business days of any</p>

<sup>43</sup> Transactions committed in contravention of the law—i.e., acquisition of shares without CBR permission—are null and void.

<sup>44</sup> The mission was told by the CBR that amendments made by the Draft of the Federal Law 770566-6 presume the requirement for legal entities (including banks) to seek CBR approval for significant acquisitions in the capital of nonbank financial institutions: including insurance entities, professional participants of security market (registers and depositories), investment funds, clearing companies, non-state pension funds, microfinance organizations).

	<p>subsequent change in the size of its stake in the statutory capital of a nonresident subsidiary (indicating the absolute amount and the amount expressed as a percentage). If through disposal of shares or in another way a bank loses the status of parent company, the bank must also notify the CBR within 15 business days.</p> <p>Regulation 290-P also requires that the economic justification for the establishment of a subsidiary abroad must contain information on the system of RM on a consolidated basis, with consideration for the activity of the foreign subsidiary organization. If the RM system does not satisfy the goals of consolidated supervision, the CBR may refuse a permit. In addition, to acquire a permit to create a subsidiary organization in a foreign state a bank must provide its written consent to an examination of the subsidiary organization by ARs of the CBR.</p> <p>In the case the CBR detects that a buyer of shares in a credit institution has acquired controlling stakes without the vetting of the CBR, the CBR is empowered to instruct the bank to correct the violation either by obtaining CBR subsequent consent for the acquisition or to dispose shares. In case the buyer failed to timely fulfill CBR's instruction, the CBR is entitled to file a claim for invalidation of the acquisition aimed at acquiring over 10 percent of shares in the bank.</p>
<b>EC2</b>	Laws or regulations provide criteria by which to judge individual proposals
Description and findings re EC2	<p>The conditions for judging individual proposals for major acquisitions are laid out in banking law Article 11. The CBR shall carry out an assessment based on the documents and information provided by the proposed acquirer, as well as on the basis of other information and documents. CBR will issue the approval having regard to the potential influence of the proposed acquirer on the credit institution in order to ensure its sound and prudent management. Due consideration will be paid to the suitability and financial soundness of the proposed acquirer. The authorization can be refused based on each of the following criteria:</p> <ul style="list-style-type: none"> <li>• the reputation of the proposed acquirer;</li> <li>• the financial soundness of the proposed acquirer; and</li> <li>• the reputation and experience of the members of the management boards.</li> </ul> <p>Full list of documents required for major acquisitions proceeding is stipulated in several norms: (i) CBR Instructions 146-I; (ii) Regulations 415-P and 416-P (18.02.2014); and (iii) Regulations 408-P (25.10.2013).</p> <p>Major acquisitions file generally contains:</p> <ul style="list-style-type: none"> <li>• petition of the acquirer for acquisition of more than 10 percent of share capital of credit institution;</li> <li>• constituting documents and general info on acquirer (by-laws, certificate of incorporation, etc.) and shareholders list;</li> <li>• information on ownership structure, including UBO;</li> <li>• documents for financial standing assessment (i.e., annual and management reports, tax certificate, adjusted net assets calculation, etc.);</li> <li>• antimonopoly conclusion on proposed acquisition;</li> <li>• documents for business reputation assessment (profile and correspondent certificates) for legal entities and individuals (e.g., senior management of the acquirer).</li> </ul>

	During the period from 2014 to the present the CBR has taken a total of 724 such decisions, including 437 in which approval was granted and 287 in which petition for approval was rejected.
<b>EC3</b>	Consistent with the licensing requirements, among the objective criteria that the supervisor uses is that any new acquisitions and investments do not expose the bank to undue risks or hinder effective supervision. The supervisor also determines, where appropriate, that these new acquisitions and investments will not hinder effective implementation of corrective measures in the future. <sup>45</sup> The supervisor can prohibit banks from making major acquisitions/investments (including the establishment of cross-border banking operations) in countries with laws or regulations prohibiting information flows deemed necessary for adequate consolidated supervision. The supervisor takes into consideration the effectiveness of supervision in the host country and its own ability to exercise supervision on a consolidated basis.
Description and findings re EC3	<p>In accordance with the requirements of Regulation 290-P, a bank projecting an acquisition must meet certain intrinsic pre-conditions. It must have been licensed and in operation for at least three years; it must meet the requirements (of financial soundness in particular) for participating in the deposit insurance system, and it must be in compliance with the reserve requirements of the CBR. The bank should not have any past-due financial obligations vis-à-vis the CBR and not to have debts with respect to the federal budget and the budget of the appropriate constituent entity of the Russian Federation among others.</p> <p>When reviewing the application for an approval, the CBR also takes into consideration external parameters like the economic feasibility of a bank's plan to establish a subsidiary within a foreign state or to acquire the status of a parent company with respect to an existing nonresident financial institution.</p> <p>Such a plan is found to be economically sound if there are prospects for the long-term viability of the subsidiary as a financially stable institution. The CBR does not grant permission for the establishment of a subsidiary in states (territories) that have been classified as uncooperative jurisdictions from an AML/CFT perspective.</p> <p>The CBR can prohibit banks from making major acquisitions/investments (including the establishment of foreign branches or subsidiaries) in countries with secrecy laws or other regulations prohibiting information flows deemed necessary for adequate consolidated supervision. Nevertheless, a question still remains as to whether the CBR, before making its determination, takes into consideration the effectiveness of supervision in the host country and its own ability to exercise supervision on a consolidated basis. Lastly, the mission could not find any specific provision according to which the CBR also determines, where appropriate, that these new acquisitions and investments will not hinder effective implementation of corrective measures in the future.</p>
<b>EC4</b>	The supervisor determines that the bank has, from the outset, adequate financial, managerial, and organizational resources to handle the acquisition/investment.
Description and findings re EC4	The notification to the CBR (by submitting an application) is the trigger for initializing the procedure for granting an approval for major acquisition in banks. According to the regulation, the CBR determines that the bank has adequate financial, managerial and organizational resources to handle the acquisition (see EC 1 above).

<sup>45</sup> In the case of major acquisitions, this determination may take into account whether the acquisition or investment creates obstacles to the orderly resolution of the bank.

<b>EC5</b>	The supervisor is aware of the risks that non-banking activities can pose to a banking group and has the means to take action to mitigate those risks. The supervisor considers the ability of the bank to manage these risks prior to permitting investment in non-banking activities.
Description and findings re EC5	As indicated under EC1, acquisitions of banks in a non-financial company are not subject to supervisory approval. It is understood that CBR is now considering proposing to amend the Banking Law whereby credit institutions would be required to obtain CBR approval for major acquisitions in domestic non-banks legal entities.
<b>Assessment of Principle 7</b>	Materially Non Compliant
	<p>Foreign investments by Russian banks require prior approval by the CBR, when they lead to the establishment of a subsidiary abroad, or acquisition of the status of parent company of a nonresident entity. A domestic acquisition of shares in a bank above a 10 percent ownership requires prior CBR approval. Acquisitions of over one-percent share require ex-post notification to the CBR.</p> <p>However, the CBL does not establish requirements for banks to seek prior CBR approval when making domestic investments in nonbank financial institutions. As indicated in previous FSAPs, without such requirement the CBR is not able to measure the possible impact of acquisitions on a bank's condition or to determine whether the acquisition will affect the transparency of the bank's organizational structure and affect the ability of the CBR to supervise it. As a result, the previous rating assigned in 2011 to this CP cannot be upgraded.</p> <p><b>Recommendations:</b></p> <ul style="list-style-type: none"> <li>• Require ex-ante CBR approval of acquisitions of domestic nonbank financial institutions.</li> <li>• Subject major acquisitions in non-financial companies to enhanced CBR scrutiny, in particular with respect to the compliance with limits.</li> <li>• Explore the possibility to set restrictions for major acquisitions in non-financial sectors deemed to pose particular concern.</li> <li>• Establish an explicit provision by which the supervisor determines, where appropriate, that new acquisitions and investments will not hinder effective implementation of corrective measures in the future, nor information flows deemed necessary for adequate consolidated supervision or the supervisor's ability to exercise supervision on a consolidated basis.</li> <li>• Subject any major acquisition to a formal follow up mechanism to ascertain that the new activities acquired do not expose the bank to undue risks.</li> </ul>
<b>Principle 8</b>	<b>Supervisory approach.</b> An effective system of banking supervision requires the supervisor to develop and maintain a forward-looking assessment of the risk profile of individual banks and banking groups, proportionate to their systemic importance; identify, assess and address risks emanating from banks and the banking system as a whole; have a framework in place for early intervention; and have plans in place, in partnership with other relevant authorities, to take action to resolve banks in an orderly manner if they become non-viable.
<b>Essential criteria</b>	
<b>EC1</b>	The supervisor uses a methodology for determining and assessing on an ongoing basis the nature, impact and scope of the risks: <ul style="list-style-type: none"> <li>(a) which banks or banking groups are exposed to, including risks posed by entities in the wider group; and</li> <li>(b) which banks or banking groups present to the safety and soundness of the banking system</li> </ul>

	<p>The methodology addresses, among other things, the business focus, group structure, risk profile, internal control environment, and the resolvability of banks, and permits relevant comparisons between banks. The frequency and intensity of supervision of banks and banking groups reflect the outcome of this analysis.</p>
<p>Description and findings re EC1</p>	<p>The methodology for the supervisory assessment of banks' activities is established by Ordinance 2005-U, which addresses the assessment of banks' economic position (capital, asset quality, profitability, liquidity) as well as RM and internal audit systems by the CBR both for supervisory purposes and for assessing whether banks meet the deposit insurance system participation requirements (Ordinance 3277-U).</p> <p>According to Ordinance 2005-U, banks' economic position is assessed using quantitative indicators on capital, assets, profitability, liquidity, interest rate risk, and concentration risk, and qualitative indicators with respect to RM and internal controls systems, strategic RM ("controlling strategic risk," which includes business focus and development) and transparency of ownership structure. Banks' compliance with prudential ratios, established by Instruction 139-I and whether any supervisory measures have been applied to the bank are also assessed. The AFSB system (see below) examines a bank's condition based on a system of indicators in relation to volumes of business, asset quality, quality of capital, liquidity, earnings, and an identification of relationships between indicators, factors that influence the indicators and comparison with peer group and the banking system as a whole. Capital and profitability indicators are projected for the coming 12 months using trend analysis based on the previous two years of data with the aim of supporting a forward looking approach in order to identify problems at an early stage.</p> <p>Assessment and analysis of the banks using the methodology is performed quarterly and the indicators are monitored on a monthly basis – using monthly prudential data and the indicators are adjusted as necessary. This assessment generates a classification of the bank. The CBR uses an IT system software program—Analysis of Financial Condition of Banks (AFSB)—to perform the classification but the system permits supervisors to make adjustments to the inputs in order to reflect supervisory judgment. While the bank's grading is refreshed on a quarterly basis it can be updated in the light of new information or data received within the period, including monthly reporting. The AFSB is available to all CBR territorial offices, facilitating peer group review and analysis. The assessors were able to view examples of the analysis based on the methodology and using the system.</p> <p>The methodology set out in Ordinance 2005-U creates a structured approach to scrutinizing the quality of internal controls, RM, strategy, ownership transparency and compensation practices. The extent to which the banks internal policies and procedures meet the standards and regulations set by the CBR is reflected in the methodology assessment, as are any inspection findings that reveal that a bank is not in compliance with its own policies or laws and regulations. For example, CG is monitored through review of documents and reports from the bank, including reports on steps taken to remedy any deficiencies notified to the bank in any previous onsite review.</p> <p>The classification, and any deficiencies identified by the supervisors, is reported to the bank's CEO, who in turn is required to report the information to the bank's Supervisory Board.</p>

	<p>The classifications used by the CBR in order to better differentiate its supervisory focus are as follows:</p> <ul style="list-style-type: none"> <li>• Group 1—banks where no current difficulties have been identified;</li> <li>• Group 2—banks where shortcomings, if not rectified, may lead to difficulties in the next 12 months. Group 2 banks are sub-divided into two subgroups;</li> <li>• Group 3—banks where shortcomings, if not rectified, may lead to a situation threatening the interests of depositors and creditors over a 12-month period;</li> <li>• Group 4—banks whose existing violations create an active threat to the interests of their depositors and creditors, and the elimination of which requires implementation of measures by the bank's management bodies and shareholders);</li> <li>• Group 5—banks whose present condition, if no measures are taken by the bank's management bodies and (or) shareholders (partners), will lead grounds for the revocation of the bank's license or bankruptcy prevention measures.</li> </ul> <p>More intensive oversight is exercised with respect to banks in classification groups 3–5, whose operations are more exposed to risks arising from defects in management systems and/or in internal bank systems.</p> <p>As part of an approach to differentiate the supervision of systemically important banks, the CBR has undertaken a number of initiatives:</p> <ul style="list-style-type: none"> <li>• supervision of systemically important banks, identified based on their systemic importance in Russia-wide and also regional markets, has been transferred from the territorial offices to a central division at the CBR's head office (SIBSD); and</li> <li>• identifying banks of regional and federal significance (banks falling within the "second line" of supervision; CBR Order OD-819dsp), and ensuring that significant supervisory decisions are made with the participation of the CBR head office and management (Ordinance 3017-V of June 18, 2013, and Order OD-2043 of August 7, 2015).</li> </ul> <p>As of December 1, 2015, there were 740 banks in the Russian Federation, 10 of which are recognized as systemically important banks, and 140 of which are recognized as banks falling within the "second line" of supervision. SIBSD has been operational since October 2013 and currently supervises 15 banks, representing about two thirds of the assets and capital of the Russian banking sector. Ten of these banks are identified as systemically important banks under the CBR Ordinance 3737, which is based on the methodology published by the BCBS.</p>
<b>EC2</b>	<p>The supervisor has processes to understand the risk profile of banks and banking groups and employs a well-defined methodology to establish a forward-looking view of the profile. The nature of the supervisory work on each bank is based on the results of this analysis.</p>
Description and findings re EC2	<p>Supervisory functions are set out in Ordinance 3089-U. The objective of the offsite analytical work is to determine banks' risk profile as well as the driving factors in the changes to risks and possible future trends over a one year projected horizon. Analysis is conducted in accordance with a set methodology which is executed by the Bank Financial Condition Analysis System (AFSB System) and as described in EC1.</p> <p>As also noted in EC1, analysis comprises a quarterly assessment of a bank's compliance with required prudential ratios and an analysis of any change in the activity of the bank or its banking</p>

	<p>group. On a semi-annual basis there is a comprehensive analysis of the bank/banking group and the quality of the bank's management. The analysis will, if appropriate, suggest changes to the supervisory plan taking a group wide perspective into account. As noted above, the analysis of the risk profile and risk drivers is "point in time" but it also has a forward looking aspect as 12-month projected values for capital and profitability are estimated (based on trend analysis and the previous two years' data) and compared with current values. Where the actual and forecast value diverges beyond a specified threshold, this is a trigger for the CBR to undertake a closer analysis and examine the underlying factors at play.</p> <p>The CBR also operates an early warning system (EWS), based on indicator analysis, and which is described in its 2013 Letter 69-T on "Urgent measures of prompt supervision response." The EWS approach examines a range of indicators, such as deposit growth, change in balance sheet structure using the AFSB system to calculate the indicators and flag cases where thresholds have been triggered, and prompt supervisory intervention is required. If the indicators set out in Letter 69-T are triggered the CBR is required to investigate the cause, obtain further explanation from the bank and initiate supervisory action as necessary.</p> <p>The AFSB system acts as a platform to generate, store, analyze and compare a range of data, information and reports on banks, facilitating peer group analysis, as well as analysis of an individual bank. For example, in addition to the analysis based on the methodology of 2005-U, the AFSB allows the supervisor to store all information on various aspects of the bank, whether internal administrative reporting, correspondence, external auditor reports (etc.). The AFSB also provides a database of information submitted by the bank in accordance with Ordinance 2181-U (February 9, 2009). The database also includes information on supervisory actions and responses.</p> <p>The frequency and target focus of inspections, consistent with Instruction 147-I, are determined through consideration of the risk profile, including sufficiency of capital adequacy, liquidity, volume of business and information on the banking group, as well as quality of management and controls of the bank. While every bank must be subject to an inspection at least every 24 months (Section 1.4), off-schedule inspections of banks are possible (Chapter 4) and can be triggered by violations of legislation and regulations or changes in the risk profile or condition of the bank as well as to check on the progress or completion of remedial actions required by the supervisor.</p>
<b>EC3</b>	The supervisor assesses banks' and banking groups' compliance with prudential regulations and other legal requirements.
Description and findings re EC3	<p>Under the CBL (Article 57.2) the CBR is required to assess a range of prudential standards including the quality of the RM, capital management and internal control systems of a bank, and its banking group, as well as the capital adequacy and liquidity of a bank. Should a bank fail to meet these standards, the CBR shall issue a direction to the bank. Ultimately, where prudential regulations have not been met, the CBR has the right to apply the corrective measures and sanctions set out in the CBL (Article 74), which are discussed more fully in CP11.</p> <p>The CBR uses both on and offsite approaches to assess the degree of compliance by banks with prudential regulations and legal requirements that are established in accordance with the CBL and the Federal Law on Banks and Banking Activity (BBAL). Banks' reporting to the CBR and the findings from inspections are used in the supervisory assessments. One of the core purposes of a</p>



	CBR inspection, as stated in Instruction 147-I, is for the supervisory authority to assess banks' compliance with legal and regulatory requirements.
<b>EC4</b>	The supervisor takes the macroeconomic environment into account in its risk assessment of banks and banking groups. The supervisor also takes into account cross-sectoral developments, for example in non-bank financial institutions, through frequent contact with their regulators.
Description and findings re EC4	<p>The macroeconomic context is taken into account through two main approaches. One is monitoring of risk indicators, including deeper analysis of and follow-up supervisory action with banks that contribute significantly to any negative trends. The CBR also undertakes banking sector stress testing on a quarterly basis for all operating banks. The results are published in the Report on the Development of the Banking Sector and Banking Supervision. Insights into the impact on banking and key trends in the banking sector are also examined in the CBR's Financial Stability Report.</p> <p>The stress testing is further complemented by analytical work performed in respect of banks in which stress testing plays an important role in the RM system.</p> <p>Coordination with the non-bank financial regulators is achieved through internal procedures as, since September 2013, the CBR has been a unified single regulator for the financial markets. There is a practice of coordinated, simultaneous onsite inspections for the regulated financial entities in the banking groups, which facilitates the cross-sectoral dimension.</p>
<b>EC5</b>	The supervisor, in conjunction with other relevant authorities, identifies, monitors, and assesses the build-up of risks, trends and concentrations within and across the banking system as a whole. This includes, among other things, banks' problem assets and sources of liquidity (such as domestic and foreign currency funding conditions, and costs). The supervisor incorporates this analysis into its assessment of banks and banking groups and addresses proactively any serious threat to the stability of the banking system. The supervisor communicates any significant trends or emerging risks identified to banks and to other relevant authorities with responsibilities for financial system stability.
Description and findings re EC5	<p>A system wide risk monitoring system based on banks' reporting as well as wider sources of information has been created. The following risks are analyzed: corporate and retail credit risk, market risks, and liquidity risk. Analysis of the dynamics of banks' capital adequacy is also performed. On the basis of the systematic analysis, banks with particular vulnerabilities are identified and additional supervisory work is done with these banks.</p> <p>With respect to credit risk, for example, trend analysis and scenario stress testing in the mortgage market are conducted. The sample of banks used for stress testing includes the largest banks, which account for approximately 79 percent of the loan debt in the mortgage lending segment. Analysis of systemic risks in the consumer lending segment is performed using a range of data, including reporting forms, survey data from retail banks, and materials provided by credit bureaus (National Bureau of Credit Histories (NBKI), Equifax). In 2016, there are plans to expand the model to incorporate the borrower's income and regional location. Risk assessment in the corporate lending segment (not including nonfinancial corporations) uses banks' reporting data, corporate sector reporting, and data obtained from direct company surveys. In 2016, a reporting form for individual operations will be introduced, which will allow for a more detailed assessment and forecasting of credit risks in the corporate sector.</p>



	<p>The CBR is represented on the National Council for Financial Stability, which also includes representatives of the Russian Federation MoF, the Russian Federation Ministry of Economic Development, the Deposit Insurance Agency State Corporation, the Executive Office of the President and members of the Russian Federation Government.</p> <p>The CBR provides the National Council for Financial Stability with consolidated data on systemic risks. Descriptions of the main direction of strategic policy (actions) of the CBR are provided to the Council.</p> <p>General information on the National Council to Maintain Financial Stability is publicly available and posted at: <a href="http://government.ru/department/271/">http://government.ru/department/271/</a>.</p>
<b>EC6</b>	<p>Drawing on information provided by the bank and other national supervisors, the supervisor, in conjunction with the resolution authority, assesses the bank's resolvability where appropriate, having regard to the bank's risk profile and systemic importance. When bank-specific barriers to orderly resolution are identified, the supervisor requires, where necessary, banks to adopt appropriate measures, such as changes to business strategies, managerial, operational and ownership structures, and internal procedures. Any such measures take into account their effect on the soundness and stability of ongoing business.</p>
Description and findings re EC6	<p>At the present time all systematically important banks must develop and submit to the CBR financial stability recovery plans. The CBR has been receiving financial stability recovery plans from the systemic banks since 2013. However, the law does not yet require non-systemic banks to prepare and submit financial stability recovery plans. Non-systemic banks, at the demand of the CBR, must develop and submit recovery plans.</p> <p>Under the new legal regime for recovery and resolution, the CBR must issue regulations to address the design of recovery plans (form, content, deadlines for submission), a regulation setting out the methodology for the assessment of recovery plans by the CBR, and a regulation on the action plan of the CBR on resolution of the systemically important credit institutions (content, measures).</p> <p>Nevertheless, banks can develop and submit recovery plans to the CBR based on CBR Letter 193-T, even though the letter is not legally binding. As of January 1, 2016, 38 plans, including five prepared by the SIFIs, had already been submitted to the CBR. The CBR has already evaluated a number of these plans and issued recommendations for additional work on most plans.</p> <p>If a bank's continuing viability is in doubt, the CBR has the right to demand a financial stability recovery plan (Article 189.10 of the Federal Law 127-FZ). Moreover, the CBR has the right to require a bank's reorganization (Article 189.26 of the Federal Law 127-FZ). Furthermore, in the event of a threat to depositors or financial stability, the CBR is entitled to send to the DIA a proposal on its participation in taking measures aimed at preventing a bank's bankruptcy (Article 189.47 of the Federal Law 127-FZ).</p> <p>However, the CBR's powers to compel reorganization and restructure are predicated on the bank or banking group's condition being a threat to its depositors or to financial stability. In other words, while a bank or banking group is in a stable and sound condition, and not, for example, being rated "doubtful" or "unsatisfactory" for the business plan, RM, and internal controls, or transparency of the ownership structure under the methodology of Ordinance 2005-U, or—in</p>

	<p>future when the provisions are fully in effect—failed to remedy deficiencies identified under Ordinance 3624-U, and is compliant with its supervisory and other legal norms, the CBR is limited to making only recommendations in relation to business strategies, managerial, operational and ownership structures, and internal procedures.</p>
<b>EC7</b>	<p>The supervisor has a clear framework or process for handling banks in times of stress, such that any decisions to require or undertake recovery or resolution actions are made in a timely manner.</p>
Description and findings re EC7	<p>Resolution and recovery matters are primarily governed by Federal Law 127-FZ. In particular, the law stipulates the grounds for the application of resolution (bankruptcy prevention) measures. Law 127-FZ establishes the sequence of actions for all the parties concerned—including both the authorities and the bank—should circumstances for resolution or rehabilitation arise.</p> <p>Under the law, the CBR has the authority to take a decision to send ARs of the CBR and DIA to examine a bank’s financial condition and prepare a joint report in order to support the decision making process on whether a proposal should be sent to the DIA regarding resolution measures. CBR Ordinance 3707-U establishes the procedures for the assessment of a Bank’s financial condition for the purpose of making a joint decision with the Deposit Insurance Agency on bank resolution. The CBR and DIA also share information on the existence of grounds indicating that a plan involving the DIA participation in resolution would be unsuccessful (Article 189.49, Clause 7, of Federal Law 127-FZ).</p> <p>In terms of the CBR’s own internal framework for dealing with banks at times of stress, any decision to examine a bank jointly with the DIA or to send the DIA a proposal for the DIA’s participation in resolution (implementing bankruptcy prevention measures or measures for settling a bank’s obligations) is taken by the CBR’s Banking Supervision Committee. Internal rules of procedure apply to the work of the BSC.</p>
<b>EC8</b>	<p>Where the supervisor becomes aware of bank-like activities being performed fully or partially outside the regulatory perimeter, the supervisor takes appropriate steps to draw the matter to the attention of the responsible authority. Where the supervisor becomes aware of banks restructuring their activities to avoid the regulatory perimeter, the supervisor takes appropriate steps to address this.</p>
Description and findings re EC8	<p>The CBR is a unified “mega regulator.” As such, in the view of the CBR, the potential for regulatory arbitrage opportunities to develop is limited and the CBR indicated that it had not had the occasion to intervene with banks that were restructuring their activities to avoid the regulatory perimeter.</p> <p>In terms of shadow banking, the CBR estimates that at the end of 2014, the shadow banking system represented less than 7 percent of financial system assets (approximately 10 percent GDP). More recent estimates are pending the adaptation of FSB monitoring techniques to the current Russian business environment.</p> <p>However, the CBR has clear powers to act. Under the BBAL (Article 4), should the CBR, in the course of its supervision, identify a potential entity that should be part of the banking group or bank holding company, it shall require the parent of the banking group or of the bank holding company and require compliance with the law (i.e., re-set the regulatory perimeter).</p> <p>In November 2015, the CBR, together with the Alliance for Financial Inclusion, hosted a conference on inclusion and shadow banking, noting that the CBR supported efforts of regulators and</p>

	supervisors (following the FSB recommendation) to identify and monitor trends in shadow banking and advance proportionate regulations to address the risks to financial stability emerging outside the regular banking system while not inhibiting sustainable nonbank financing models that do not pose systemic risk.
<b>Assessment of Principle 8</b>	<b>Largely Compliant</b>
Comments	<p>The CBR has developed its risk based approaches since the last assessment. An analytical methodology is applied to differentiate between banks with differing risk profiles and a dedicated department for systemic banks has been set up. The use of supervisory discretion has not, historically, been straightforward in the context of the Russian legal and regulatory system, but the approach articulated through Ordinance 2005-U creates a structured consideration of qualitative issues and appears to allow for the exercise of informed supervisory judgment based on documents the assessors were able to consider. The introduction of the supervisory review process (SREP) based on banks' ICAAPs and integration with the risk assessment approach under Ordinance 2005-U is a further welcome evolution of a risk based supervisory approach. (Please see CP15 and 16 for more discussion of ICAAP and SREP).</p> <p>Where the CBR is less well advanced is in the field of resolution assessment and planning, although the CBR and indeed the banks themselves have by no means been inactive based on the early submission and evaluation of recovery plans prior to regulations being issued. Compliance with this principle is partly a matter of the remaining time needed to issue and implement outstanding regulations. However, the principle can only be met provided that the CBR ensures it assesses the resolvability and is able to require, where necessary, banks to adopt appropriate measures, such as changes to business strategies, managerial, operational, and ownership structures, and internal procedures. It is the assessors' understanding that the CBR lacks the requisite power to require operational or institutional changes based on an assessment of the bank's ability to recover. A legal amendment to ensure this power in place is important if the CBR is to be assessed as compliant with this CP in any future assessment.</p> <p>Shadow banking activities in the Russian financial sector appear to be low but not fully insignificant. A dependence on solo reporting using Russian rather than IFRS standards may encourage banks to move assets outside the prudential regulatory perimeter. It is therefore essential for the CBR to remain assiduous in using all forms of information available to it so that the potential for regulatory arbitrage does not arise. The CBR should not hesitate to use its powers under the BBAL (Article 4) if the need should arise.</p> <p>It would be important to ensure, when the CBR assesses the resolvability of a bank, that the CBR has the powers to require, where necessary, banks to adopt appropriate measures, such as changes to business strategies, managerial, operational, and ownership structures, and internal procedures.</p>
<b>Principle 9</b>	<b>Supervisory techniques and tools.</b> The supervisor uses an appropriate range of techniques and tools to implement the supervisory approach and deploys supervisory resources on a proportionate basis, taking into account the risk profile and systemic importance of banks.

<b>Essential criteria</b>	
<b>EC1</b>	The supervisor employs an appropriate mix of onsite <sup>46</sup> and offsite <sup>47</sup> supervision to evaluate the condition of banks and banking groups, their risk profile, internal control environment and the corrective measures necessary to address supervisory concerns. The specific mix between onsite and offsite supervision may be determined by the particular conditions and circumstances of the country and the bank. The supervisor regularly assesses the quality, effectiveness and integration of its onsite and offsite functions, and amends its approach, as needed.
Description and findings re EC1	<p>The CBR supervises banks through a system of on and offsite supervisory techniques.</p> <p><b>Curator—offsite function</b></p> <p>The supervisory process is founded on the use of curators, a position established in 2007 (Regulation 310-P). The curators enable a single point of contact in the supervisory relationship and are appointed to perform the CBR’s oversight functions. All banks have an appointed curator and while a curator may have responsibility for more than one bank, it is recommended that an individual curator have the responsibility for all the banks within a single banking group to support the overall quality of oversight of the group.</p> <p>The curator’s main role is to exercise professional judgment, in a forward looking manner, on the condition of the bank he or she is responsible for, using all information obtained through the supervisory process. Deficiencies in the bank and potential supervisory solutions and remedies are proposed by the curator with the aim of achieving early intervention, though it should be noted that the curator does not possess delegated powers of decision making. The curator is also responsible for proposing the scope of onsite inspections and for drawing up any supervisory action plan.</p> <p>A Methodological Guide (a so-called curator’s handbook) has been prepared and covers issues relating to the collection and systematization of information on banks as well as analysis and assessment of quantitative aspects of financial soundness as well as qualitative issues around management and internal controls.</p> <p><b>Authorized representatives</b></p> <p>The CBR has the power to appoint an “authorised representative” to major institutions—defined as having assets equal to or greater than 50 billion rubles or retail (public) deposits equal to or greater than 10 billion rubles—or to banks that have received financial support. The purpose of authorised representatives is to allow the CBR access to real time information to facilitate timely supervisory action. The CBR authorised representatives have wide ranging rights of access to the banks, including the right to observe (no voting power) the meetings of banks’ management</p>

<sup>46</sup> Onsite work is used as a tool to provide independent verification that adequate policies, procedures, and controls exist at banks, determine that information reported by banks is reliable, obtain additional information on the bank and its related companies needed for the assessment of the condition of the bank, monitor the bank’s follow-up on supervisory concerns, etc.

<sup>47</sup> Offsite work is used as a tool to regularly review and analyze the financial condition of banks, follow up on matters requiring further attention, identify and evaluate developing risks and help identify the priorities, scope of further offsite and onsite work, etc.

bodies, as well as meetings of the credit risk committee and asset liability committees (ALCO), and all documents and records relating to the activity of the bank, including compensation packages for the executive management and boards. At the time of the assessment mission, the CBR has appointed authorised representatives to 158 banks, including to all banks of national or regional significance.

The role of “authorized representative” is set out in Article 76 of the CBL and the procedures for appointment, performance of functions, and termination of role is further articulated through a number of ordinances, namely: Ordinance 2182-U; Ordinance 2181-U, and Ordinance 3057-U. The ordinances do not require the rotation of individuals who serve as an “AR.” It should be noted that the inspectors of the CBR are also termed “ARs” in the CBL, in Article 73, but the two functions are not the same.

The assessors were able to review some examples of instruction mandates given to ARs, as well as reports submitted to the CBR by the representatives, which were informative, analytical and timely.

### **Inspections**

The offsite analysis is complemented and informed by the work of the Chief Inspectorate. Following reforms, all inspectors of the CBR have been consolidated within the Chief Inspectorate rather than being part of the CBR territorial branch network.

The CBR can carry out three kinds of inspections: comprehensive, thematic, and specialized (Section 1.4); however, coordination processes are set out (Section 3.1). Inspections can be either scheduled or unscheduled but frequency of inspections must be at least every 24 months (Instruction 147-I, Section 1.4). The ratio of unscheduled to total inspections is approximately one-third, which is consistent with the ratio at the time of the last full BCP assessment in 2008. For example, in 2014 there were 817 inspections, of which 266 were unscheduled. In terms of intensity, the range between the more targeted inspections and the full scope examinations is from two weeks to six months.

The periodicity and scope of inspections are determined by taking into account:

- the financial condition and future outlook of the institution;
- the institution’s exposure to risks, and quality of management, which may include an evaluation of the RM system and the status of internal control;
- the reliability of accounting (reporting); and
- the results of previous inspections.

The main objective of the CBR inspection is to determine the level of risks and evaluate the quality of management, including an evaluation of RM and internal controls as well as to evaluate the financial stability, economic position, and financial condition of the institution and its future outlook. (See Section 1.3 of Instruction 147-I.)

The assessors were not able, owing to time constraints, to view many inspection reports. However, the reports that were viewed supported the description given by the CBR. In the reports seen by the assessors, careful attention had been paid to the institution’s adherence to its control

	<p>environment, its adherence to regulations and laws, and the inspection focused thoroughly on the issues contained in the specific inspection mandate.</p> <p>Supervisory themes that have informed the scoping of inspections in the past couple of years include concentration risk and AML/CFT. Recent trends have also included the move to a greater use of coordinated inspections across an institution (and its branches) and financial groups. Concerns with asset quality and the need for banks to adhere to regulations are a constant theme.</p>
<b>EC2</b>	<p>The supervisor has a coherent process for planning and executing onsite and offsite activities. There are policies and processes to ensure that such activities are conducted on a thorough and consistent basis with clear responsibilities, objectives and outputs, and that there is effective coordination and information sharing between the onsite and offsite functions.</p>
Description and findings re EC2	<p>The Chief Inspectorate coordinates with other departments (e.g., SIBSD) in the CBR and the territorial offices in designing the overall inspection program for the year. Inspections are planned on an annual basis and managed through a "Summary Plan," and a monitoring system is in place to ensure the relevance and timeliness of inspections. Instruction 149-I sets out the rubric for inspections, including the scoping and coordination processes. Planning procedures, for example, including for unscheduled inspections, are found in Chapters 2–4, and cooperation procedures for the "interregional" inspectorates are in Chapters 6–7.</p> <p>The scoping of the inspection is determined based on proposals made by the territorial offices but the final decision rests with the Chief Inspectorate (usually on a mutual consent basis). Scoping proposals and inspection decisions take into account the priority themes that have been set for the year by the Chief Inspectorate. In turn, these themes take into account inputs from the divisions responsible for supervision of systemic banks, licensing, and financial markets so that the inspection plan is responsive to current and emerging risks and vulnerabilities.</p> <p>Responsibility for monitoring the continuing need for an inspection and the relevance of the terms of reference lies with the territorial offices and SIBSD (i.e., offsite function), and this is complemented by a dedicated monitoring section within the Chief Inspectorate Division to ensure that the Summary Plan is progressing. Amendments to the CBR inspection plan are made as necessary (Instruction 149-I, Section 3.1).</p> <p>Monitoring of inspections is governed by procedures set out in Ordinance 3017-U and other internal documents. The monitoring of inspections entails the timely sharing of information between the onsite and offsite functions including the interim findings of an inspection, for the purpose of:</p> <ul style="list-style-type: none"> <li>• guiding the inspection subdivisions in identifying the most problematic areas; and</li> <li>• informing offsite supervisory subdivisions about violations and deficiencies to allow for the possibility of the timely adoption of supervisory decisions (if needed) before the completion of an inspection (e.g., arranging a meeting of onsite and offsite with or without inspected bank).</li> </ul> <p>At the close of an inspection, the findings are submitted to the offsite teams, who make decisions on whether supervisory measures are needed or whether further inspections may be needed.</p>
<b>EC3</b>	<p>The supervisor uses a variety of information to regularly review and assess the safety and soundness of banks, the evaluation of material risks, and the identification of necessary corrective actions and supervisory actions. This includes information, such as prudential reports, statistical returns,</p>

	<p>information on a bank's related entities, and publicly available information. The supervisor determines that information provided by banks is reliable<sup>48</sup> and obtains, as necessary, additional information on the banks and their related entities.</p>
<p>Description and findings re EC3</p>	<p>The principal task of the curators/offsite based supervision is to identify possible problems at the earliest stage, using all sources of information, and initiate supervisory action as appropriate.</p> <p>Offsite supervision constitutes the regular analysis and evaluation of reporting data, findings of inspections, and other relevant information. For banks where an AR has been appointed, there is a direct conduit of up to date information flowing to the curator and the assessors (as noted in EC1) were able to review some samples of this.</p> <p>Analysis seeks to identify any areas of elevated risk and deficiencies (violations). In the event of negative findings, the CBR will issue either an advisory letter or a formal order containing requirements for amendments by the institution.</p> <p>The principal sources of information used by the CBR are the reporting forms and financial statements from the supervised institution. Wider sources are also used, including open databases, official information resources of federal government authorities, including the Russian Federation Federal Tax Service, data from arbitration courts, the press, data from the CBR settlement network on payments, as well as information from supervisory authorities of foreign states. In a number of cases, reliability is ensured through cooperation with various institutions and control and supervisory bodies. The assessors noted that analytical documents prepared by the offsite supervisors routinely note the information sources used to support the descriptions, comments, and judgment.</p> <p>The CBR conducts regular analysis and assessment of the supervised institutions, taking into account the following information:</p> <ul style="list-style-type: none"> <li>• composition of the banking group, information about the stockholders (partners) of group and banking entities within the group as well as affiliates, including data on their state registration and banking licenses;</li> <li>• corporate and governance structures of the banking group and its entities (notably including information on the entities that provide risk and capital management systems, and internal controls);</li> <li>• business plans and strategies; information on business models used in the group, and information on related business plans of banks within the banking group;</li> <li>• internal documents such as the rules, regulations, ordinances, decisions, orders, methodologies, job descriptions from the banking group;</li> <li>• consolidated financial statements and other information as specified by the CBR BoD; risk exposures; procedures for risk assessment and management; the results of internal procedures for evaluating capital adequacy, as well as reporting by major participants in the banking group and other information about the activities of major participants in the banking group;</li> <li>• recovery and resolution plans of the banking group and the banking entities within it (where these exist); and</li> </ul>

<sup>48</sup> Please refer to Principle 10.



	<ul style="list-style-type: none"> <li>• other documents (information) concerning the banking group’s activities may be obtained through the supervisory process, such as auditor’s opinions regarding the accounting (financial) statements; press; rating agencies and other external sources.</li> </ul> <p>The CBR obtains its assurance of the reliability of information submitted by banks through its onsite inspections. Indeed, one of the principal objectives of bank inspections, as laid out in the general provisions of Instruction 147-I (Section 1.3) is to evaluate the reliability of the accounting (reporting) by a bank. Conclusions on the reliability of a bank’s accounting (reporting) are included in the final inspection report (Instruction 147-I, Section 7.5.2 and Section 1.12). Inspection procedures in respect of examining the reliability of reporting are covered in CBR Letter 77-T.</p> <p>The inspection team has extensive rights to request and obtain information in order to confirm and verify documents of the bank under inspection. This includes the right to request information from a range of individuals and entities that have contractual relationships with the bank. These include, the shareholders (partners), the customers and correspondents of the bank; banking payment agents and operators of payment infrastructure services (other than banks) used by the bank. (See Instruction 147-I, Section 2.7 and Annex 5) Also, information can be obtained from the following (See Instruction 147-I, Section 2.8 and Annex 5):</p> <ul style="list-style-type: none"> <li>• other banks that are not customers and correspondents of the bank under inspection, at which accounts of customers and correspondents of the inspected bank are or were held;</li> <li>• from banks participating in a payment system operated by the bank under inspection and/or which have been contracted by the bank as operators of payment infrastructure services; and</li> <li>• from federal executive government bodies of the Russian Federation and law enforcement authorities.</li> </ul> <p>The inspection reports reviewed by the assessors illustrated a systematic and thorough approach capable of identifying, among other things and when relevant, issues of misreporting, misclassification, and miscalculations that would allow the offsite teams to determine whether a bank’s reporting could be relied upon or whether supervisory measures might be called for.</p>
<b>EC4</b>	<p>The supervisor uses a variety of tools to regularly review and assess the safety and soundness of banks and the banking system, such as:</p> <ol style="list-style-type: none"> <li>(a) analysis of financial statements and accounts;</li> <li>(b) business model analysis;</li> <li>(c) horizontal peer reviews;</li> <li>(d) review of the outcome of stress tests undertaken by the bank; and</li> <li>(e) analysis of CG, including RM and internal control systems.</li> </ol> <p>The supervisor communicates its findings to the bank as appropriate and requires the bank to take action to mitigate any particular vulnerabilities that have the potential to affect its safety and soundness. The supervisor uses its analysis to determine follow-up work required, if any.</p>
Description and findings re EC4	<p><b>Analysis of financial statements and accounts</b></p> <p>For the purposes of evaluating a bank’s financial condition, the CBR has developed a formal Methodology for Analysis of a Bank’s Financial Condition. This is discussed in more detail in CP8. However, the approach is based on an assessment of risks regulated by the CBR, and aimed at the performance of a comprehensive analysis of a bank’s financial condition on the basis of reporting,</p>

as well as other sources of official information about its activities. Summary analyses, as viewed by the assessors, can thus be prepared based on the use of this methodology, permitting a concise overview of an institution. As noted below, this methodology is not limited only to financial and quantitative elements. Also it is required for Curators to assess and analyze the annual reports and accounts (Regulation 310-P, Section 2.5).

#### **Business model analysis**

The methodology set out in 2005-U includes an assessment of the management of strategy within an institution (Annex 5). The curator's handbook provides further guidance on how to evaluate strategy and business model, but this aspect of supervision is expected to be enhanced once the CBR starts to undertake the supervisory review process of the ICAAPs (i.e., the SREP). Nevertheless, SIBSD routinely requests the business plans and strategies for the purposes of assessing strategic risk using the 2005-U methodology. Also, the quality of the business plan (and the state of RM and internal control) is assessed within the Ordinance 3277-U for compliance with the terms of the credit institution's participation in the deposit insurance system.

#### **Horizontal peer reviews**

The ASFB system provides all curators with the ability to interrogate the data base in order to undertake peer group analysis. It is standard practice of analysis for curators to assess banks against peer groups (regional, business type, etc.) and to identify outliers who may require more intensive scrutiny.

#### **Review of the outcome of stress tests undertaken by the bank**

Again, the methodology in Ordinance 2005-U assists a structured examination of a bank's stress testing processes (Annex 6). The methodology seeks to ascertain that banks have put stress testing procedures in place and in evaluating this question, the CBR considers whether the stress tests are comprehensive, that is, whether they cover the principal risks inherent in the bank's activities (credit, market, and interest rate risk; the risk of loss of liquidity; and operational and other risks associated with a bank's activities). Furthermore, Ordinance 3624-U, which is not yet in force for all institutions, sets requirements for stress testing for significant risks and capital adequacy. Greater focus on the effectiveness of the banks' stress testing will be introduced through the SREP process, which has not yet—formally—taken place for any bank (i.e., the first formal ICAAP submission is not until January 2017). Informally, however, ICAAPs have been submitted and the CBR has been able to consider and provide feedback on them.

#### **Analysis of CG, including RM and internal control systems**

Evaluation of CG is chiefly carried out through the prism of analysis of RM and internal control systems, which are also covered by the methodology, set out in Ordinance 2005-U, (Annexes 6 and 7). The CBR is concerned to ensure that the board is performing an active oversight function and places heavy emphasis on a bank drawing up an adequate quality of internal governance documents and abiding by them. In the view of the CBR, such internal documents carry almost as much significance as the bank's Charter. Changes to such documents and any indirect evidence

	<p>that controls and RM have weakened are taken as indications that CG has flaws. At a minimum on an annual basis, changes to control and governance procedures are documented so that inspectors can perform checks, but a review of RM, control, and governance is carried out on a quarterly basis in any case. Further information in the inspection and evaluation of the organization of internal control and RM is included in CBR Letters 47-T and 26-T.</p> <p>The results of an assessment performed by the CBR are communicated to the bank, and this includes information provided for the purpose of eliminating deficiencies and violations that have been identified. The findings of the offsite analysis in any case inform the scoping and terms of reference of the onsite inspections. Major deficiencies would result in an unscheduled inspection being organized. The assessors saw instances where such unscheduled inspections had been requested for this reason.</p>
<b>EC5</b>	The supervisor, in conjunction with other relevant authorities, seeks to identify, assess and mitigate any emerging risks across banks and to the banking system as a whole, potentially including conducting supervisory stress tests (on individual banks or system-wide). The supervisor communicates its findings as appropriate to either banks or the industry and requires banks to take action to mitigate any particular vulnerabilities that have the potential to affect the stability of the banking system, where appropriate. The supervisor uses its analysis to determine follow-up work required, if any.
Description and findings re EC5	The CBR conducts a top-down, quarterly stress test for the banking sector with the objective of assessing systemic stability as well as assessing individual bank's vulnerabilities to stress. The stress test results are used in the supervisor work of the CBR as an additional input. Thematic meetings are held with banks to discuss results and to provide recommendation. In 2014, for example, there was a series of meetings in respect of credit exposures to individuals.
<b>EC6</b>	The supervisor evaluates the work of the bank's internal audit function, and determines whether, and to what extent, it may rely on the internal auditors' work to identify areas of potential risk.
Description and findings re EC6	<p>A bank's internal control function is assessed as part of the framework of an evaluation of a bank's economic position in accordance with CBR Ordinance 2005-U (PU5). The assessment takes place on a quarterly basis. The methodology for assessing the PU5 indicator is based on prevailing laws and regulations including Regulation 242-P and the relevant BCBS guidelines. Please see also CP26.</p> <p>The evaluation of internal control (PU5) is based on an assessment of the responses to questions in Annex 7 Ordinance 2005-U. These questions permit, inter alia, an evaluation of a bank's internal documents governing the rules for the organization of an internal control system, including AML/CFT measures; a bank's compliance with these rules; the effectiveness of the functioning of a bank's internal control system (complete oversight of all of the areas of a bank's activities); the role of a bank's BoD (supervisory board) in overseeing the activities of the internal control function; organization of a bank's AML/CFT efforts and the level of their effectiveness; a bank's compliance with the legislation and regulatory acts of the CBR; as well as efforts to eliminate violations that are identified. As with the other indicators assessed under Ordinance 2005-U, responses to the questions are evaluated according to a four-point scale, and the PU5 score is the weighted-average value of the individual question scores.</p> <p>To illustrate the scale, a bank's accounting and/or reporting are found to be unreliable (scoring 4) if it fails to comply with federal laws, standards, and rules established by the CBR, and the bank's</p>

	<p>own accounting policy. A bank is also deemed unsatisfactory if deficiencies or errors have a significant impact on an assessment of its economic position, namely an impact on any one of the key quantitative indicators of the assessment of capital, assets, profitability, and liquidity, which would result in the assignment of an “unsatisfactory” rating to the overall result for the group as a whole, and/or to noncompliance with even one of the required ratios.</p> <p>Questions related to the effectiveness of the functioning of the internal control system are also examined in the course of the CBR’s inspections. The purpose of an inspection on the organization of internal control at a bank is to evaluate:</p> <ul style="list-style-type: none"> <li>• the bank’s compliance with Regulation 242-P of December 16, 2003, on the Organization of Internal Control at Banks and in Banking Groups (this includes, for example, coverage, independence, and use of appropriate methodologies);</li> <li>• the accuracy of reporting and other information submitted to the CBR regarding internal control at the bank; and</li> <li>• the consistency of the organization of internal control with the nature, scale, and conditions of the bank’s operations.</li> </ul> <p>The CBR uses the Methodological Recommendations for the Review and Evaluation of the Organization of Internal Control at Banks (CBR Letter 47-T of March 24, 2005) when conducting its inspections.</p>
<p><b>EC7</b></p>	<p>The supervisor maintains sufficiently frequent contacts as appropriate with the bank’s board, non-executive board members and senior and middle management (including heads of individual business units and control functions) to develop an understanding of and assess matters such as strategy, group structure, CG, performance, capital adequacy, liquidity, asset quality, RM systems, and internal controls. Where necessary, the supervisor challenges the bank’s board and senior management on the assumptions made in setting strategies and business models.</p>
<p>Description and findings re EC7</p>	<p>The CBR holds meetings, typically annually, with the board, executive management, and also shareholders to evaluate CG and business strategy, as well as to discuss weaknesses and vulnerabilities in the bank.</p> <p>Meetings can also be held with the executive management or board during the course of an inspection if the head of the inspection team deems it to be necessary. This is in addition to any meetings that are held to communicate the preliminary findings of the inspection (See EC8 and Instruction 147-I Chapter 5, Section 5.4).</p> <p>Effective cooperation with a bank’s management is supported by the introduction of the curators, and for the banks that are systemic or weak, the presence of the ARs of the CBR. The curators operate in accordance with CBR Regulation 310-P, and ARs of the CBR are appointed to work with banks in accordance with CBR Ordinance 2182-U and CBR Ordinance 3057-U.</p> <p>The CBR maintains contact with the supervised banks (following Ordinance 3089-U of October 25, 2013, on the Procedure for the Supervision of Banking Groups, Section 2.7) at multiple levels including the management bodies of the consolidated banking group (including chairman, chief executive, members of the board) and key responsible managers within the bank, such as chief risk officer (CRO). The chief objective of such contact is to communicate the CBR’s assessment of any deficiencies identified in the bank, including any breaches of levels of risk that have been set by the CBR within the group or individual group entities.</p>

	<p>The frequency and extent of contact is determined by the responsible supervisory unit within the CBR and reflects the CBR's assessment of the bank's risk profile and potential impact of the bank on the financial system. However, in practice the CBR aims, both in its regional offices and SIBSD, to maintain continuous contact with the supervised institutions' management bodies. Daily contact is normal practice for institutions in SIBSD.</p>
<b>EC8</b>	<p>The supervisor communicates to the bank the findings of its on- and offsite supervisory analyses in a timely manner by means of written reports or through discussions or meetings with the bank's management. The supervisor meets with the bank's senior management and the board to discuss the results of supervisory examinations and the external audits, as appropriate. The supervisor also meets separately with the bank's independent board members, as necessary.</p>
Description and findings re EC8	<p>It is required for the CBR to inform the bank of the category to which the bank has been assigned using the methodology from Ordinance 2005-U. In future, when ICAAPs are assessed, the findings and outcome of the evaluation will also be communicated to the bank on a mandatory basis. The information is sent to the CEO, who is required to share this information with the board.</p> <p>Further, as a result of the ongoing assessment and analysis of the bank by the curator, any deficiencies and weaknesses and failures to meet the CBR regulations and standards that have been identified are notified to the bank (also with the requirement that the information must be shared with the board).</p> <p>Other information that is notified to the bank includes whether the CBR has established a supervisory team to focus on the banking group of which the bank is a member.</p> <p>In particular, representatives of the banking group (the manager, chairman, and/or members of the BoD (supervisory board) of the principal bank of the banking group, and key individuals from the wider banking group) may be invited to attend an annual meeting of the CBR supervisory group for the banking group. This meeting is to discuss the activities of the banking group, its risk profile, as well as a supervisory action plan.</p> <p>The findings of an inspection must be communicated to a bank in writing. However, it is not obligatory for an inspection to convene a closing meeting to deliver the conclusions of the inspection. Communication of the findings of an inspection to a bank must be done in writing and the bank must, in writing, acknowledge receipt of the report. The bank has 5 business days to make the acknowledgement (or 10 if it is a larger institution). The bank is not asked to confirm agreement with the substance of the findings, only acknowledgement of receipt, but is given a formal period (which is the same 5–10 business days) in which it can dispute the findings or provide evidence that errors have been made (i.e., objections to inspection results). These objections are taken into account when CBR makes decisions on supervisory measures. If necessary, a meeting can be arranged with the bank to discuss its objections (Instruction 147-I, Sections 9.2–9.3). However, the bank may provide objections to the inspection results later. For its part, the CBR is subject to a formal deadline to make decisions on supervisory measures. If, therefore, the bank chooses to submit further information or evidence of changes that it has made, then the CBR may tailor its measures and sanctions accordingly.</p>
<b>EC9</b>	<p>The supervisor undertakes appropriate and timely follow-up to check that banks have addressed supervisory concerns or implemented requirements communicated to them. This includes early</p>

	<p>escalation to the appropriate level of the supervisory authority and to the bank's board if action points are not addressed in an adequate or timely manner.</p>
Description and findings re EC9	<p>The CBR communicates clear deadlines for the elimination of any deficiencies when it issues orders to banks. The assessment team was able to examine a number of examples of letters issued to banks with the deficiencies and follow up requirements clearly delineated.</p> <p>In face of persistent violations, the CBR escalates its supervisory procedures, including fines or, in more severe cases, may include restrictions and prohibitions are put into place. As also discussed in CP11, management failure to cooperate, or significant errors and risks in the bank's operation, may lead to the CBR using its power to replace officials in the bank or restrict compensation packages (CBL, Article 60).</p> <p>As noted above, it is part of the protocol of the CBR to organize unscheduled inspections of banks (see Instruction 149-I, Sections 4.1 and 4.3) when there is information indicating that banks have not complied with orders issued by the CBR, or where there is a need to verify the successful compliance by banks with obligations they have assumed including, any obligations to implement action plans for the financial recovery of the banks, or to review a bank's implementation of measures to prevent insolvency (bankruptcy) based on the issues established under item 4.2 of CBR Ordinance 1650-U.</p>
<b>EC10</b>	<p>The supervisor requires banks to notify it in advance of any substantive changes in their activities, structure and overall condition, or as soon as they become aware of any material adverse developments, including breach of legal or prudential requirements.</p>
Description and findings re EC10	<p>The CBR does not have a specific requirement that creates a general obligation on banks to provide advance notification of changes and material adverse developments. There is a specific requirement in relation to liquidity risk (LCR) if a bank is likely to fall below the required threshold. It may be noted that the regulatory system places an onus on timely ex post notification to the supervisor. The CBR noted that it was, in practical terms, in a bank's interest to provide an early notification of difficulties to the supervisor, and broadly this was their experience.</p> <p>The CBR has a number of regulatory requirements concerning information on certain types of substantive changes in the activities, structure, and overall condition of a bank, particularly those related to reorganization and expansion of the range of banking operations performed, by virtue of the need to obtain a permit (license) from the CBR for said changes.</p> <p>In particular, the CBR requires immediate notification of a change in the composition of a banking group.</p> <p>Banks also provide monthly information on whether they have any violations of prudential standards (Form 0409135—information on required ratios and other indicators of a bank's activities, which is submitted in accordance with CBR Ordinance 2332-U, indicating the numerical values of the standards that have been violated and the dates of the month on which they were violated). The CBR notes that in order to avoid the application of supervisory measures, banks provide timely notification of violations and the reasons for them frequently as part of a request not to apply enforcement measures.</p> <p>In addition, the CBR has the ability to identify substantive changes through a number of methods. For example, banks' activities are monitored through reporting, and many banks are subject to</p>

	daily reporting requirements. Information is also provided, for example, by the AR of the CBR, who has access to meetings of the bank's board.
<b>EC11</b>	The supervisor may make use of independent third parties, such as auditors, provided there is a clear and detailed mandate for the work. However, the supervisor cannot outsource its prudential responsibilities to third parties. When using third parties, the supervisor assesses whether the output can be relied upon to the degree intended and takes into consideration the biases that may influence third parties.
Description and findings re EC11	Inspections (audits both scheduled and unscheduled) may also be performed by auditing firms on instructions from the CBR BoD (CBL, Article 73) and Regulation 442-P sets the procedure for selecting the audit firms (Regulation 442-P of November 30, 2014, on the Procedure for the Selection of Auditing Firms of the Performance of Audits of Banks (their Branches) on Instructions from the BoD of the CBR). Regulation 442-P sets out the criteria an audit firm must meet in order to be hired, and as a condition of hiring, the audit firm must meet these criteria throughout the duration of the inspection and review process (Regulation 442-P, Section 2.1 (or 2.2), 3.2, and 6.2). Inspections conducted by audit firms follow Instruction 147-I and take into account Ordinance 3463-U which establishes, among other things, the rights, responsibilities, and liability of the head and members of a group of auditors. As noted in CP10 EC 11, the power to use such experts has not yet been exercised.
<b>EC12</b>	The supervisor has an adequate information system which facilitates the processing, monitoring and analysis of prudential information. The system aids the identification of areas requiring follow-up action.
Description and findings re EC12	<p>The CBR's key information system is the "reporting automated workstation," which is used by specialists in supervisory subdivisions of the CBR to access banks' reporting data.</p> <p>The offsite supervisory function of the regional offices of the CBR perform a monthly analysis of the current financial condition of banks. The analysis is performed in accordance with the recommendations (methodology) for the analysis of the financial condition of a bank, which are (is) carried out using the AFSB System software. (Please see EC4 above.).</p> <p>The AFSB System is used for the processing of prudential reporting data and for the monitoring of changes in a bank's financial condition through an analysis of trends in indicators describing the financial condition of banks, and also through the forecasting of their condition up to one year in advance.</p> <p>The main purpose of analyzing the financial condition of banks is to determine a bank's exposure to various risks at the time that the analysis is performed, and to determine factors affecting a change in the nature of the risks assumed.</p> <p>Based on the results of an analysis, areas of elevated risk are identified, along with deficiencies and problems in the activities of banks that require the adoption of corrective measures on the part of the CBR. The CBR has developed and is continuing to improve the system for the Analysis of the Effectiveness of Supervisory Activities (AEND), which provides for the monitoring of the timeliness and adequacy of the principal supervisory actions taken by the dedicated supervisor for a bank.</p>
<b>Assessment of Principle 9</b>	<b>Largely Compliant</b>



Comments	<p>The CBR has developed a careful and scrupulous system of supervisory techniques, integrating on- and offsite approaches. Many of the risk principles of the BCP rely on whether the supervisor actively determines the quality of the banks' practices. The Chief Inspectorate, supplemented by the AR where one is appointed, fulfils this function, and the assessors consider this to be the case.</p> <p>Existing practices largely meet the terms of the principle but, as the CBR matures and develops its experience with risk based supervision, there are some areas, in relation to the nature of communication and flexibility in the system as discussed in the paragraphs below, which merit attention to ensure that future practices remain as effective as necessary.</p> <p>There is no general obligation upon for banks to notify the CBR in advance of any substantive changes or of material adverse developments (EC10). Notification requirements, with some specific exceptions (e.g., LCR), are retrospective. By introducing this notification requirement, the CBR will be able to signal to banks that the responsibility for information exchange should be pro-active and not only focused on a backwards looking reporting regime, or investigations that the Chief Inspectorate conduct. The burden should not be solely upon the CBR to "find out" but also there should be some responsibility for the bank to "volunteer" and actively provide information.</p> <p>In terms of obtaining information from banks the CBR is, indeed, well placed owing to the work and insights of its offsite curators, its Inspectorate, and the role of ARs. This view is supported by the assessors' consideration of documents the CBR made available. Roles, responsibilities, and processes are very clearly articulated through a number of CBR instructions and also made very transparent to the banks. The CBR should, though, consider rotation practices for the individuals serving as ARs. There are also two aspects of communication to banks that could be given more consideration.</p> <p>The CBR has multiple levels of contacts with firms and seeks, in general terms, to be transparent in communicating its expectations. Nevertheless, at a senior level, the CBR may wish to build on the recommendations of the FSB and reinforce the priority messages of supervisory concern, particularly with the systemic institutions, with the board (supervisory board). Numerous jurisdictions have found the contact between the most senior supervisors and the board to be one of the most effective modes of delivering a message and achieving the desired response and remedy from the bank. Greater contact with the boards may also foster the understanding that both the CBR and the banking sector should have a common interest in improved risk identification and RM.</p> <p>At a more operational level, meetings between inspection teams and the management or board of a bank are possible but not necessarily routine. A bank will receive a written report and requirement to remedy deficiencies and may provide objections to the written report, but requirements may already have been issued to the bank at this time, as the CBR has a deadline to issue its requirements to the bank based on the inspection. Meetings to discuss the findings with the institution are not, however, mandatory. This process emphasizes the importance of conforming with requirements but has less scope for dialogue and communication with the bank. In an increasingly risk based environment, it is therefore possible that the banks will comply with direct requirements but the banks' understanding of the deeper risks and issues that are leading to deficiencies and violations may be weaker or may not be achieved. It is advisable for meetings with banks, for example, to be seen as routine even by the inspectorate, rather than a more exceptional "as necessary" event.</p>
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	In relation to flexibility, the assessors appreciate that it is important in the Russian system for there to be clear and formalized processes. For example, the overall inspection system is orderly and very well planned, supported by very explicit instructions in 149-I (and as noted in EC2, for example). As a general point, highly formalized systems can sometimes find it more difficult to respond to fast moving situations. The practical challenge, therefore, is to ensure that when critical issues are identified, they must be communicated and then escalated quickly and, if necessary, changes to supervisory actions are rapid. It is not clear to the assessors that present arrangements maximize the CBR's ability to respond swiftly and nimbly to deficiencies or vulnerabilities that could deteriorate into violations or major future deficiencies. In the context of a supervisory system that is evolving further into the risk based approach and seeking to be more forward looking, it is worth, as a standard practice, reviewing existing protocols and regulations with a view to ensuring they not only permit but actively support sufficient flexibility and, in particular, timeliness for the CBR to act.
<b>Principle 10</b>	<b>Supervisory reporting.</b> The supervisor collects, reviews, and analyzes prudential reports and statistical returns <sup>49</sup> from banks on both a solo and a consolidated basis, and independently verifies these reports through either onsite examinations or use of external experts.
<b>Essential criteria</b>	
<b>EC1</b>	The supervisor has the power <sup>50</sup> to require banks to submit information, on both a solo and a consolidated basis, on their financial condition, performance, and risks, on demand and at regular intervals. These reports provide information such as on- and off-balance sheet assets and liabilities, profit and loss, capital adequacy, liquidity, large exposures, risk concentrations (including by economic sector, geography, and currency), asset quality, loan loss provisioning, related party transactions, interest rate risk, and market risk.
Description and findings re EC1	<p>The CBR has the power under the CBL (Articles 4 and 57) to perform banking supervision of the activities of banks on both a solo and a consolidated basis, namely: to establish rules for the performance of banking operations by banks and banking groups, for accounting, for the organization of internal control, for the compilation and submission of reporting, and for the calculation of equity (capital) and required ratios; and also to monitor compliance with the established rules and to take enforcement action as needed for violations that are identified. On the basis of Article 57, Ordinance 2332-U governs all reporting issues—including templates and instructions.</p> <p>A wide range of reporting forms for the purposes of supervision on a solo and a consolidated basis:</p> <ul style="list-style-type: none"> <li>• the accounting balance sheet: full working register of accounts in a bank's accounting system, which contains information about on- and off-balance-sheet assets and liabilities and sources of equity;</li> <li>• financial performance, which contains detailed information about a bank's income and expenditures;</li> <li>• quality of assets, including, information about reserves that have been created for possible losses on loans and claims for interest income receivable;</li> </ul>

<sup>49</sup> In the context of this Principle, "prudential reports and statistical returns" are distinct from and in addition to required accounting reports. The former are addressed by this Principle, and the latter are addressed in Principle 27.

<sup>50</sup> Please refer to Principle 2.

- securities held, including the structure of a bank's securities portfolios, the currency of their issue, the state registration numbers of issues, the volume of securities, the value, and the size of reserves created for possible losses;
- large exposures, including the 30 largest loans to non-bank legal entities and also including information about the borrower, and details on the loan such as purpose, interest rate, the date of issue, the maturity, the existence of any restructuring, the volume and duration of arrears, and the value of collateral;
- concentration of credit risk, including concentration of credit risk assumed by banks with respect to borrowers (groups of related borrowers), as well as parties related to the bank. This information is submitted on both a solo and a consolidated basis for the purpose of the assessment of risks assumed by a group's participants);
- liquidity coverage ratio (LCR, Basel III), including the LCR and other liquidity risk monitoring instruments;
- calculation of equity (Basel III), including information about the sources of base, supplementary, and additional capital, as well as sources excluded from this group;
- information on required ratios and other indicators of a bank's performance, including information on compliance with banks' required ratios and about indicators for calculating the amount of interest rate, stock, market, and FX risks;
- information on assets and liabilities by the time remaining to the demand date and maturity and including information about a bank's liquidity position;
- interest rate risk, based on a gap analysis and containing, among other things, information about on- and off-balance-sheet instruments that are sensitive to a change in interest rates;
- information on contingent liabilities and derivatives;
- information on major depositors, includes concentration of a bank's liabilities to depositors, the aggregate amount of liabilities to whom represents 10 percent or more of the bank's total liabilities;
- information on funds placed and attracted, including sectoral, geographical and currency breakdown.
- report on open FX positions, including information on the FX risk assumed by a bank and a banking group with regard to the same set of participants for which a consolidated balance sheet is compiled;
- information on internal controls, including documents governing the functions of a bank's internal control system and information about the internal control function;
- report on the entities in the banking group, including information on all of the legal entities (engaged in financial and nonfinancial activities, including nonresidents) that are controlled by the bank or over whose activities the bank has a significant influence, regardless of the inclusion of their reporting data in other consolidated prudential reporting, including information about the control methods, the size of investments in the statutory capital of other legal entities and the types of activities of the investees; information about securities issued by participants in a banking group and held by a bank and/or participants in a banking group; as well as information about investments by participants in a banking group in the statutory capital of the principal bank of the banking group and investments by the principal bank of the banking group and/or participants in the banking group in the shares of investment funds;

	<p>On a consolidated basis:</p> <ul style="list-style-type: none"> <li>• consolidated balance sheet, which includes information with a breakdown by group participants (residents and nonresidents) engaged in financial and insurance activities, financial intermediation, and ancillary activities, as well as those that are structured enterprises established for the purpose of performing certain financial operations (for example, the securitization of assets of the principal bank of a banking group and/or participants in a banking group) and/or nonfinancial operations (for example, real estate), grouped by types of business of the banking group participants;</li> <li>• consolidated statement of financial performance, which includes information about a group's financial performance for the same set of participants for which a consolidated balance sheet is compiled;</li> <li>• calculation of equity (capital) and values of required ratios for a banking group, which contains information on the amount of a group's capital, its compliance with the prudential standards established by the CBR, including compliance by the principal banks of banking groups that are systemically important banks, the liquidity coverage ratio, and capital adequacy ratios for the same set of participants for which a consolidated balance sheet is compiled;</li> <li>• risks assumed, procedures for their assessment, and risk (including liquidity) and capital management procedures on a solo and consolidated basis.</li> </ul> <p>Prudential reports are checked to verify that they have been properly compiled, including internal checks for logical consistency. Reporting statements are checked, and their accuracy is also evaluated in the process of their analysis within the context of ongoing supervision, and in the course of inspections as discussed elsewhere.</p>
<b>EC2</b>	<p>The supervisor provides reporting instructions that clearly describe the accounting standards to be used in preparing supervisory reports. Such standards are based on accounting principles and rules that are widely accepted internationally.</p>
Description and findings re EC2	<p>Prudential reporting is based on Russian accounting standards, which are based on the International Financial Reporting Standards (IFRS) but not yet fully reconciled. All reporting data submitted by banks to the CBR must be compiled on the basis set out in Regulation 385-P, which sets out mandatory accounting rules for bank.</p> <p>When issuing accounting standards, the CBR is governed by the requirements of Federal Law 402-FZ on Accounting, with regard to the application of the IFRS as the basis for the development of federal and sectoral national accounting standards (see Section 4.4 of Ordinance 2851-U).</p> <p>The CBR is continuing its process of implementing IFRS standards. For example, IFRS based rules for hedge accounting by banks will be introduced in the first quarter of 2016. The CBR will issue regulations to implement IFRS9 as of January 1, 2018. At the present time, banking groups may, but are not obliged, to use IFRS for prudential indicators although the option does not support the comparability of indicators.</p>
<b>EC3</b>	<p>The supervisor requires banks to have sound governance structures and control processes for methodologies that produce valuations. The measurement of fair values maximizes the use of relevant and reliable inputs and is consistently applied for RM and reporting purposes. The valuation framework and control procedures are subject to adequate independent validation and verification, either internally or by an external expert. The supervisor assesses whether the valuation used for regulatory purposes is reliable and prudent. Where the supervisor determines</p>

	that valuations are not sufficiently prudent, the supervisor requires the bank to make adjustments to its reporting for capital adequacy or regulatory reporting purposes.
Description and findings re EC3	<p>The CBR has regard to the quality of valuation based on the CBL (in particular Article 72 but also 72,<sup>1</sup> and 73).</p> <p>The CBR has issued Letter 37-T, on Measures to Monitor the Correct Reflection of Assets at Fair Value by Banks to provide guidance to the banks. It should, however, be noted that the CBR letter has the force of recommendation and is not a binding requirement. Nonetheless, 37-T (item 1.2) provides that the approved internal documents of a bank ought to contain:</p> <ul style="list-style-type: none"> <li>• procedure and periodicity for evaluating the methodology for determination of the fair value of assets of each type, with a detailed description of the methods (models) employed for the measurement of assets at fair value, the source data, and assumptions used; quantitative threshold values (criteria), deviation from which may indicate inadequacy of the results of the measurement of assets at fair value in accordance with the approved methodology; and</li> <li>• the procedure for the disclosure of information regarding methods for the measurement of assets at fair value.</li> </ul> <p>A bank is expected to take into consideration the degree of consistency between the source data used by the bank for the purpose of measuring the fair value of assets and the nature of the assets, the current status of the market, and source data and assumptions used by market participants for determining prices for similar assets, in accordance with the methodologies accepted for setting prices for financial instruments (regarding the level of risks associated with an asset, the status of and level of activity in the market, and the economic situation). The results of an assessment of the consistency of the source data should serve as the basis for a decision to make corrections in the source data (Section 1.3 of Letter 37-T).</p> <p>Active market prices are recommended as the most reliable source data, when assessing the consistency. Also absence of corrections in source data, when there are grounds to find that the source data are not consistent, serves as grounds for concluding that the fair value measurement of assets is not reliable.</p> <p>Banks are expected also to create databases to store information for at least five years on source data (market prices, the value of transactions with respect to a similar asset) and other information used in fair value calculations (Section 1.4 of CBR Letter 37-T).</p> <p>Banks' management must ensure regular monitoring of the correct fair value measurement of assets and the methodology used for its application (verification, testing, monitoring) (Section 1.5 of CBR Letter 37-T). The accounting rules provide for the valuation of assets at their initial value at the time of their initial recognition. Subsequently, a bank's assets are measured at fair value in accordance with the requirements of IFRS 13—Fair Value Measurement, which is officially recognized within the Russian Federation.</p> <p>Segregation of duties is considered as the methodology for determining the fair value of assets, and must be developed without the involvement of staff engaged in operations (transactions) related to the assumption of market risk and measurement of the value of trading book instruments (Section 3.4—Market risk Annex to Ordinance 3624-U).</p>

	<p>The methodology for determining the fair value of trading book instruments must provide that if a market for the financial instruments is no longer active, its prices no longer serve as a reliable input, and the bank must change the measurement method and uses several measurement methods, such as the market and income approaches, for example.</p> <p>The methodology for measuring the value of trading book instruments used by a subsidiary must be approved in writing by the principal bank of the banking group, and must be subject to periodic monitoring to ensure its suitability.</p> <p>Information about trading book instruments measured using quantitative measurement models must be communicated to the management bodies of a bank (principal bank of a banking group). A bank (principal bank of a banking group) develops a methodology for estimating the degree of uncertainty of measurements obtained using these models, and when necessary makes corrections to the value of instruments measured using the models.</p> <p>The internal audit function of a bank that uses quantitative market risk measurement models performs a quarterly assessment of the quality (accuracy) of these models based on historical data, and also based on current data in the course of ongoing activities. This check can also be performed by another division of a bank provided it is independent of the sections of the bank that actively assume market risk for the bank and of the section of the bank that develops quantitative market risk measurement models.</p>
<b>EC4</b>	The supervisor collects and analyses information from banks at a frequency commensurate with the nature of the information requested, and the risk profile and systemic importance of the bank.
Description and findings re EC4	<p>The range of information banks must submit is discussed in EC1. In accordance with Ordinance 2332-U, the CBR receives prudential reporting with varying periodicity. Broadly speaking, the systemic banks are required to maintain a more frequent reporting schedule than other banks, with weekly and daily reporting being included if the CBR considers the need. The CBR has the right to require that bank submit reporting statements more frequently (Procedures for the Compilation and Submission of Reporting Forms). In the event of the rapid deterioration of a bank, particularly a member of the deposit insurance system, the CBR can require daily reporting. (Please also see CP8.) (Letter 69-T on Urgent Measures for a Prompt Supervisory Response.)</p> <p>As an example of differentiation in reporting, for banks defined as systemically important, reporting on the LCR on a consolidated basis was increased to monthly as of January 1, 2016. The largest Russian banks (including systemically important credit institutions) with total assets of RUB 50 billion or more and (or) retail deposits of RUB 10 billion or more have reported the LCR monthly on a solo basis since July 2014 (first reports as of August 1, 2014).</p> <p>Some reports are required only when there is a change in circumstances. For example, the report on the composition of participants in a banking group is submitted to the CBR when changes occur (i.e., within 10 days of the date of the change).</p> <p>In addition, and on the request of the CBR, banks submit reports on the composition of the banking group and open FX positions within 10 days of the receipt of a written request from the CBR, as well as duly certified copies of documents and other information from participants in a</p>

	<p>banking group that are not banks (residents and nonresidents), which were used in the compilation of the report.</p> <p>In terms of timely analysis and evaluation, prudential returns and reports are processed by the System for the Analysis of a Bank's Financial Condition (the AFSB System). The AFSB System uses the methodology for analyzing the financial position of a bank that is consistent with the approach used by the curators (offsite function) for the analysis of the financial condition of a bank (Letter 15-5-3/1393). The AFSB System also uses the methodology for the evaluation of the economic condition of a bank in accordance with Ordinance 2005-U.</p>
<b>EC5</b>	In order to make meaningful comparisons between banks and banking groups, the supervisor collects data from all banks and all relevant entities covered by consolidated supervision on a comparable basis and related to the same dates (stock data) and periods (flow data).
Description and findings re EC5	<p>Banks that are the parent banks of banking groups submit reporting statements to the CBR on a solo and a consolidated basis.</p> <p>Consolidated reporting by banking groups includes:</p> <ul style="list-style-type: none"> <li>• monthly—LCR and individual indicators used in its calculation, which is part of a report on capital adequacy and other required prudential ratios of the banking group (see also EC4);</li> <li>• quarterly—asset quality, data on large loans, data on the concentration of credit risk, a consolidated balance sheet, a consolidated statement of financial performance, a report on the amount of equity (capital) and the values of the required ratios of the banking group, a report on open FX positions of the banking group, and explanatory notes regarding the consolidated reporting;</li> <li>• semi-annual and annually—information about risks assumed, procedures for their assessment and for the management of risks and capital, consolidated financial reporting as part of a report on the financial condition of the bank, a report on aggregate income of the bank, a cash flow statement of the bank, a statement of changes in equity of the bank, interim consolidated financial statements, and in the event that an audit has been performed, the auditor's opinion based on the results of a review audit of the reliability of the reporting. Annually, as part of the information on risks assumed, procedures for their assessment and for the management of risks and capital, a report on the financial condition of the bank, a report on aggregate income of the bank, a cash flow statement of the bank, a statement of changes in equity of the bank, annual consolidated financial reporting, and an auditor's opinion regarding its reliability.</li> </ul> <p>The consolidated reporting forms have been developed on the basis of the forms for solo accounting (financial) statements of banks taking into consideration the specific aspects of consolidation and they consequently have the same format as the published reporting statements, they are compiled on the same date and for the same reporting period, and in connection with this, they provide comparable information for analysis.</p>
<b>EC6</b>	The supervisor has the power to request and receive any relevant information from banks, as well as any entities in the wider group, irrespective of their activities, where the supervisor believes that it is material to the condition of the bank or banking group, or to the assessment of the risks of the bank or banking group or is needed to support resolution planning. This includes internal management information.
Description and findings re EC6	The CBR, in accordance with Article 57 of the CBL, has the right to request and receive from banks, parent banks of banking groups, and principal institutions of bank holding companies, the



	<p>necessary information about their activities, including information about participants in banking groups and bank holding companies that are not banks, and to request explanations regarding this information.</p> <p>The CBR also has the right to receive information about the activities of a bank (the activities of a banking group) directly from its management (the management of the principal bank of a banking group). The CBR receives this information from ARs of the CBR, as well as, for example, in the context of meetings with the banks' management of the banks, and written responses to inquiries by the CBR.</p> <p>A draft federal law has now been prepared that provides for amendments to Federal Law 127-FZ with regard to granting the power to representatives of the CBR and the DIA to also perform an analysis of the financial condition of legal entities that are financial institutions participating in the same banking group (holding company) as the bank whose financial condition is being analyzed, when performing an analysis of a bank's financial condition within the framework of Article 189.47.</p> <p>In discussion with the CBR and also some market participants, it was indicated that the CBR did make use of the power to obtain management information.</p>
<b>EC7</b>	<p>The supervisor has the power to access<sup>51</sup> all bank records for the furtherance of supervisory work. The supervisor also has similar access to the bank's Board, management and staff, when required.</p>
Description and findings re EC7	<p>According to the CBL (Article 73) and Instruction 147-I, in the course of an inspection the CBR may request and receive from a bank all of the documents (information) for the period being inspected necessary to achieve the objectives of the inspection.</p> <p>This scope of information includes, for example, documents related to the state registration of the bank and obtaining a banking license; organizational and administrative documentation; instructions, regulations, orders, rules, and other internal documents; materials of the internal control function; analytical and summary accounting documents; accounting, statistical, and financial statements; explanatory notes; statements and written and oral explanations provided by the manager and employees of a bank; auditor's opinions regarding financial (accounting) statements; reports and materials from inspections performed by the CBR and/or federal authorities; contracts; documents confirming that FX operations being performed are in compliance with the legislation of the Russian Federation and that the Law on AML/CFT is being observed; and other documents (information). A bank may be requested to provide documents (information) in hard copy or in electronic form.</p> <p>The CBL does not explicitly describe the CBR's right of access to the board or senior management. However, a number of articles of the CBL establish the principle of the CBR's right to access information and persons in a bank. Article 76, which establishes the position of AR (discussed in CP9) notes that the AR has the right to participate, on a non-voting basis, in the executive management meetings and decision making committees of the institution.</p> <p>Similarly, Instruction 147-I (Section 2.3) confirms that the head of an inspection team should have access to the persons with whom the inspection is coordinated:</p>

<sup>51</sup> Please refer to Principle 1, Essential Criterion 5.

	<ul style="list-style-type: none"> <li>• the chief executive officer, his deputies, and members of the executive board of a bank; the manager of a branch of a bank and his deputies; the head of a representative office and his deputies (referred to hereinafter as the manager of a bank);</li> <li>• the chief accountant of a bank and his deputies.</li> </ul> <p>Further, the inspection team (Section 7.9) “shall be entitled if necessary to acquaint the head of the credit organization (its branch), the BoD (supervisory council) of the credit organization with the motivated judgments reflected in the report about the results of the inspection.” Although the assessors encountered different views on the matter in the course of their meetings and discussions in the mission it was not, though, the assessors’ overall impression that it was common for the inspection team to take this opportunity. (Please see comments CP9).</p>
<b>EC8</b>	<p>The supervisor has a means of enforcing compliance with the requirement that the information be submitted on a timely and accurate basis. The supervisor determines that the appropriate level of the bank’s senior management is responsible for the accuracy of supervisory returns, imposes sanctions for misreporting and persistent errors, and requires that inaccurate information be amended.</p>
Description and findings re EC8	<p>Reporting submitted by banks to the CBR in accordance with Ordinance 2851-U on the Rules for the Compilation and Submission of Reporting by Banks to the CBR must be signed by the CEO and the chief accountant, who are responsible in accordance with said ordinance for the timely, complete, and accurate submission of information to the CBR.</p> <p>If a bank is found to have submitted inaccurate reporting statements that contain incorrect data as a result of a violation of the established procedure for the maintenance of accounting records and/or for the compilation of reporting statements, including inaccurate information about financial condition and property status, the bank responsible for the misrepresentation of reporting data is required to correct the data (Section 5 of Ordinance 2851-U). Corrected reporting statements and indicators must be submitted (unless otherwise provided for by the procedure for the compilation and submission of reporting statements).</p> <p>The CBR has the right to apply enforcement measures against a bank in accordance with the CBL (Article 74) for a failure to submit reporting statements, for the submission of incomplete and inaccurate reporting statements, and for the submission of reporting statements in violation of the deadlines established by regulatory acts of the CBR. In the event that material inaccuracies are identified in the reporting data in accordance with the BBAL (Article 20), the CBR may revoke a bank’s banking license. Please see comments section in CP11 for greater detail.</p> <p>Further, the CBR has the right to apply measures against the parent bank of a banking group in the event that the parent bank of a banking group violates the requirements of federal laws in connection with its participation in the banking group, including a failure to submit information, the submission of incomplete or inaccurate information, a failure to perform a mandatory audit, and a failure to comply with orders by the CBR to eliminate violations related to its participation in the banking group, or if these violations threaten the lawful interests of creditors (depositors) of the given bank or of banks that are participants in the banking group (CBL, Article 74).</p>

<b>EC9</b>	The supervisor utilizes policies and procedures to determine the validity and integrity of supervisory information. This includes a program for the periodic verification of supervisory returns by means either of the supervisor's own staff or of external experts. <sup>52</sup>
Description and findings re EC9	<p>As stated in Instruction 147-I (Section 1.3), one of the principal objectives of the CBR's inspections is to evaluate the accuracy of the accounting (reporting) by a bank. This issue may be verified in the context of a thematic or a full-scope inspection of a bank.</p> <p>Information on the accuracy of accounting (reporting) by a bank is reflected in the analytical part of an audit report (Sections 7.5.2 and 1.12 of Instruction 147-I).</p> <p>The procedure for the organization and performance of an inspection of the accuracy of accounting (reporting) by a bank and for the reflection of the results of such an inspection is outlined in the Methodological Recommendations for the Organization and Performance of an Audit of the Accuracy of Accounting (Reporting) by a Bank (Branch) (CBR Letter 77-T).</p> <p>Inspections (including those for the purpose of evaluating the accuracy of accounting (reporting)) may also be performed by auditing firms on instructions from the CBR BoD. In connection with this, the CBR has published (CBL, Article 73, Part 2):</p> <ul style="list-style-type: none"> <li>• CBR Regulation 442-P, on the Procedure for the Selection of Auditing Firms of the Performance of Audits of Banks (their Branches) on Instructions from the BoD of the CBR;</li> <li>• Ordinance 3463-U.</li> </ul> <p>Verification of the correct compilation of reporting statements is also performed as part of offsite supervision:</p> <ul style="list-style-type: none"> <li>• when receiving reporting statements, using internal arithmetic and logical control checks; and</li> <li>• in the process of their analysis by dedicated supervisors using the AFSB System.</li> </ul>
<b>EC10</b>	The supervisor clearly defines and documents the roles and responsibilities of external experts, <sup>53</sup> including the scope of the work, when they are appointed to conduct supervisory tasks. The supervisor assesses the suitability of experts for the designated task(s) and the quality of the work and takes into consideration conflicts of interest that could influence the output/recommendations by external experts. External experts may be utilized for routine validation or to examine specific aspects of banks' operations.
Description and findings re EC10	Inspections (both scheduled and unscheduled) may also be performed by auditing firms on instructions from the CBR's BoD (CBL, Article 73, Part 2). The procedure for the selection of auditing firms for the performance of inspections of banks is established by CBR Regulation 442-P, which establishes the criteria that must be met by an auditing firm in order to be appointed. The CBR has been using this procedure in order to identify suitable audit firms but has not yet made any appointments to carry out tasks for the CBR.

<sup>52</sup> Maybe external auditors or other qualified external parties, commissioned with an appropriate mandate, and subject to appropriate confidentiality restrictions.

<sup>53</sup> Maybe external auditors or other qualified external parties, commissioned with an appropriate mandate, and subject to appropriate confidentiality restrictions. External experts may conduct reviews used by the supervisor, yet it is ultimately the supervisor that must be satisfied with the results of the reviews conducted by such external experts.

	<p>A draft contract for the performance of an inspection includes a requirement that an auditing firm must meet said criteria throughout the entire duration of its inspection of a bank and the review by the auditing firm of written objections or comments regarding the auditing firm's report on the inspection of the bank (if applicable), (Section 6.2 of Regulation 442-P).</p> <p>When the CBR employs its powers to instruct auditors to carry out inspections, the inspections of banks must be carried out by auditing firms in accordance with Instruction 147-I, auditing standards, and the code of professional ethics of auditors, taking into account the specific considerations referred to in Ordinance 3463-U. Ordinance 3463-U establishes, among other things, the rights, responsibilities, and liability of the head and members of the team of auditors.</p> <p>Issues to be reviewed by an auditing firm when auditing a bank are specified in the inspection mandate (an addendum to the audit mandate) (Section 2.1 of Ordinance 3463-U).</p>
<b>EC11</b>	The supervisor requires that external experts bring to its attention promptly any material shortcomings identified during the course of any work undertaken by them for supervisory purposes.
Description and findings re EC11	<p>It is clear from Ordinance 3463-U (Section 3.5) that any expert who performs an inspection at the request of the CBR is required to provide information to the CBR regarding all of the issues related to the performance of the inspection. If material information falls outside of the scope of the inspection then it is not covered. Also there is no explicit requirement for the external expert to bring any matter promptly to the attention of the CBR.</p> <p>The CBR has not yet instructed any external experts to undertake any work for supervisory purposes, but at the time of the assessment it was planning to do so in the near future. As a matter of good practice the auditor may well raise any matter within the scope of its mandate as expeditiously as possible. Once the CBR has had the experience of working with appointed audit firms to carry out certain reports for it, it is to be expected that the relationship and mutual understanding of information flows between the audit community and the CBR will be more strongly established.</p> <p>It may be noted that the external expert is not without any ability to communicate with the CBR even though the EC is not met. Under Ordinance 3463-U (Section 3.5), the head of group of auditors has the right to send written appeals to CBR on all questions of carrying out the inspection, and also, as noted above, is obliged to provide to CBR information on all questions of carrying out the inspection at the request of the official of the CBR. According to Ordinance 3463-U (Section 6.8), a group of auditors can include in their concluding findings the professional judgments of the team (regarding going concern assumption), and also other data received during the audit work within the defined scope of the work. Other information can be reflected by the auditing organization in the modified audit opinion prepared (including statutory audit).</p>
<b>EC12</b>	The supervisor has a process in place to periodically review the information collected to determine that it satisfies a supervisory need.
Description and findings re EC12	The CBR seeks to deliver a continuous process of streamlining its data requests and requirements from banks. Work is carried out with the participation of all relevant sections of the CBR, and aims to ensure that submissions to the CBR are relevant and meaningful—reflecting the complexity of and changes to banks and banking groups—as well as to eliminate duplication of information.

	<p>In addition, based on the results of the ongoing analysis of the activities of banks, regional offices of the CBR prepare proposals for the revision of reporting forms to bring them up to date and into line with the supervisory needs, the risk profile, and the types of operations performed by banks.</p> <p>Issues related to the optimization of reporting are considered within the framework of a working group created within the CBR to address the development of statistical work and the optimization of reporting, with the participation of specialists from supervisory subdivisions of the CBR, as well as representatives of banks.</p> <p>The assessor's discussions with industry participants suggested that at the present time there was scope to identify and eliminate some areas of overlapping and duplicative information requirements.</p>
<b>Assessment re Principle 10</b>	<b>Largely Compliant</b>
Comments	<p>The CBR has strong powers and rights of access to information and uses its inspection process to obtain assurance that it can depend on the substance and quality of information submitted by the banks.</p> <p>The CBR is in the course of introducing a number of important and valuable developments. These include the establishment of a dedicated department to the issue of valuation (covering all aspects); a move to an XBRL taxonomy for supervisory reporting; and the completion of scrutiny of audit firms who would be eligible to be instructed by the CBR to undertake specific inspections for supervisory purposes (i.e., firms who meet the criteria set out in Regulation 442-P). Not all of these developments can be finalized and implemented quickly—the XBRL project, for example, is expected to take two to three years. However, the changes are indicative of the CBR's continuing progress.</p> <p>Equally, and where possible, the CBR adopts a professional approach to the introduction of new reporting requirements and the streamlining of existing requirements. It is, for example, the CBR's practice when possible to test run new reporting requirements. It is also welcome that the CBR has an inter-departmental project to focus on the relevance and business need of the CBR's existing reporting requirements.</p> <p>A continuing concern, and which persists since the last assessment, is that the CBR does not have the right to require the prompt notification of a material issue that has come to the attention of an external expert in the course of that expert's work for the CBR on a supervisory matter. It may be stressed that an external expert has the right to contact the CBR and may of course exercise this option, but no obligation is placed on the external expert (except in cases of an official request from the CBR). At present the onus is, therefore, very much upon the CBR to request information, rather than imposing a notification obligation on either the supervised institution or a professional expert who has knowledge of the institution, to pro-actively inform the CBR of matters of material significance. It is strongly recommended that legislative amendments are made such that the CBR is able to impose this requirement. It is an issue of good practice that supervised institutions and professional service providers fully understand that they have a responsibility to ensure that the supervisor is in the position to exercise its own function as effectively as possible and in as timely a manner as possible. The CBR's ability to intervene, for example, in a deteriorating situation is more</p>

	likely to result in a successful outcome that protects the interest of depositors and the banking system, if the CBR is made aware of a material issue as soon as possible.  This recommendation echoes the concerns and recommendations noted under CPs 9 and CP27.
<b>Principle 11</b>	<b>Corrective and sanctioning powers of supervisors.</b> The supervisor acts at an early stage to address unsafe and unsound practices or activities that could pose risks to banks or to the banking system. The supervisor has at its disposal an adequate range of supervisory tools to bring about timely corrective actions. This includes the ability to revoke the banking license or to recommend its revocation.
<b>Essential criteria</b>	
<b>EC1</b>	The supervisor raises supervisory concerns with the bank's management or, where appropriate, the bank's board, at an early stage, and requires that these concerns be addressed in a timely manner. Where the supervisor requires the bank to take significant corrective actions, these are addressed in a written document to the bank's board. The supervisor requires the bank to submit regular written progress reports and checks that corrective actions are completed satisfactorily. The supervisor follows through conclusively and in a timely manner on matters that are identified.
Description and findings re EC1	The legal foundation for corrective and sanctioning powers of the CBR is enshrined in Article 73 of the CBL according to which to fulfill its functions, the CBR " <i>shall conduct inspection of credit institutions, give them instructions, which the credit institution must obey, to eliminated violations discovered in their work and involving the breach of federal laws and CBR's regulations.</i> " Article 74 of the same law determines the different types of measures at the disposal of the supervisors; some of them are preventive, others are coercive. However, whenever the CBR identifies a breach in prudential regulations or if the banks operate in a manner that jeopardize the interest of the depositors, the CBR by all means will resort to enforcement action.  There is a constant dialogue between the relevant staff of the CBR (Credit Institutions Supervision Directorate) and representatives of the different hierarchy levels of every bank, which includes the supervisory board (BoD) and senior management. The intensity of this dialogue depends on the risk profile, size, and systematic importance of the different credit institutions. For systemic banks and banks that have received government funding support, the cooperation with the senior management of the banks is also carried out through the institution of dedicated supervisors and ARs of the CBR <sup>54</sup> who constitute a permanent channel of communication (see below for more details).  The CBR raises its supervisory concerns with the Bank's management at different stages. This can take place during or at the end of the onsite visit (see CP8), as well as in an official letter in the cases when the deficiency is ascertained during the offsite analysis. Intensity of CBR's intervention will depend on the seriousness of each case.

<sup>54</sup> The role of these representatives is governed by the following regulations: CBR Regulation 310-P of September 7, 2007, on Dedicated Supervisors of Lending Institutions; CBR Directive 2182-U of February 9, 2009, on the Procedure for the Appointment of Authorized Representatives of the CBR; CBR Directive 2181-U of February 9, 2009, on the Procedure for the Submission of Information and Documents to Authorized Representatives of the CBR by Lending Institutions; CBR Directive 3057-U of September 6, 2013, on the Procedure for the Appointment of Authorized Representatives of the CBR.

If the deficiency identified by the CBR does not directly threaten the interests of the lending institution's creditors and depositors and the further operation of the bank itself, the CBR will apply preventive measures in accordance with CBR Instruction 59 of March 31, 1997.<sup>55</sup> These measures require full cooperation and commitment of the bank's management bodies. The CBR's concerns can be raised either during a meeting arranged with the bank's management or in the form of a letter. The CBR will notify in writing to the Bank's senior management the deficiencies identified and the action plan to be taken by the institution to redress the situation as well as a timetable for its implementation. This arrangement can also subject the bank to enhanced scrutiny until the final implementation of the action plan. In that regard, the monitoring of the fulfillment of remedial measures is ensured through regular written progress reports from the bank (item 1.12 of Instruction 59).

In addition, the CBR can issue recommendations in certain particular circumstances, for example when the CBR has been tipped off by a third party. The bank will be recommended to take some corrective measures and in case of inaction, the CBR will resort to more prescriptive instruments.

If the application of preventive measures described above does not attain the expected results, or in situations where the bank has committed serious breaches (e.g., violation of federal laws, regulatory acts or orders of the CBR, failure to submit compulsory information, submission of incomplete or inaccurate data, failure to disclose reporting statements or perform mandatory audits, etc.), the CBR will turn to enforcement measures as contemplated in the CBL, Article 74, Part 1. To that end, the CBR will issue an order containing detailed reference to specific provisions of federal laws and regulatory acts of the CBR that have been breached, the types of violations identified, the deadlines for their elimination, the specific compulsory measures being applied with respect to the breaches and a clear timetable for reporting to the CBR on progress made to restore the situation. More forceful sanctions, including revocation of the banking license (see EC 2 below) can be taken in case a bank does not comply with CBR's orders or in cases where the bank operates in a way that poses a real threat to the interests of the depositors or to the stability of the system.

In determining the type of sanctions to be applied, the CBR takes into account the nature and materiality of the violations and the factors contributing to their occurrence, the systematic nature of their commission, the overall financial condition of the lending institution, as well as its position in the regional and federal banking services market. The CBR Instruction 59 of March 31, 1997 spells out both preventive and coercive measures and stipulates the main conditions of their use. These enforcement measures are applied by the central administration and regional offices of the CBR. In accordance with the procedure established by CBR Directive 2387-U of January 26, 2010,<sup>56</sup> enforcement measures are applied with respect to a lending institution as a whole, including those applied for violations committed by branches taken in aggregate.

The CBR has also established mechanisms to monitor compliance with CBR's orders or protocols. Its regional offices will follow up on the implantation by banks of their commitments. Said monitoring

<sup>55</sup> On the Application of Enforcement Measures against Lending Institutions.

<sup>56</sup> On Cooperation among Regional Offices of the CBR in the Application of Measures against Lending Institutions, the Main Offices and Subdivisions of Which Are Located in Different Constituent Territories of the Russian Federation (referred to hereinafter as Directive 2387-U).



	<p>is performed on the basis of an analysis of the reporting statements submitted by lending institutions, sometimes on a daily basis. Further monitoring can also include onsite audits. The CBR is also able to regularly monitor remedial actions taken through its on-line “Remedial Measures Database.” This custom-developed software enables the CBR to determine progress on correcting enforcement actions at any bank through sorting information by institution, territorial office, or type of regulatory violation.</p> <p>As indicated at the beginning of this section, consultations are held regularly with the management, members of the BoD, and stockholders for the purpose of evaluating existing deficiencies and violations, discuss trends in risks and any strategy related issues.</p> <p>Effective cooperation with bank’s senior management is also carried out through the institution of dedicated supervisors<sup>57</sup> and ARs of the CBR appointed for systemic banks and lending institutions that have received government funding support. These ARs of the CBR participate without voting rights in meetings of management bodies of lending institutions and also bodies of lending institutions that make decisions regarding lending issues and the management of its assets and liabilities. They play a role of interface between the CBR and the bank and can convey important messages to the credit institution, especially when there are matters of concerns (for more detail see the description of Criterion 1 of Principle 8).</p> <p>It is also noteworthy that, in accordance with CBR Directive 2005-U, the CBR performs at least once per quarter an evaluation of the economic condition of banks and a classification of banks. Information about the assignment of a bank to a classification group and about deficiencies in its activities that motivated its classification is sent by the CBR to the bank’s chief executive officer, with the recommendation that he communicates said information to members of the bank’s BoD (supervisory board) and to its collegial executive body.</p>
<b>EC2</b>	<p>The supervisor has available<sup>58</sup> an appropriate range of supervisory tools for use when, in the supervisor’s judgment, a bank is not complying with laws, regulations or supervisory actions, is engaged in unsafe or unsound practices or in activities that could pose risks to the bank or the banking system, or when the interests of depositors are otherwise threatened.</p>
Description and findings re EC2	<p>The Russian enforcement regime for banks is governed by the CBL (Article 74), the banking law (Article 19) and by other regulations (e.g., the AML law<sup>59</sup>). The CBR is empowered to impose measures (discussed right below) when a bank or any of its administrators or shareholders have committed certain offenses detailed in the law, consisting of, inter alia, violation of the banking law and other acts including AML law, the CBR regulations, by-laws, and orders. The same regime will apply wherever a bank is threatening depositor’s interest, providing or disclosing incomplete or inaccurate information, ignoring CBR orders, engaging in money laundering operations, and carrying out transactions outside the ambit of its license.</p>

<sup>57</sup> CBR Regulation 310-P of September 7, 2007, on Dedicated Supervisors of Lending Institutions.

<sup>58</sup> Please refer to Principle 1.

<sup>59</sup> Federal Law “On Countering the Legalization (Laundering) of Criminally Obtained Incomes and the Financing of Terrorism.”

The CBR has available a wide range of supervisory tools to address situations where banks do not comply with laws and regulations or where banks engage in unsound practices. The CBR may, depending on its view of the seriousness and nature of detected shortcomings, take one or more of a broad selection of supervisory measures, if deemed necessary. These measures are of different nature and include administrative compulsory measures and administrative penalties.

For example, in the cases when the shortcomings in the work of a bank do not pose an immediate threat to the interests of creditors and depositors, the CBR can instruct the bank to address the situation by adopting a series of measures. The remedial measures can take various forms, including asking the bank to cease a particular conduct, to eliminate a specific violation or to take certain actions to bring the situation back to normal.

In more serious scenarios, in particular if a bank is considered financially unstable or represents a material threat to the interests of its depositors, the CBR can:

- restrict or suspend the performance of certain bank's operations,<sup>60</sup> including lending activities for a period of up to six months;
- impose a ban on certain transactions for a period of up to one year;
- request additional capital under certain conditions;
- prohibit payment of dividends and request a reduction in variable remuneration;
- force the bank to change its internal organization;
- instruct the bank to replace bank's officials;
- impose a limit on the interest rates,
- limit certain operations like opening accounts with correspondent banks and non-banking credit organizations;
- restrict branch expansion;
- impose a ban for a period of up to one year, on operations with the parent credit institution of the banking group;
- restrict any transactions and dividend flows between the bank and the parent entity;
- place the bank under provisional administration.

The CBR has the power to force a bank or a banking group to change their organizational structure only in specific circumstances, for example if a bank fails to fulfill CBR orders, or when violations, banking operations, or transactions carried out by the bank pose a real threat to the interests of its depositors.

Under the new ICAAP regime (Ordinance 3883-U of December 7, 2015) to be implemented from 2016, in the event that the risk and capital management and internal control systems are found to be unsatisfactory, the CBR is empowered to issue an order requesting the bank to make the necessary adjustments in light of the nature and scale of the risks. This can include an increase of CAR, even if it is above the minimum threshold. Since 2014, the CBR can also prohibit a bank that is a member of the deposit insurance system from attracting deposits from individuals if certain conditions are no longer met.

<sup>60</sup> Including operations with the principal lending institution of a banking group, the principal institution of a bank holding company, and the participants in a banking group (bank holding company).

It is worthwhile noting that the CBR can combine administrative compulsory measures and administrative penalties where needed.

Under certain circumstances, for example when a bank displays signs of possible insolvency, the CBR can also appoint a temporary administration for the management of the lending institution for a period of up to six months. In 2016, for example, a bank (ranking 63) was placed under temporary administration after it stopped making payments due to a cash shortage.

The CBR is also empowered to use other types of sanctions consisting of “administrative penalties.” In effect, the CBL contains several provisions according to which financial institutions can be subjected to fines up to 0.1 percent of the minimum amount of statutory capital. The Russian Federation Code on Administrative Offenses (RF CAO) also permits the CBR to apply administrative penalties against lending institutions and their officials in cases specified in the Code. Fines can also be imposed on banks and their officials for violations with AML/CFT requirements (see CP 29 for more details).

Compulsory measures can be imposed on shareholders as well. Article 74 of the CBL allows the CBR to send orders to the shareholders asking them to take measures to address CBR concerns. In the event that a stockholder does not comply with an order by the CBR, the voting rights at a general meeting can be suspended until the order is complied with or rescinded. The shares of the given stockholder will not be treated as voting shares and not considered for the determination of the quorum.

Finally, in the most extreme scenarios stipulated in the law, the CBR can revoke the license, via a decision to be made by the Bank Supervision Committee of the CBR. The banking law, in Article 20, defines several circumstances under which a bank license can be revoked: for example, if the capital adequacy ratio of the credit institution falls below 2 percent; the amount of the bank’s own capital is lower than the minimal level of capital set by the CBR in accordance with BBL; the information used when issuing the license has been found unreliable; reported data have not been accurate; the bank has performed activities outside the ambit of its authorization; a credit institution is unable to meet creditors’ claims on money obligations. Since the issuance of the *Federal Law 484-FZ of December 29, 2014*, repeated violations of the AML/CFT provisions also constitute a ground for the mandatory revocation of a banking license. A license cannot be revoked on grounds other than those specified by this Federal Law. There have been multiple examples over the past few months of licenses being revoked by the CBR for serious breaches with prudential regulations and/or for suspicious activities (see below, comments section).

In practice, the process for taking corrective measures and imposing sanctions follows a bottom-up approach. Territorial units of the CBR have full autonomy to make certain decisions in their area of competence (banks with capital under 5 billion rubles); however, the decision is taken in a collegial manner. In the regions, there are committees to discuss the relevance of certain sanctions and Territorial offices will consult with the supervisory department at headquarters. More severe measures however will have to be agreed upon by the BSC. Other critical decisions fall under the exclusive responsibility of the BCS, such as revoking a license or imposing a ban on retail deposit taking. For systemic banks, preventive and enforcement measures are to be made by the deputy-governor of the CBR in charge of SIFIs and further-reaching measures rest with the first-deputy

	<p>governor or the Governor of CBR. In any case, the nearest physical CBR branch office will apply the measures and conduct follow up. Measures taken by local offices, regardless of their nature (preventive or prescriptive), has to be reported to the central level. All measures are uploaded and kept in a central database.</p> <p>Further, it is worthwhile noting that the CBR is maintaining a database on persons holding positions in banks (CEO, senior managers, board members, members of collegiate bodies, chief accountants) whose activities contributing to damaging the financial position of a credit institution or violated Russian Federation law and CBR normative acts.</p>
<b>EC3</b>	The supervisor has the power to act where a bank falls below established regulatory threshold requirements, including prescribed regulatory ratios or measurements. The supervisor also has the power to intervene at an early stage to require a bank to take action to prevent it from reaching its regulatory threshold requirements. The supervisor has a range of options to address such scenarios.
Description and findings re EC3	<p>The CBR has a wide range of options to intervene at an early stage to require a bank to take actions if it falls below established regulatory threshold requirements. For the purpose of preventing the violation of prudential ratios by lending institutions, the CBR has the right to apply preventive measures with respect to lending institutions as stipulated in the CBR Instruction 59. Preventive measures are applied at the early stages of the appearance of deficiencies in the activities of a lending institution. The CBR can issue a written order instructing the bank to hold additional capital or to improve banks' financial position. Under the new ICAAP regime, the CBR can also act even though a bank may fulfill minimum regulatory requirements.</p> <p>As indicated to the team, it is common practice for CBR to raise its supervisory concerns at an early stage with management—via ongoing dialogue—and to require that these concerns be addressed in a timely manner. In that respect, the presence of designated representatives in systemic banks allows permanent communication channels so that the CBR can act preventively.</p> <p>As mentioned under EC 2, Article 20 of the banking law also defines conditions for revoking a license if, for example, the value of all equity capital adequacy ratios of a credit institution falls below two percent or if a credit institution fails to comply within the term set by paragraph 41, Chapter IX of the Federal Law on the Insolvency (Bankruptcy) of Credit Institutions with the CBR's demand for bringing in line its authorized capital with the law.<sup>61</sup></p> <p>Written orders do not emanate solely from the results of onsite examinations. The supervisor may deem them necessary as a result of the offsite analysis or the results of bottom-up stress tests of the institution, which would suggest that, for example, a capital inadequacy issue is looming. Over the past years, the CBR has requested banks to increase their capital in several instances. As of January 1, 2015, the number of banks with equity capital less than RUB 300 million was 13, of which, in 2015, 2 banks were reorganized through mergers, two banks raised their equity capital above 300 million rubles, three banks had their banking licenses revoked, and five banks changed their bank status to that of a non-bank credit institution.<sup>62</sup></p>
<b>EC4</b>	The supervisor has available a broad range of possible measures to address, at an early stage, such scenarios as described in essential criterion 2 above. These measures include the ability to require a

<sup>61</sup> This last provision was introduced by the Federal Law 432-FZ of December 22, 2014.

<sup>62</sup> Source: CBR annual report.

	<p>bank to take timely corrective action or to impose sanctions expeditiously. In practice, the range of measures is applied in accordance with the gravity of a situation. The supervisor provides clear prudential objectives or sets out the actions to be taken, which may include restricting the current activities of the bank, imposing more stringent prudential limits and requirements, withholding approval of new activities or acquisitions, restricting or suspending payments to shareholders or share repurchases, restricting asset transfers, barring individuals from the banking sector, replacing or restricting the powers of managers, board members or controlling owners, facilitating a takeover by or merger with a healthier institution, providing for the interim management of the bank, and revoking or recommending the revocation of the banking license.</p>
Description and findings re EC4	<p>As discussed under EC2, the banking law, Article 19, defines the general principle that govern CBR enforcement powers; it reads: <i>"in case a credit institution violates federal laws, CBR regulations or instructions, required ratios, or fails to provide information or presents incomplete or inaccurate information, fails to perform a mandatory audit, and to disclose statements and an auditor's report, fails to provide information to a credit history bureau, or commits any actions creating a real threat to the interests of depositors and creditors, the CBR shall be entitled to take supervisory measures against the credit institution as stipulated by the Federal Law on the Central Bank of the Russian Federation."</i> These measures can be imposed also on the parent company in case of banking groups.</p> <p>Article 74 of the CBL also contains several provisions that empower the CBR to act quickly. For example, if a credit institution violates federal laws or CBR normative acts or orders, the CBR has the right to require the credit institution to eliminate the violations, charge a penalty of up to 0.1 percent of the minimum amount of authorized capital, or prohibit the credit institution from conducting some banking operations for up to six months, including operations with the parent credit institution of the banking group. Additional and more forceful measures (described in detail under EC2) are also available to the supervisor if the bank fails to fulfill CBR's orders or if the bank pose a serious threat to the interests of its creditors.</p> <p>Under the law on bankruptcy, Article 189.30 offers the possibility to restrict powers of the executive body of the bank by subjecting decisions of senior management to the previous authorization of a temporary administrator. This includes decisions on the transfer of bank's real property under a leasing arrangement or as collateral. It also covers transactions with affiliated and RPs.</p> <p>Recent measures have also been passed to increase CBR's enforcement powers, for example in the area of AML/CFT. Also, for the banks that are participants in the deposit insurance system and in accordance with the recent CBR Directive 3229-U of April 5, 2014,<sup>63</sup> the CBR can terminate the bank's right to attract funds for deposit from individuals and to open and maintain bank accounts for individuals if certain conditions are not being met or in case of serious deficiencies that persist beyond a certain period of time established in the law (Article 48, Part 1 of the federal law on the Deposit Insurance System).</p> <p>It is worthwhile noting that before visiting a bank for onsite examination purposes, CBR inspectors will collect information on any previous sanctions issued against the bank by using a software</p>

<sup>63</sup>On the Procedure for the Notification of Banks of the Identification of Conditions in their Activities that Will Lead to the Loss of the Bank's Right to Attract Funds for Deposit from Individuals and to Open and Maintain Accounts for Individuals, the CBR.

	<p>elaborated on the basis of reporting forms # 0409637 on "Information on Imposed Sanctions...." (CBR Inspection methodology 26-T of March 23, 2007).</p> <p>In light of the above, the CBR enjoys a broad range of possible measures to address at an early stage the scenarios described in EC 2, above. These measures are graduated to the gravity of the situation.</p>
<b>EC5</b>	The supervisor applies sanctions not only to the bank but, when and if necessary, also to management and/or the board, or individuals therein.
Description and findings re EC5	<p>In accordance with Article 74, Part 2 of the CBR law, the CBR can impose sanctions on bank's management if the credit institution did not observe supervisor's orders to eliminate violations identified in bank's activities or if its operations have created a real threat to the interests of the depositors. In those cases, the CBR has the right to require the replacement of bank's officials (identified as such in Article 60 of the CBL). The list includes the following individuals:</p> <ul style="list-style-type: none"> <li>• chief executive officer and his deputies;</li> <li>• members of the collegial executive board;</li> <li>• members of the BoD (supervisory board);</li> <li>• chief accountant and his deputy;</li> <li>• chief accountant of a branch.</li> </ul> <p>In addition, the CBR can set limits on the amount of compensation and/or incentive payments to the persons above for a period of up to three years. Moreover, in accordance with the CAO, the CBR has the right to apply administrative penalties against officials in the form of warnings and administrative fines (see EC 2).</p> <p>Sanctions are also possible against persons holding controlling interest in the bank, directly or indirectly. In accordance with Article 72, Part 7, of the Law on the Central Bank, the CBR has the right to impose a ban on the adoption of decisions by a lending institution to distribute earnings among its founders (partners) and to pay (declare) dividends, and also to impose a ban on the distribution of earnings among its founders (partners), on the payment of dividends to them, on the fulfillment of requests by founders for the allocation of their stake (or part of their stake) or the payment of its actual value, or on the repurchase of the lending institution's stocks. Such a measure is introduced by the CBR at the same time as the suspension of payment of principal and/or interest on a debt owed under an agreement on a subordinated credit (deposit, loan) or on bonds</p> <p>In certain situations, the CBR can appoint a temporary administration for management of the lending institution for a period of up to six months. This can be the case, for example, if the lending institution does not comply with CBR's requests to replace the bank's manager.</p> <p>There have been a few cases recently where the CBR applied sanctions against managers.</p>
<b>EC6</b>	The supervisor has the power to take corrective actions, including ring-fencing of the bank from the actions of parent companies, subsidiaries, parallel-owned banking structures and other related entities in matters that could impair the safety and soundness of the bank or the banking system.
Description and findings re EC6	In accordance with Article 74 of the CBL, the CBR has the right to limit the performance of certain operations between the bank and its parent company or affiliated companies for a period of up to six months or to prohibit the performance of certain banking operations for a period of up to one year.

	<p>The CBR can also take all the measures necessary to protect banks and banking groups from risks arising from entities with which they have structural links. In particular, to ensure safety and soundness, the CBR has the right to take against the parent company measures concerning the group as a whole or its individual components</p>
<b>EC7</b>	<p>The supervisor cooperates and collaborates with relevant authorities in deciding when and how to affect the orderly resolution of a problem bank situation (which could include closure, or assisting in restructuring, or merger with a stronger institution).</p>
Description and findings re EC7	<p>According to Article 189.20, the CBR is entitled to send a credit organization a demand for taking measures aimed at its financial rehabilitation and according to Article 189.45 the CBR is allowed to demand a reorganization of a credit institution in the form of merger or affiliation.</p> <p>Not later than the day following the date of the relevant decision, the CBR shall inform the DIA about:</p> <ul style="list-style-type: none"> <li>• the issuance of the CBR's permit for the bank;</li> <li>• the decision taken on carrying out an inspection of the bank on the DIA's proposal;</li> <li>• the appointment of temporary administration;</li> <li>• the revocation (annulment) of a license;</li> <li>• the imposition of a moratorium on a meeting creditor's claims;</li> <li>• the replacement of a license; and</li> <li>• the imposition of a ban on attracting deposits.</li> </ul> <p>According to Article 189.47 of Federal Law 127-FZ, the CBR has the right to submit a proposal for the DIA's participation in measures aimed at preventing a bank's bankruptcy if there is evidence that it is in an unstable financial position. The CBR can also submit a proposal for the DIA's participation in the settlement of a bank's liabilities if there is evidence that bank's conditions create a threat to the interests of its depositors.</p> <p>The Laws of the Russian Federation do not contemplate the creation of a bridge bank but there are conversations with the Minister of Finance to introduce bail-in procedures to be able to write down or convert unsecured liabilities, which could result in legislation changes in 12 to 18 months.</p> <p>When a bank exhibits signs of instability that can endanger the interests of its creditors (depositors) and/or the stability of the banking system as a whole, both CBR and DIA examiners team up to analyze the bank's financial position. The outcomes of this joint evaluation will permit a decision on the type of actions required, preventing bankruptcy, or settling liabilities. In addition, according to Article 27 of Federal Law 177-FZ, the DIA is entitled to propose that the CBR inspects a bank or takes measures against a bank.</p> <p>According to Article 189.47, the decision by the CBR of the proposal to prevent the bankruptcy of a bank should be taken by the Banking Supervision Committee of the CBR. No later than ten days after receiving CBR's proposal, the DIA should inform the CBR on its decision to participate or refuse</p>



	<p>to participate in preventing the bankruptcy of the bank or in the settlement of the bank's liabilities.<sup>64</sup> In the case of refusal, the reasons need to be substantiated.</p> <p>For the prevention of a bankruptcy and according to 189.49 of Federal Law 127-FZ, once the proposal is accepted, the DIA needs to propose an implementation plan to CBR within 20 days of the DIA's decision to participate. Subsequently, CBR is required to express its adoption/approval or refusal of the plan within 10 days.</p> <p>The cooperation between DIA and CBR is very close. As of today, the DIA has not taken a decision on inexpediency of participation in taking measures aimed at preventing bank's bankruptcy. Refusal to rehabilitate a bank by the DIA has only taken place five or six times, and some of the reasons were the impossibility of selling the assets of the bank. In this case, the CBR revoked the license and the DIA proceed with the pay-out of insured deposits. Decision on bankruptcy prevention measures between 2011 and 2014 were taken in connection with 15 banks (in only one of which a purchase-and-assumption transaction was used), and several of them are still undergoing rehabilitation. In the majority of cases, these banks were acquired by other banks with financing provided by the DIA.</p>
<b>Assessment re principle 11</b>	<b>Largely Compliant</b>
Comments	<p><b>Overview of corrective measures and sanction practices</b></p> <p>In practice, the CBR has used a wide variety of measures and sanctions over the past years as shown in the tables below, including—albeit rarely—against individuals. In 2014, preventive measures were actively applied to credit institutions: written notices were sent to the management of 873 supervised banks; and 444 meetings with banks were held. Compulsory measures in the form of orders to eliminate violations were applied to 546 banks, fines were imposed on 133 banks, restrictions on certain transactions were imposed on 209 credit institutions, some transactions were banned in 64 banks and 53 banks were prohibited from opening branches. In 2015, preventive actions were applied to 822 banks and 673 Credit institutions were subject to enforcement actions (see table below).</p> <p>The CBR has also imposed multiples fines on banks over the past five years, including on state-owned banks. 212 banks were fined in 2015, 133 in 2014, 171 in 2013, and 192 in 2012. While the relevant laws and codes define the ceiling for administrative fines, it is not clear whether the CBR uses some guidance to determine the quantum of a fine. It is up to the CBR to decide based on the frequency of the infringement. The mission was told that discussions are currently taking place at the CBR to define processes for determining fines in connection with AML/CFT breaches.</p> <p>Issues related to AML/CTF laws were also considered in 48 percent of all completed scheduled and unscheduled inspections of credit institutions. As a result, during 2014, the consideration of 1,120 administrative offense cases was completed, with 319 adjudications on imposing fines (including 62 rulings with regards to executives of credit institutions), 539 adjudications on issuing warnings (including 290 rulings with regards to executives of credit institutions), and</p>

<sup>64</sup> The DIA cannot refuse to pay the insurance to the bank's depositors if the bank is part of the deposit insurance system.

262 adjudications to close administrative cases (including 75 rulings with regards to executives of credit institutions).

**Table 1. Number of Credit Institutions that Committed Violations and thus Subjected to Enforcement Actions in 2015 on the Basis of Article 74 of the Federal Law "On the Central CBR Federation"<sup>65</sup>**

#	Violation	Number of credit institutions subjected to enforcement actions						
		Total	Preventive actions	Total	Enforcement actions including			
					Fines	Restrictions on specific activities	Prohibition of specific activities	Requirements
	<b>Total number of CI subjected to enforcement actions *)</b>	<b>832</b>	<b>822</b>	<b>673</b>	<b>212</b>	<b>243</b>	<b>73</b>	<b>623</b>
	<b>including for</b>							
1	Violation of the requirements for registration, licensing and of expansion activities of the CI	69	61	11	4	3	1	8
2	Failure to comply with regulatory standards for CI activities (one or more)	41	28	20	7	8	5	9
3	Failure to comply with the procedure for calculating the regulatory standard (one or more)	21	15	14	1	3	1	14
4	Failure to comply with the reserve requirements	60	14	51	50	0	0	6
5	Violation of the procedure for formation of the reserves for possible losses	551	397	452	46	176	62	445
6	Providing false statements	178	144	63	12	11	5	57
7	Violation of the order and timing of statements, as well as of its publication in the open domain	411	399	41	20	6	1	26
8	Failure to comply with the requirements within the prescribed timeframe	44	18	38	6	14	13	32
9	Violation of the provisions of Article 189.10 of the Federal Law "On Insolvency (Bankruptcy)"	20	12	14	0	9	5	8
10	Violation of the provisions of Article 189.19 of the Federal Law "On Insolvency (Bankruptcy)" in terms of the implementation of bankruptcy prevention measures	18	15	6	0	2	0	4
11	Reduction of equity (capital)	18	7	16	0	4	1	15
12	Violation of the currency legislation of the Russian Federation and the currency regulation and currency control instruments	64	45	26	15	5	0	13
13	Violation of legal provisions in the field of counteraction to legalization (laundering) of proceeds from crime and financing of terrorism, as well as violation of the requirements stipulated by Articles 6 and 7 of the Federal Law "On counteraction to legalization (laundering) of proceeds from crime and financing of terrorism" with the exception of article 7, paragraph 3 of the Law	467	319	360	103	115	10	296
14	Inadequate quality of the internal control system	27	23	10	3	3	1	9
15	Violation of the requirements for the development of internal bank regulations	81	64	38	2	8	2	34
16	Formation of the equity (capital) (parts thereof) sources with investors using inappropriate assets	42	31	13	0	3	0	13
17	Violation of accounting and reporting rules	252	216	119	22	45	9	112
18	Violation of the requirements of the Federal Law of 27.06.11 №161-FZ "On the National Payment System" or related bylaws	40	32	18	3	5	1	16

Revocation of licenses has been quite significant over the past years, with an acceleration during 2015. In 2014 and 2015, the CBR revoked multiple banking licenses (86 and 93 respectively), citing the unsatisfactory quality of banks' assets, the loss of capital, risky lending practices, and involvement in money laundering activities. There seem to be different objective factors that can explain this massive revocation of banking licenses and banks' closures. First, the supervisory role and powers of the CBR have been reinforced; second, the tightening control in general over the banking sector; and third, stricter requirements, particularly in terms of professional qualifications for banks' senior management. This also reflects a much more rigorous approach to eradicating cases of misconduct, bad management, and fraudulent practices in banks. The CBR has definitely made a large-scale effort to reinforce the banking sector, especially since the appointment of the current CBR Governor.

<sup>65</sup> The number of listed credit institutions in the totals is lower than the total of the sub-items due to several actions being taken against a bank at the same time for several sub-items

It is also noteworthy that the Central Bank and executive authorities initiated actions and legislation aimed at minimizing the consequences of international economic sanctions against Russia and creating favorable conditions for business development in the country. In that context, in his Address to the Federal Assembly on December 4, 2014, the President of the Russian Federation advanced several major initiatives aimed at improving the business climate, including the so-called “supervisory holidays.” This initiative allows a company that has acquired a reliable reputation and for three years had no significant complaints, to be free for the next three years of routine checks by the State, and there will also be no municipal control. The mission was told that the “supervisory holidays” do not apply to financial institutions.

Decisions on sanctions are made public, which is a good practice in assessors’ opinion. They are disclosed on the CBR website, clearly stipulating the name of the bank, the type of sanction and the ground that led to the decision.

### **CBR internal processes and enforcement powers**

All measures described under EC 2 are taken by the CBR at its own discretion, on a case by case basis, and in a collegial fashion. Article 74 of the CBL stipulates in that regard that the CBR “*shall have the right to*” or the CBR “*shall be entitled to*”. As a result, if a bank does not pose a threat to the system or if the violation is minor, the CBR can discuss options to address the problem. In more serious circumstances, the CBR will send an order to instruct the bank to take certain measures or to stop certain operations. In case of glaring deficiencies, the CBR adopts more forceful decisions. In making its determination, the CBR takes into consideration several factors or circumstances such as (i) the gravity of the violations and their occurrence; (ii) the general financial state of the bank; and (iii) its position in the market, either at federal or regional level. The authorities also look at issues from a bankruptcy perspective. In case of systemic banks, the potential impact of a sanction will be analyzed to avoid spill-over effects on the rest of the system.

Instruction 59 of March 31, 1997 on “Penalizing Credit Organizations for Violating Prudential Standards” stipulates the cases in which preventive measures are preferable to coercive ones and vice versa, while leaving the CBR enough room to maneuver. It recommends using preventive measures as a first step in making the credit organization change its ways, provided that its management and, if necessary, participants (shareholders) act in a constructive and responsible manner. Coercive measures are recommended when the violations committed by a credit organization make such measures inevitable and when it is clear that preventive measures alone would not be enough to make the bank change its behavior.

However, Instruction 59 has not been made public and up to now it has been an internal document only. The instruction is now being revised since a reform introduced in 2014 with the view to make the enforcement process more transparent. The new instruction is expected to be finalized sometime in the first half of 2016. The establishment of transparent procedures is highly desirable to establish stronger confidence among the industry in CBR’s processes in relation to sanctions. There is a sentiment among market participants that equal treatment by the CBR might not always be achieved. In that respect, a recent case was mentioned in which the Ninth Court of Appeals of the City of Moscow ruled in favor of a bank and overturned the decision of the first-instance court on the grounds that the CBR could have levied a lighter penalty. In 2014, 14 cases of revocation were challenged in justice, one was ruled against the CBR; in 2015, 22 cases took place with no

	<p>overturn. As for orders against credit institutions (regional branches), 23 were challenged in 2014, 2 of which were overturned. In 2015, 3 cases were ruled against CBR out of 46.</p> <p>The BCP assessors also noted in the law the following limitations. Article 74 of the CBL stipulates that when a violation has been committed by a shareholder (e.g., failure to disclose information on controlling interest, failure to take prompt action to prevent bank's bankruptcy or any misdeed causing the bank to violate prudential ratios), the CBR shall no later than 30 calendar days from the day of discovering the violation send an order to the shareholder to redress the violation; besides, the CBR's order is possible if no more than one year has passed since the violation was committed. This provision suggests that any gross violation older than one year cannot be subject to any CBR action. Further, if the CBR misses the 30 calendar day's window to act, it is considered to have violated the law and any interested party could sue the CBR for "inaction". The CBR told the mission that this window of 30 days is large enough as it starts when the facts (justifying the issuance of an order) have been established; which give one month to process the order. The CBR also indicated that the window of 30 days has never been missed.</p> <p>In assessors' opinion, this provision provides some form of impunity to negligent shareholders and creates a reputational risk—yet theoretical—for the CBR if the bank goes bankrupt. The mission was told that the legislator's intention was to protect shareholders.</p> <p>Another limitation can be found in Article 74, last two paragraphs that limits the possibility of CBR to take any enforcement measures (contemplated in the same article) if five years have passed since the violation were committed. The same paragraph stipulates that the CBR "may appeal to court to recover a fine from a credit institution or apply some other sanctions against it, stipulated by federal laws, no later than six months after any of the violations (listed in parts one to four of Article 74) was recorded. The CBR told the mission that this limitation has no practical impact on CBR's operations; since supervision is exercised on an ongoing basis and banks are subjected to an onsite visit every two years, the probability to discover violations older than five years is very low. Against this background, the five-year statute of limitation appears adequate.</p> <p><b>Recommendation:</b></p> <ul style="list-style-type: none"> <li>• Explore possible amendments to the CBL to: <ul style="list-style-type: none"> <li>- permit the CBR to take enforcement measures against shareholders who violated the law or CBR's regulations, even if the violation is older than one year;</li> <li>- augment the 30-day timeframe during which the CBR has to send an order to a party who committed a violation; and</li> <li>- provide the CBR the possibility to impose changes in banks' internal organization and structure.</li> </ul> </li> <li>• Complete the revision of Instruction 59 on "Penalizing Credit Organizations for Violating Prudential Standards" so that criteria for sanctions used by CBR become more transparent.</li> <li>• Establish formalized guidelines for determining the quantum of an administrative fine.</li> <li>• Increase number of sanctions against individuals (namely bank's senior executives, board members and shareholders).</li> </ul>
<b>Principle 12</b>	<b>Consolidated supervision.</b> An essential element of banking supervision is that the supervisor supervises the banking group on a consolidated basis, adequately monitoring and, as appropriate,

	applying prudential standards to all aspects of the business conducted by the banking group worldwide. <sup>66</sup>
<b>Essential criteria</b>	
<b>EC1</b>	The supervisor understands the overall structure of the banking group and is familiar with all the material activities (including non-banking activities) conducted by entities in the wider group, both domestic and cross-border. The supervisor understands and assesses how group-wide risks are managed and takes action when risks arising from the banking group and other entities in the wider group, in particular contagion and reputation risks, may jeopardize the safety and soundness of the bank and the banking system.
Description and findings re EC1	<p><b>Banks, banking groups and bank holding companies</b></p> <p>To preface the discussion on consolidated supervision, it may be helpful to note the specific powers granted to the CBR in respect of consolidated supervision under the CBL and certain specific definitions that are used in the BBAL.</p> <p>The CBR's obligation to conduct consolidated and solo supervision flows from the CBL (Articles 4, 56, and 57). The CBL requires the CBR to exercise supervision over individual banks and banking groups. It further establishes the CBR's right to obtain information and analyze the activities of "bank holding companies" for the purposes of banking supervision over credit institutions and banking groups integrated into bank holding companies. In other words, the CBR has direct powers of supervision in respect of individual banks and banking groups but has information gathering powers over bank holding companies (BHC).</p> <p>The BBAL provides the definition of a banking group and the definition of a BHC. Under the BBAL (Article 4), a banking group is defined as an association of legal entities in which one or more of the entities are under the control or significant influence of a bank. The definitions of control and influence are taken from IFRS.</p> <p>In terms of powers, the CBR has information gathering powers under the CBL (Article 57) in respect of banks and banking group, including the right to demand further elaboration and explanation of any information received. Thus, under Article 57, the CBR "shall have the right to request and receive from credit institutions, the parent credit institutions of banking groups and the parent organizations of bank holding companies' information on the activities of credit institutions, banking groups and bank holding companies, respectively, including data on the members of banking groups and bank holding companies other than credit institutions, and demand elucidation of the information received." Further, Article 57 clarifies that the CBR may set regulations that are "binding for bank holding companies, for compiling and presenting data required for assessing the risks of a bank holding company and conducting supervision of credit institutions participating in a bank holding company."</p> <p>However, the term bank holding company, as defined by the BBAL (Article 4), does not denote an entity that is a holding company for a banking group. In practice the BBAL definition for a BHC describes what may be more readily understood as a "bank holding company group" rather than a parent entity of a bank holding group. The BBAL definition is noted below, for completeness, but</p>

<sup>66</sup> Please refer to footnote 19 under Principle 1.

in practice a “BHC group” contains at least one bank, which is not the parent entity, and which is under the control of a parent entity of a BHC group, and the overall balance of business in the BHC group must be no less than 40 percent banking activities, measured according to a CBR methodology that assesses the ratio of assets and/or revenues of the credit institutions to the BHC group as a whole. As in the case of banking groups, members of a BHC are identified by using definitions of control and significant influence in accordance with IFRS.

The definition of BHC (BBAL, Article 4, as amended in 2013) is as follows: “the association of legal entities, with such an association not being a legal entity (afterwards referred to as the members of a BHC), including at least one credit institution controlled by a legal entity other than a credit institution (afterwards referred to as the parent organization of a BHC), as well as other (if any) legal entities (other than credit institutions) that are under control or significant influence of the parent organization of the BHC or participate in the banking groups of credit institutions that are members of the BHC, provided that the share of banking operations assessed on the basis of the CBR’ methodology, accounts for no less than 40 percent of the activities of the BHC.”

### **Understanding the structure of banking groups**

#### ***Supervisory process:***

The CBR establishes supervisory groups responsible for consolidated supervision of banking groups that include representatives from different CBR’ Departments (Section 1.3, the CBR’ Regulation 3089-U). At the time of the assessment there were over 120 banking groups in Russia.

There are a range of CBR regulations setting out the CBR’s supervisory and reporting requirements for banking groups, including prudential requirements. Reporting submissions are made by the parent entity of the banking group. The key regulations are:

- Regulation 3089-U re the procedure for supervising banking groups;
- Regulation 3876-U re disclosure of information for parent banks of banking groups;
- Regulation 2923-U re disclosure and submission of consolidated financial statements by the parent banks of banking groups;
- Regulation 509-P on capital, prudential ratios and limits of open FX positions of banking group; Regulation 510-P on the Liquidity Coverage Ratio on a consolidated basis for systemically important banks;
- Regulation 462-P on consolidated statement and other information on the activity of the banking group;
- Regulation 2332-U on reporting forms and submissions of banking groups.

Reports made to the CBR by the parent of the banking group include:

- annually, or in the event of changes or at the CBR’s request: Statement on the composition of the members of the banking group;
- quarterly: Consolidated balance sheet; Statement on financial results, capital calculation, statutory requirements of BG and open currency positions;
- monthly: or in the event of non-compliance with the minimum requirements (actual or expected) or at the CBR’s request: Liquidity Coverage Ratio on a consolidated basis for systemically important banks.

The CBR uses the reported information to identify the core activities of the banking group and of the major entities within the banking group. Asset size, concentration and location are included in the CBR assessment. RPs are also assessed (please see also CP 21) on the basis of information supplied in reporting submissions on lists of RPs and list of RPs of credit institution's owners.

### **Group wide risk management**

Under the CBL, notably Articles 57<sup>1</sup> and 57<sup>2</sup>, the CBR sets the risk, capital management, internal controls, capital adequacy and liquidity standards for banking groups as well as for individual credit institutions. The CBR has articulated its standards in the following regulations:

- Regulation 3624-U and Regulation 3883-U On requirements for risk and capital management and ICAAP assessment;
- Regulation 242-P on internal controls;
- Regulations 509-P on calculation of required capital ratios and net open positions;
- Regulation 510-P with Annex 1 on the sound principles of liquidity RM in systemically important banks; and
- Regulation 3223-U On qualification requirements for significant individuals in the institution, including Head of Risk, Head of Internal Audit Division and Head of Internal Control.

The supervisory process for banking groups is consistent with the supervisory approach described in CP8. There is quarterly monitoring of the banking group's reporting, and on a semi-annual basis there is an assessment of the banking group. The assessment is based on Regulation 3089-U and includes, for example:

- an overview of BG' structure; main activities (including foreign operations) and market position;
- an analysis of BG' consolidated balance sheet (including dynamics and composition); consolidated financial results (including dynamics and composition); equity (capital) structure (including dynamics and composition); required ratios (for example, regarding credit risk, liquidity risk, FX risk); and main risks (in particular, credit risk, liquidity risk, market and FX risk, OR, contagion risk, reputation risk).

As noted in CP9, the CBR aims to confirm its understanding through an onsite inspection program. The inspections are coordinated (by timing and scope) of the members of the banking group (banks and non-bank financial institutions) with the intention of obtaining a fuller picture that is not possible from stand-alone inspections of a banking entity.

The Systemically Important Banks Supervision Department has already participated in and plans to continue to coordinate and develop bank and non-bank offsite supervision and inspections (banking groups' members) with the responsible departments in the CBR. The main criteria in scoping the inspections was the significance of the influence of respective members of the financial group, though SIBSD's view is that there are no non-bank members of the banking groups supervised by SIBSD that exert significant influence on the banking group activity. The Chief Inspectorate organizes the coordination based on proposals submitted by the relevant departments (as also discussed in CP9). To assist in the coordination of the joint inspections, the CBR creates an analytical group which organizes information exchange between the working groups which are conducting the coordinated inspections. Information exchange is performed at



	<p>all stages of carrying out inspections (prior to, during and after the end of the inspections. The Chief Inspectorate of the CBR carried out the coordinated inspections of:</p> <ul style="list-style-type: none"> <li>• 14 non-credit financial institutions and 12 credit institutions—in 2014;</li> <li>• 18 non-credit financial institutions and 10 credit institutions—in 2015; and</li> <li>• further coordinated inspections are planned in 2016.</li> </ul> <p>Coordinated inspections in support of consolidated supervision of banking groups are also performed. In 2014, there were coordinated inspections of 3 banks that were members of the same banking group, and in 2015, there were 4 such inspections, with 11 further inspections planned for 2016.</p> <p><b>Bank holding group</b></p> <p>The definition of a BHC is discussed above. The CBL (Article 57) empowers the CBR to set the standards for BHCs to submit information necessary for the CBR to conduct effective supervision of credit institutions who are members of BHC groups. The parent of a BHC is obliged to notify the CBR if a BHC is formed, and if a management company of the BHC is formed, including the authority assigned to such a management company (Regulation 3780-U).</p> <p>The parent of a BHC, pursuant to the BBAL (Article 43) and the CBR regulations (Regulation 3777- U) must submit semi-annual reports to the CBR on the risks. This comprises:</p> <ul style="list-style-type: none"> <li>• information on the BHC’s risks (also at the request of the CBR);</li> <li>• statement on the structure of the BHC and on the shares in investment funds (also at the request of the CBR);</li> <li>• information on the parent organization of a BHC including its responsibilities.</li> </ul> <p>On an annual basis, the parent of the BHC submits financial statements, the independent auditor’s conclusion, (3087-U—on disclosure and presentation of consolidated financial statements by the parent entities of BHC groups) and information on the BHC’s risks, necessary for the supervision of the banks that are members of the BHC group.</p> <p>The CBR may also require information from the parent organizations of the BHC’s groups regarding the activity of these groups, including the information about the non-bank members of the group and any further necessary explanations. The CBR exercises these powers but does not meet with and may not conduct inspections of the parent organization of the BHC groups.</p> <p>In the event of any legal violations, the CBR has powers to restrict the operations between the bank and the members of the wider BHC group, including the parent entity, for up to one year should there be legal violations.</p> <p>For context, as of July 2015 there were 42 BHCs in Russia. The parent entities of these groups (that is 29 companies or about 70 percent of the total number) are active in a range of nonfinancial sectors (such as construction, commerce, advertising, food industry, agriculture, and broadcasting).</p>
<p><b>EC2</b></p>	<p>The supervisor imposes prudential standards and collects and analyses financial and other information on a consolidated basis for the banking group, covering areas such as capital adequacy, liquidity, large exposures, exposures to RPs, and lending limits and group structure.</p>

Description and findings re EC2	<p>As noted in EC1, the CBR's powers to exercise supervision of banks and banking groups is established in the CBL (Article 56) and the reporting and information requirements are also discussed in EC1, above. The CBL (Article 62) grants the CBR the power to impose a range of required ratios at banking group as well as solo level. These include, maximum non-monetary contributions to the authorized capital of a bank; maximum risk per borrower or a group of related borrowers; the maximum amount of high credit risks; the liquidity ratios; the own funds (capital) adequacy ratios; the amount of FX, interest rate, and other financial risks; the minimum amount of provisions created for risks; the ratios for a credit institution to use its own funds (capital) to acquire shares (stakes) of other legal entities; the maximum amount of loans, bank guarantees, and sureties provided by a credit institution (a banking group) to its shareholders (members); and the maximum risk per counterparty related to the credit institution (group of parties related to the credit institution).</p> <p>Reporting is on a consolidated and standalone basis. The CBR analyses the information on liquidity on a consolidated basis for the banking groups.</p> <p>Additionally, BGs' parent companies are required to submit, quarterly, information on risks, risks assessment, RM, and capital management (Regulation 3876-U).</p> <p>Group structure is reported and monitored for banking groups as noted in EC1 above.</p>
<b>EC3</b>	<p>The supervisor reviews whether the oversight of a bank's foreign operations by management (of the parent bank or head office and, where relevant, the holding company) is adequate having regard to their risk profile and systemic importance and there is no hindrance in host countries for the parent bank to have access to all the material information from their foreign branches and subsidiaries. The supervisor also determines that banks' policies and processes require the local management of any cross-border operations to have the necessary expertise to manage those operations in a safe and sound manner, and in compliance with supervisory and regulatory requirements. The home supervisor takes into account the effectiveness of supervision conducted in the host countries in which its banks have material operations.</p>
Description and findings re EC3	<p>The supervision over most foreign operations carried out by Russian banks is conducted by SIBSD, as volume of cross-border operations is a qualifying criterion for a bank to be recognized as a D-SIB and as a consequence to be supervised directly by the CBR head office. This also implies that the banks with significant volumes of foreign operations have an AR of the CBR (see CP1 EC5) able to provide additional information and insight into the operation and management of the banking group.</p> <p>In terms of powers and information gathering, CBL grants the CBR powers of group wide supervision covering, inter alia, RM and controls (Articles 57<sup>1</sup> and 57<sup>2</sup>), and the BBAL imposes an obligation on banking groups to ensure adequate risk and control management, which is further elaborated in Regulation 242-P. The CBR obtains a range of information, such as:</p> <ul style="list-style-type: none"> <li>• foreign operations of banks and banking groups—Regulation 2332-U);</li> <li>• consolidated supervision reporting—Regulation 462-P;</li> <li>• loan loss reserves in respect of residents in offshore zones—Regulation 1584-U;</li> <li>• liquidity, where with the advent of the CBR's implementation of the LCR on a consolidated basis for systemically important banks from January 1, 2016—Regulation 510-P—banking groups are required to manage their liquidity risk taking into account the availability of</li> </ul>

	<p>assets for transfer between the banking group member and the parent credit institution; and the CBR' regulation also sets a treatment of the operations of the bank's foreign branches and subsidiaries conduct for short-term liquidity purposes.</p> <p>Direct information on banks' management of and oversight of risks in non-domestic subsidiaries is obtained through meetings and onsite inspections, the latter of which are used to examine the quality of banks' documentation for internal risk governance (credit, market, exchange rate, liquidity risk, etc.), whether those documents conform to established standards, and whether the documents are adhered to in practice. The CBR has not been informed of any hindrance experienced by parent banks in obtaining information on their foreign branches and subsidiaries.</p> <p>With respect to the assessment of the quality of local management of cross border operations, the CBR's policies and practices appear to be more limited. The CBR noted that it has regard to the qualifications for the heads of RM and internal audit and internal controls in banks—these qualifications are established by Regulation 3223-U—and assesses whether these standards are met in the course of its internal control assessments. The comments from the CBR indicated that the process is largely reliant on evaluation of RM and control systems, particularly through internal compliance documents. If the CBR notices risks or deficiencies that might affect the control of foreign operations, it may ask questions, point out failings, and of course if necessary adopt formal measures. Information could also be obtained through the ARs, and the CBR indicated that in case of concern the management would be called in for a meeting.</p> <p>The CBR's approach to assessing the effectiveness of supervision conducted in the host countries in which its banks have material operations is primarily based on analysis of reports submitted by the banks and banking groups. These reports contain information on foreign operations and branches (Regulation 2332-U). The CBR also has right of access to internal documents of the banks and banking groups.</p>
<b>EC4</b>	<p>The home supervisor visits the foreign offices periodically, the location and frequency being determined by the risk profile and systemic importance of the foreign operation. The supervisor meets the host supervisors during these visits. The supervisor has a policy for assessing whether it needs to conduct onsite examinations of a bank's foreign operations, or require additional reporting, and has the power and resources to take those steps as and when appropriate.</p>
Description and findings re EC4	<p>The CBR has the authority (CBL Article 73) to inspect the non-domestic activities of banks and their banking groups. Additionally, the CBR (CBL Article 51) may request supervisory information from the supervisory authority in the relevant jurisdiction concerning the non-domestic entities, including inspection reports. Such information is subject to professional secrecy constraints. Information exchange extends to non-domestic financial market regulators and is based on IOSCO multilateral MoUs; international treaties' and bilateral treaties as relevant, providing that professional secrecy is observed.</p> <p>The CBR has limited experience of visiting the foreign operations of domestic banks. The assessors were informed of one example when, in 2014, an onsite inspection of the branch of a Russian bank located in Cyprus was carried out. The inspection was coordinated to take place simultaneously with an inspection of the parent bank. The Russian and Cypriot authorities cooperated, and exchanged information and inspection findings.</p>

	<p>In practical terms, the same regulations that govern inspections in the Russian Federation also govern the CBR in any inspection it would wish to undertake in another jurisdiction. (Regulation 147-I on inspection rubric and also Regulation 3463-U.) Any such inspections would also take place in the context of agreed MOUs. In identifying such inspections, the CBR would take into account the significance of the subsidiary or branch to the parent bank, financial condition of the bank, the reliability of its reporting, and results of previous onsite inspections when determining the frequency of its inspections. The CBR noted its practice would be to share and discuss the findings of such onsite inspections with the host supervisors.</p>
<b>EC5</b>	<p>The supervisor reviews the main activities of parent companies, and of companies affiliated with the parent companies, that have a material impact on the safety and soundness of the bank and the banking group, and takes appropriate supervisory action.</p>
Description and findings re EC5	<p>While Regulation 415-P is primarily aimed at assessing the suitability of a prospective shareholder taking a stake over 10 percent, it also includes criteria for assessing the financial position of corporate entities holding—directly or indirectly—over 10 percent of equities (shares) of the bank and measures aimed at improving the unsatisfactory financial position of the specified entities. Under the terms of Regulation 3089-U, the CBR (semi-annually) undertakes a supervisory assessment of banking groups, which contains, in particular, an overview of parent companies' activity (see EC1).</p> <p>As noted above, the CBR coordinates onsite inspections for the members of a banking group or BHC group. There were a number of such onsite inspections during 2015, organized in different formats (duration, focus, etc.). However, intra-group transactions are a key focus of the onsite inspections, where the inspectors wish to determine that there is a valid economic rationale for transactions. On a related point, coordinated inspections of credit institutions facilitated the identification of signs of "circular" transactions within the banking group where the economic justification appeared insufficient; and also sought to identify where transactions between the bank and its clients might have a significant impact on the stability of the group. In other words, the general objective of the CBR inspections is to uncover the general risks of the banks in the group, whether banks are concealing the true levels of risk and the degree of banks' involvement in related party lending.</p>
<b>EC6</b>	<p>The supervisor limits the range of activities the consolidated group may conduct and the locations in which activities can be conducted (including the closing of foreign offices) if it determines that:</p> <ul style="list-style-type: none"> <li>(a) the safety and soundness of the bank and banking group is compromised because the activities expose the bank or banking group to excessive risk and/or are not properly managed;</li> <li>(b) the supervision by other supervisors is not adequate relative to the risks the activities present; and/or</li> <li>(c) the exercise of effective supervision on a consolidated basis is hindered.</li> </ul>
Description and findings re EC6	<p>The CBR has ex ante powers to restrict the geographic reach of a bank but not of a non-bank member of a banking group or BHC group (please see CP7). The CBR must grant explicit permission for a bank to establish a non-domestic branch (BBAL Article 35). A bank must meet minimum criteria— Regulation 290-P—in order to obtain permission to create or acquire a subsidiary in a foreign jurisdiction (e.g., meeting the CBR reserve requirements). In such cases, the CBR must also consider the economic feasibility of the proposal. Should the proposal not meet these requirements or if the proposed subsidiary is in a country or territory classified by Russian Federation statutes as non-cooperative for the purposes of AML/CFT, the CBR will deny permission.</p>

	<p>The quality of host-state supervision or the influence on the effectiveness of consolidated supervision are not factors that are explicitly considered.</p> <p>Should the CBR determine that the activities of a bank, a banking group, or a BHC group could endanger the interests of depositors or the banking system (CBL Article 75), its powers under CBL Article 74 are triggered. These powers provide that the CBR may restrict the activities of a bank in a number of respects, including the structure of its assets or its organization.</p> <p>However, although the activities and location of a bank and its branches can be addressed by CBL and, as noted above, the opening new branches may be explicitly prevented, the CBR lacks the powers to oblige the closure of a foreign branch or subsidiary.</p> <p>The powers under CBL Article 74 fall short of providing the CBR with the ability to limit the type or location of an activity by a non-bank member of the banking group or BHC group.</p>
<b>EC7</b>	In addition to supervising on a consolidated basis, the responsible supervisor supervises individual banks in the group. The responsible supervisor supervises each bank on a stand-alone basis and understands its relationship with other members of the group. <sup>67</sup>
Description and findings re EC7	<p>The CBL (e.g., Articles 57, and 57,<sup>1</sup> and 57<sup>2</sup>) establishes that the CBR exercises supervision in respect of individual banks and also banking groups. Pursuant to the CBL, the CBR conducts its supervisory activities on both a stand-alone and consolidated basis. Also, in accordance with the CBL (Article 67), the CBR applies a principle of capital conservation to ensure that a bank does not distribute profits to its parent entity until it has met the minimum level of capital adequacy. The CBR noted that its chief tool for intra-group transactions monitoring is through the supervision of a bank on a solo basis.</p> <p>The CBR monitors distribution of capital and liquidity through the group, not least through the monitoring and assessment of required ratios, and taking all risks into consideration, adjustments to the supervisory plan for a banking group are discussed at the relevant supervisory group meeting.</p>
<b>Assessment of Principle 12</b>	<b>Largely Compliant</b>
Comments	<p>The assessors agree that subsequent to the last assessment, the legal and regulatory framework in respect to consolidated supervision has been significantly developed and enhanced. A number of material deficiencies were noted in the targeted assessment of 2011 which have been resolved by the passage of legislation that was anticipated at the last assessment. Enhancements include:</p> <ul style="list-style-type: none"> <li>• powers to act in the event of violations committed by the parent entity of a banking group, such as to impose restrictions on transactions between the bank and its the parent or group entities (CBL, Article 74);</li> <li>• enhanced scope of information exchange with non-domestic regulatory agencies (CBL Articles 51 and 51<sup>1</sup>);</li> <li>• information exchange with domestic regulatory agencies facilitated by the merger of the sectoral regulators into the CBR;</li> <li>• expanded definition of direct and indirect influence, based on IFRS (BBAL, Article 4);</li> <li>• introduction of regime for Bank Holding Groups.</li> </ul>

<sup>67</sup> Please refer to Principle 16, Additional Criterion 2.

	<p>The regulatory and legal changes are, nevertheless, still relatively recent and the practical application and supervisory practice based on the new framework is yet to be substantively demonstrated. The assessors believe that the CBR will build up its track record if it continues on its current path, but has not yet had the opportunity to do so. The assessors appreciate that the CBR has already instituted the practice of coordinated inspections of banking and nonbanking entities within consolidated groups. The assessors are also aware that much focus of inspection work is to uncover the nature and extent of intra-group exposures, including to wider group entities that fall outside of the banking consolidation.</p> <p>In considering this principle, the assessors noted that the cross-border dimension of consolidated supervision is still mostly undeveloped (for illustration, assets due to foreign individuals and entities, on a consolidated basis represent approximately 10 percent of the banking sector's assets). The CBR does not conduct onsite inspections of foreign establishments of Russian banking groups and has not yet clearly scrutinized the Russian banking groups' management abilities and oversight in managing their non-domestic interests and activities. The CBR has not explicitly considered whether the supervision and oversight by host supervisory authorities is effective or sufficient to the complexity and activities of the foreign establishments. Similarly, as noted in CP5, the mission could not determine whether the CBR routinely confirmed whether a home supervisory authority practiced consolidated supervision at the time a new branch or subsidiary wished to establish in the Russian Federation. In terms of whether cross border establishments are significant for the Russian banking group (or indeed for the host jurisdiction), these supervisory tasks may not be the most urgent priority in a risk based context, but such assessments are still necessary. Greater priority should be placed on establishing whether banking groups with foreign interests have the requisite skills and are exercising effective management and oversight of these subsidiaries and branches.</p> <p>Some legal gaps remain and are a hindrance to the CBR and relate to the perimeter of the consolidation. First, the supervisor may not require the closure of a foreign branch of a Russian bank. Secondly, the supervisor may not prevent the acquisition of a non-bank financial entity by a banking group. This second issue is discussed and graded in the context of CP7, but the issue is important in relation to the effectiveness of consolidated supervision as a banking group might expand in size or in its activities in directions that the group is not able to manage prudently. An ex-post power to restrict or close activities is a second best option in these situations because the damage to the stability of the banking group may already have been sustained.</p>
<b>Principle 13</b>	<b>Home-host relationships.</b> Home and host supervisors of cross-border banking groups share information and cooperate for effective supervision of the group and group entities, and effective handling of crisis situations. Supervisors require the local operations of foreign banks to be conducted to the same standards as those required of domestic banks.
<b>Essential criteria</b>	
<b>EC1</b>	The home supervisor establishes bank-specific supervisory colleges for banking groups with material cross-border operations to enhance its effective oversight, taking into account the risk profile and systemic importance of the banking group and the corresponding needs of its supervisors. In its broadest sense, the host supervisor who has a relevant subsidiary or a significant branch in its jurisdiction and who, therefore, has a shared interest in the effective supervisory oversight of the banking group, is included in the college. The structure of the college reflects the nature of the banking group and the needs of its supervisors.

Description and findings re EC1	<p>The CBR, as home supervisor, has established supervisory colleges for two international banking groups (Sberbank and VTB) and participates in the college arrangements for a further ten international groups (domiciled in Austria, China, Cyprus, Germany, Hungary, India, Italy, Netherlands, and the U.K.).</p> <p>In order to enhance the supervision of banking groups, the CBR forms a supervisory team (described by the CBR as a form of domestic college arrangement) for a banking group when certain conditions are met. One of these conditions is whether the bank has a subsidiary on the territory of a foreign state which is supervised by a central bank or another supervisory authority of a foreign state authorized for banking supervision (point 1.3 of Regulation 3089-U).</p> <p>Representatives of a foreign state banking supervisory authority are included in its members subject to the consent of this authority (point 1.4 of the CBR Regulation 3089-U). With respect to domestic organization, the number and composition of the supervisory team for the banking group, including changes in its structure, and distribution of powers between its members, is defined taking into consideration the character and the scale of operations that are carried out in the banking group, and the level and the combination of risks accepted by the banking group.</p> <p>In passing, it may be noted that the other two conditions for a supervisory team to be formed are (a) when the parent bank is a systemically important credit institution as defined and (b) when the parent bank is formally identified by the CBR as exhibiting significantly negative signs.</p> <p>The scope of information that is provided to host supervisory authorities customarily covers the following issues: current situation and main risks of the Russian banking sector, an overview of banking supervision in Russia, regulatory framework, overall profile of the banking group, the role and position of the banking group in the Russian banking system, performance highlights of the banking group, and results of recent onsite inspections.</p>
<b>EC2</b>	<p>Home and host supervisors share appropriate information on a timely basis in line with their respective roles and responsibilities, both bilaterally and through colleges. This includes information both on the material risks and RM practices of the banking group<sup>68</sup> and on the supervisors' assessments of the safety and soundness of the relevant entity under their jurisdiction. Informal or formal arrangements (such as memoranda of understanding) are in place to enable the exchange of confidential information.</p>
Description and findings re EC2	<p>Cooperation, information exchange and interaction between the supervisory team responsible for a banking group with a non-domestic bank and the relevant foreign supervisory authority in the supervision of the banking group is set out in Regulation 3089-U (see, for example, Sections 4.1, 5.3, and 5.4).</p> <p>Based on recent legislative amendments (please see CP3, EC 5), the updated version of a draft MoU in banking supervision with a foreign supervisory authority includes provisions aimed at enhancing cooperation with foreign supervisory authorities specifically in relation to resolution and crisis management, including notification of resolution measures, measures to protect deposits in a parent institution, measures for cross border liquidity support, or other support</p>

<sup>68</sup> See Illustrative example of information exchange in colleges of the October 2010 BCBS Good practice principles on supervisory colleges for further information on the extent of information sharing expected.



	<p>measures. All information exchange must comply with national legislation, including professional secrecy and confidentiality.</p> <p>The updated version of the MoU, including the procedures for cooperation in resolution, was signed with the Financial and Capital Market Commission of the Republic of Latvia on October 2, 2015.</p> <p>As noted in EC 2 of CP 3, the practical implementation of cooperation agreements (MoUs) covers:</p> <ul style="list-style-type: none"> <li>• the regular exchange of information on arising supervisory issues, with the closest cooperation links established with supervisory authorities of the following countries: Austria, China, Cyprus, CIS countries (especially countries of the Eurasian Economic Union—Belarus, Kazakhstan, Kyrgyzstan), Germany, Hungary, Latvia;</li> <li>• regular high-level meetings and meetings of experts from supervisory authorities of Austria, China, Germany, Hungary, Kazakhstan;</li> <li>• cooperation, meetings, and information sharing in the framework of supervisory visits and onsite inspections carried out by home country supervisors in Russian members of international banking groups; and</li> <li>• regular update of lists of contacts.</li> </ul> <p>In practical terms, most exchange of information has been on the basis of bilateral contacts within the past five years. However, colleges of supervisors are held for the two internationally active Russian banking groups on a regular basis. Other, broader, college meetings for cross border banking groups have also been held recently, for example with the Kazakhstan National Bank in 2015 for banking groups that were active in both countries. Bilateral meetings are held with the Chinese Banking Regulatory Commission (CBRC) on a regular basis.</p> <p>The frequency of supervisory college meetings where CBR takes part as a host-member is defined by the home supervisory authority. The usual frequency is once or twice a year.</p> <p>In terms of general issues, it would be normal for the following to be discussed:</p> <ul style="list-style-type: none"> <li>• evaluation of the financial situation of banks—members of the group;</li> <li>• assessment of the financial position of the group on a consolidated basis;</li> <li>• risk assessment—for some colleges the home supervisor asks all college members to complete questionnaires on risk assessment;</li> <li>• plans for oversight activities; and</li> <li>• recovery plans.</li> </ul> <p>The CBR is also in the process of seeking to establish a MoU with the ECB. Please see CP3 for a discussion of cooperation agreements.</p>
<b>EC3</b>	Home and host supervisors coordinate and plan supervisory activities or undertake collaborative work if common areas of interest are identified in order to improve the effectiveness and efficiency of supervision of cross-border banking groups.
Description and findings re EC3	The CBR engages with foreign supervisors at both high level and expert level, and for jurisdictions where there are more significant home/host relationships, there is more consistent and regular contact, though it is more common to exchange information and discuss issues than plan supervisory activity. Collaborative work arrangements have not been pursued at this time. However, the MoUs signed by the CBR (available on the website) indicate the recognition of the

	value of such work and set out arrangements for how such collaborative activity would be managed. In some cases, the CBR has cooperated with foreign supervisors to develop more effective practices of consolidated supervision (covering a number of banks and thus covering situations both where the CBR is home and host supervisor).
<b>EC4</b>	The home supervisor develops an agreed communication strategy with the relevant host supervisors. The scope and nature of the strategy reflects the risk profile and systemic importance of the cross-border operations of the bank or banking group. Home and host supervisors also agree on the communication of views and outcomes of joint activities and college meetings to banks, where appropriate, to ensure consistency of messages on group-wide issues.
Description and findings re EC4	<p>The framework of cooperation agreements and MoUs (now signed 38 such agreements and memoranda) determine the conditions of exchange of information between the CBR and the banking supervisory authority of the relevant foreign state. The MoUs are based on a standardized template and, broadly, they indicate that information exchange is upon request although certain information, such as in respect of concerns relating to the parent entity of a group would be notified to the other supervisory authority. The MoUs provide that in the event of concerns can be directed request to the appropriate supervisory authority which forwards the request to the bank. If necessary meetings with the banks and the supervisory authorities can be arranged. MoUs are typically annexed with lists of contact persons including direct contact details which are updated as needed.</p> <p>Communication strategies in respect of delivering supervisory messages to banks are not addressed by the agreement documents but the CBR was able to confirm that questions raised by supervised banks had been discussed in the context of college meetings.</p>
<b>EC5</b>	Where appropriate, due to the bank's risk profile and systemic importance, the home supervisor, working with its national resolution authorities, develops a framework for cross-border crisis cooperation and coordination among the relevant home and host authorities. The relevant authorities share information on crisis preparations from an early stage in a way that does not materially compromise the prospect of a successful resolution and subject to the application of rules on confidentiality.
Description and findings re EC5	<p>The CBR has a framework agreement in place with one host authority in relation to effective management of cross-border crisis.</p> <p>The CBR has thus, so far, signed an annex to the MoU with the CBRC on crisis management. Provisions on cooperation in the rehabilitation and restructuring of credit institutions are also included in the new version of the MoU with the Commission on the financial and capital markets of Latvia, signed in 2015.</p>
<b>EC6</b>	Where appropriate, due to the bank's risk profile and systemic importance, the home supervisor, working with its national resolution authorities and relevant host authorities, develops a group resolution plan. The relevant authorities share any information necessary for the development and maintenance of a credible resolution plan. Supervisors also alert and consult relevant authorities and supervisors (both home and host) promptly when taking any recovery and resolution measures.
Description and findings re EC6	According to the CBL (Article 57) and the BBAL (Article 24), the CBR is entitled to demand that a credit organization develop and present to the CBR their Recovery Plans. At the present time all

	<p>systematically important banks must develop and submit to the CBR financial stability recovery plans.</p> <p>As noted in CP8, currently the CBR is developing regulations to establish the methodology for developing resolution plans (including the content of such plans, and the procedure and timeframe for submission) but active work has not yet taken place on resolution planning. Hence, although there have been discussions on recovery and resolution in the context of the CBR's cross border relationships, no resolution plans have yet been agreed.</p> <p>At present, institutions are expected to develop their recovery plans with reference to the CBR recommendations (Letter 193-T) in the field of recovery and resolution, and these are addressed to banks with respect to recovery plans. ("On the Methodical Recommendations for the Development of Plans for the Financial Stability Restoration of Credit Institutions," September 29, 2012).</p> <p>As noted in EC5 above, the CBR has signed an MoU annex with the CBRC on crisis management, covering also recovery and resolution. The MoU with Latvia has also been updated in this regard in 2015. Other MoUs are to be updated.</p> <p>At the present time, the CBR does not participate in resolution colleges of banking groups which contain Russian credit institutions.</p>
<b>EC7</b>	The host supervisor's national laws or regulations require that the cross-border operations of foreign banks are subject to prudential, inspection and regulatory reporting requirements similar to those for domestic banks.
Description and findings re EC7	<p>In Russia, a banking subsidiary of a foreign banking group is regarded as a domestic bank and therefore treated as a locally owned bank. This treatment is based on the CBL (Article 56), which establishes CBR supervision over banking activities on a stand-alone basis as well as of groups. The supervisory standards, practices, and processes are the same for foreign owned and for domestically owned banks. The supervisory process is based on Regulation 2005-U of April 30, 2008. Similarly, domestic standards (e.g., reporting, inspections) apply to a foreign owned branch located in the Russian Federation. Further details are available, for example, in Instruction147-I regarding onsite inspections of credit institutions (their branches).</p> <p>Russian law does not permit the presence of a foreign owned branch in the territory of the Russian Federation. All foreign owned banks are subsidiaries, which are incorporated locally and thus subject to national treatment.</p>
<b>EC8</b>	The home supervisor is given onsite access to local offices and subsidiaries of a banking group in order to facilitate their assessment of the group's safety and soundness and compliance with customer due diligence requirements. The home supervisor informs host supervisors of intended visits to local offices and subsidiaries of banking groups.
Description and findings re EC8	<p>Under the CBL (Article 73), access to the premises of credit institutions located on the territory of the Russian Federation is granted to the foreign home state supervisory authorities, provided that the written consent of the bank that is established in the Russian Federation is obtained. The foreign supervisor is obliged to inform the CBR of the results of any such visit.</p> <p>The relevant arrangements are described in the standard MoU between the CBR and the supervisory authority from the country of origin of the bank. Thus the foreign supervisor has the</p>

	<p>right to check the activity of, and has access to premises of, the cross-border institutions (providing written consent is obtained), as well as other members of the relevant banking group. The foreign supervisor shall notify the CBR of its intention to conduct an inspection and will inform the CBR of the results of such an inspection. These provisions are reciprocal.</p> <p>In practical terms, the CBR has supported the work of foreign supervisory authorities in the context of performing asset quality reviews and has also met with supervisors who were making supervisory visits to representatives of Russian subsidiaries (Netherlands, Turkey). At least one further inspection by a home jurisdiction to the Russian subsidiary is already planned in 2016.</p> <p>For those cases where the CBR is the home supervisor, the CBR has informed the host authorities of a visit to local offices/subsidiaries. Please see CP12 EC4.</p>
<b>EC9</b>	The host supervisor supervises booking offices in a manner consistent with internationally agreed standards. The supervisor does not permit shell banks or the continued operation of shell banks.
Description and findings re EC9	This criterion is not applicable to Russia (no existing shell banks).
<b>EC10</b>	A supervisor that takes consequential action on the basis of information received from another supervisor consults with that supervisor, to the extent possible, before taking such action.
Description and findings re EC10	A standardized MoU provides that supervisory authorities (home/host) shall inform each other, in good time and to the extent reasonable, about any event which has the potential to endanger the stability of credit institutions having cross-border establishments in the other country. According to the standardized MoU, CBR shall also notify a foreign supervisory authority of administrative penalties which it has imposed or other action which it has taken on such a cross-border establishment as host supervisor, or on the (parent) credit institution as home supervisor if the information is important to other authority. There is no recent (post 2014) experience of such information having been received.
<b>Assessment of Principle 13</b>	<b>Largely Compliant</b>
Comments	<p>Removal of legislative obstacles to the exchange of supervisory information have allowed progress in the field of home and host supervisory cooperation.</p> <p>Supervisory expectations and practices have been improving globally over the past five years, as reflected in the 2014 publication of the BCBS principles for effective supervisory colleges (replacing the 2010 document on good practices of supervisory colleges). The CBR's participation in a number of colleges, as the host supervisor, means that the CBR is informed of and involved with some of the latest developments and practices in respect of home and host cooperation and collaboration. In future it is hoped that greater opportunities for cross border collaboration and cooperation (joint inspections, inspections of non-domestic subsidiaries, and branches) will be pursued actively.</p> <p>While accepting that the CBR has approached the ECB in respect of signing an MoU and has notified the EBA of the 2013 legislative changes protecting the confidentiality of information (as discussed in CP3), and while it is to be hoped that future agreements will support home/host relationships with the EU, it is important for bilateral and college arrangements to be prioritized and college meetings to be re-instituted as soon as practicable for domestic banks with cross</p>

	<p>border activity and establishments, whether or not all relevant host authorities are able to participate.</p> <p>Initial moves have been made in terms of cross border crisis planning and involvement in recovery and resolution plans for cross border groups, now that the legal provisions are in place, but although the CBR has participated, as a host supervisor, in discussions on recovery and resolution, and has adjusted some MoUs, it has not been possible to achieve much progress at this stage.</p> <p>The CBL (Article 73) contains a potential obstacle to effective home host practices, as a foreign supervisory authority requires written consent to access the premises of a subsidiary established in Russia (foreign owned branch establishments are not permitted). In practice, it does not appear that credit institutions have withheld consent, as cross border supervisory visits have taken place. While it is understood that an institution that is incorporated in the Russian Federation is a Russian institution subject to Russian law, and should therefore be subject to Russian law consistently with other entities, it is recommended that the removal of this provision from the CBL be explored.</p>
<h2>B. Prudential Regulations and Requirements</h2>	
<p><b>Principle 14</b></p>	<p><b>Corporate governance.</b> The supervisor determines that banks and banking groups have robust CG policies and processes covering, for example, strategic direction, group and organizational structure, control environment, responsibilities of the banks' boards and senior management,<sup>69</sup> and compensation. These policies and processes are commensurate with the risk profile and systemic importance of the bank.</p>
<p><b>Essential criteria</b></p>	
<p><b>EC1</b></p>	<p>Laws, regulations or the supervisor establish the responsibilities of a bank's board and senior management with respect to CG to ensure there is effective control over the bank's entire business. The supervisor provides guidance to banks and banking groups on expectations for sound CG.</p>
<p>Description and findings re EC1</p>	<p>In Russia, there are multiple regulations, instructions, ordinances, letters, and codes that govern CG in banks. Some are binding, others are not.</p> <p>Responsibilities of a bank's board and senior management are stipulated in the Russian Federation Civil Code and in two other key laws, the Federal Law 'On Joint-Stock Companies' 208 FZ of December 26, 1995 on the one hand and the Federal Law 14-FZ "On Limited Liability Companies" of February 8, 1998 on the other. As stipulated in these laws, the BoD (supervisory board) carries out the general governance of the credit institution's activity, excluding issues within the competence of the general meeting of shareholders defined by the law. Competence of the Board is detailed in the Article 65 of the Federal Law 208 FZ and in the Article 32 of the Federal Law 14-FZ abovementioned. Article 4 of the civil code also refers to CG.</p> <p>Additional relevant provisions can be found in the banking law. While this law does not contain an explicit reference to CG (the word "governance" is not mentioned), it establishes the responsibilities of a bank's board and senior management and provides supplementary powers of the board as follows:</p> <ul style="list-style-type: none"> <li>• approving the strategy for managing bank's risks and capital, as well as approving the procedure for managing major risks and exercising control over its implementation;</li> </ul>

<sup>69</sup> Please refer to footnote 27 under Principle 5.

- approving the procedure for applying bank RM methods and quantitative risk assessment models;
- approving the procedure for preventing conflicts of interest;
- approving the head of the internal audit division and its plan, as well as a wage policy and control over its implementation;
- assessing the compliance by senior management of the credit institution with the strategies and procedures approved by the board based on internal audit's reports;
- establishing committees (e.g., audit and remuneration committees);
- approving compensation and remuneration policies.

Ordinance 3624-U on Risk Management also contains several relevant provisions. For example, the BoD should (i) approve and oversee the implementation of the institution's strategic objectives, risk strategy, and internal governance; (ii) ensure the integrity of the accounting and financial reporting systems; (iii) oversee the process of disclosure and communications; and (iv) be responsible for providing effective oversight of senior management.

Regulation 408-P of October 27, 2013 establishes the procedures for assessing reputation and qualification of people holding senior positions in banks and sets out the requirements for heads of internal control and RM units. CBR Ordinance 3639-U also establishes a tracking mechanism for information relating to qualification/reputation of banks' senior executives and BoD members.

Other important regulations include CBR Letter 199 of September 13, 2005 entitled "On Modern Approaches to Organizing Corporate Governance in Credit Institutions." This recommends, *inter alia*, that approval of internal written policies concerning bank RM be placed under the authority of the BoD. This text explicitly recognizes the importance of CG for banks, and intends to provide information on current good international practices.

Regulation 11-T is also a CG annual self-assessment questionnaire to be returned by banks to the CBR. The questionnaire addresses issues such as distribution of powers among governing bodies of the bank, approval process of a bank's strategy, RM coordination, prevention of conflicts of interest, relations with affiliated entities, code of ethics, disclosure policies, and internal control monitoring.

CBR also released Instruction 154-I of June 17, 2014 "On the Procedure for Assessing Remuneration Systems of Credit Institutions" that sets the general principle in relation to remuneration policies. This instruction gives more power to the CBR over management of employee's motivation policies.

The CBR has also recommended to publicly traded joint-stock companies—which includes credit institutions—to apply the CG Code according to CBR Letter 06-52/2463 of April 10, 2014. This code that was first published in 2001 and improved in 2014 recommends that institutions implement the following:

- organizing efficient work of the BoD, i.e., determining the approaches to reasonable and bona fide performance of duties by board members;
- determining the functions of the BoD, and organization of its work and that of its committees;
- clarifying requirements to board members, including those relating to their independence;

	<ul style="list-style-type: none"> <li>• developing a remuneration system for members of management bodies and key managers of the company, including recommendations relating to various components of such remuneration system (short-term and long-term incentives, severance pay, etc.);</li> <li>• making recommendations on the development of an efficient system of RM and internal controls; and</li> <li>• making recommendations on additional disclosure of material information about the company and entities controlled thereby and their internal policies.</li> </ul> <p>The application of this CG code, however, is not mandatory but voluntary. In its introduction, it is said that its application by a company is voluntary.</p> <p>Also, the CBR has published the Basel Committee recommendations on CG on its official website and has recommended their application by the banks (CBR Letter 14-T of February 6, 2012). Other communications from the CBR have also been made to promote CG principles in the industry, including the list of questions for CG self-assessment by the credit institution (CBR Letter 11-T of February 7, 2007).</p>
<b>EC2</b>	<p>The supervisor regularly assesses a bank's CG policies and practices, and their implementation, and determines that the bank has robust CG policies and processes commensurate with its risk profile and systemic importance. The supervisor requires banks and banking groups to correct deficiencies in a timely manner.</p>
Description and findings re EC2	<p>Banks' CG policies and practices are assessed in the context of the RM oversight, by taking into consideration the quality of banks' management and the respective roles played by the BoD and senior management vis-à-vis the RM system as a whole. The bank's RM system is inspected as part of the onsite assessment, consistent with the scale and conditions of a credit institution's activity. In accordance with the CBR Letter 26-T and Ordinance 2005-U (on estimating bank's economic position), the following are considered: compliance of internal bank RM practices with the requirements of Russian Federal legislation and CBR regulations/recommendations; procedures that support the institution's division(s) responsible for RM; decision-making process by management; and the role of the BoD, including the independence of the RM function to assess risks. The outcomes of these diligences allow CBR examiners to make a judgement on the quality of CG and to assign banks a rating (from 1 to 5) based on risk indicators.</p> <p>A similar approach is also followed during onsite examination of the internal control system of a bank as contemplated in the CBR Letter 47-T of March 24, 2015. The CBR examiners' analysis will consider the governance system (the supervisory, management and control bodies), the organization (planning and control systems, information and IT systems) and the control functions (internal audit, RM, and compliance functions). As discussed in CP 17, requirements for banks include: the segregation of duties between operating and control personnel, the existence of a system for integrated management of the different types of risk, the effectiveness of the risk control unit.</p> <p>Since 2014, the CBR has started to assess annually the remuneration systems of credit institutions in order to ensure financial soundness of credit institutions, and to make sure that the remuneration systems of credit institutions correspond to the nature and scope of their operations, performance, and to the level and combination of risks taken (CBR Instruction 154-I of June 17, 2014).</p>



	Where breaches are detected, credit institutions are required to adopt corrective actions, which vary depending upon the type and intensity of the problem. CBR can issue an order to the bank to bring its RM or its internal control systems into conformity with the regulations. In the statistics on sanctions provided by the CBR to the mission, there was no sanction in relation to CG per se, but the BoD of 813 banks received in 2015 written notices on shortcoming in banks' activities, indicating issues of possible lack or insufficient engagement of BoD and top managers in bank's operating system.
<b>EC3</b>	The supervisor determines that governance structures and processes for nominating and appointing board members are appropriate for the bank and across the banking group. Board membership includes experienced non-executive members, where appropriate. Commensurate with the risk profile and systemic importance, board structures include audit, risk oversight, and remuneration committees with experienced non-executive members
Description and findings re EC3	<p>The banking law (Articles 11.1 and 16) and CBR Regulation 408-P establish requirements and expectations with regard to governance structures and the need for experienced board members. On October 25, 2013 the CBR approved Regulation 408-P "On the Procedure for Assessing Compliance with the Requirements to Qualification and Business Reputation..." The regulation was issued following recent legislative changes (Federal Law 146-FZ of July 2, 2013) requiring a bank's managers, members of the BoD, shareholders owning more than 10 percent of a bank's shares, controlling persons of such shareholders, and managers of such shareholders/controllers persons to comply with certain requirements regarding qualification and/or business reputation.</p> <p>Regulation 408-P contains updated rules on the procedures for coordinating the appointment of bank's managers with the CBR and notifying it of any appointment/selection and dismissal of managers and members of the BoD. It also sets out criteria for board members in terms of experience, education, and suitability for the post. The banking law also subjects banks to the obligation of disclosing information about board members (qualification, work experience, education) on their websites.<sup>70</sup> Also, when estimating the economic position of banks, the CBR evaluates whether the members of the board have appropriate management experience in finance, accounting, or in any other relevant field.</p> <p>In the course of their onsite examinations, CBR staff will determine if SIFIs have set up dedicated committees (audit committee, remuneration committee) and whether these committees exercise their duties in conformity with the regulations.<sup>71</sup></p> <p>The CG Code also recommends that institutions elect to the BoD only persons with an impeccable business and personal reputation. Such persons should also have the knowledge, skills, and experience necessary to make decisions that fall within the jurisdiction of the BoD and to perform its functions efficiently. The BoD should include a sufficient number of independent directors. Besides, the BoD can form committees such as audit committee, remuneration committee, and others.</p>

<sup>70</sup> Article 8 of Federal Law «On banks and banking activities» and Ordinance of the CBR 3639-U of May 19, 2015.

<sup>71</sup> The CBR assesses internal control system of a systemically important credit institution and will determine whether an audit committee under the board of the credit institution has been formed (Article 5.3 of the Regulation of the CBR 242-P of April 24, 2014). The board of a credit institution with assets of more than RUB 50 billion and (or) with funds raised from individuals as deposits and (or) on bank accounts of more than RUB 10 billion shall form a special body—for example, a remuneration committee consisting of non-executive directors who have qualifications and experience appropriate to make decisions concerning remuneration issues.

	<p>However, as already mentioned, this code is not binding.</p> <p>In practice, major banks established CG structures a long time ago. During the mission, assessors met with several major banks, both public and private. One of the most important Russian state-owned banks has a Supervisory Board consisting of 17 directors, 7 of whom are independent directors. The same bank has also set up several committees, including an Audit Committee, a HR and Remuneration Committee, a Strategic Planning Committee, and a Risk Management Committee. Another prominent private commercial bank has established an Audit Committee that provides assistance to the BoD in assuring the high quality of CG system, and in maintaining efficient corporate control. The Staff and Remuneration Committee reports to the BoD and contributes to the appointment of highly qualified specialists to management positions and provides incentives for their work.</p> <p>To collect information and obtain insights on CG practices in banks, the CBR supervisory department reviews CG questionnaires that are returned to the supervisor on a regular basis. These questionnaires, however, are not mandatory for banks.</p>
<b>EC4</b>	Board members are suitably qualified, effective and exercise their "duty of care" and "duty of loyalty." <sup>72</sup>
Description and findings re EC 4	<p>As discussed above, board members shall possess the knowledge, skills, experience, reputation, and suitability for the position. Further, they should act in the interest of the company and not to the detriment of the shareholders. These requirements can be found in the Article 53 of the Civil Code of the Russian Federation, p.1 and in Article 71 of 208-FZ "On joint-stock companies," according to which a person who by virtue of a law or another legal act is empowered to act in its name "<i>shall act in the interests of the legal entity he represents in a bona fide and reasonable manner.</i>"</p> <p>There are several provisions in the CG Code relating to the concepts of "duty of care" and "duty of loyalty." As stipulated by the CGC, the purpose of applying standards of CG is to protect the interests of all shareholders. In its Article 2.3, the same code recommends that the BoD should be an efficient and professional governing body of the company that is able to make objective and independent judgments and pass resolutions in the best interests of the company and its shareholders. Article 2.6 also states that board members must act reasonably and in good faith in the best interests of the company and its shareholders, being sufficiently informed, with due care and diligence. This means in particular that board members should take their decisions considering all available information, in the absence of a conflict of interest, and treat shareholders equally, and assuming normal business risks.</p>

<sup>72</sup> The OECD (OECD glossary of CG-related terms in "Experiences from the Regional Corporate Governance Roundtables," 2003, [www.oecd.org/dataoecd/19/26/23742340.pdf](http://www.oecd.org/dataoecd/19/26/23742340.pdf)) defines "duty of care" as "The duty of a board member to act on an informed and prudent basis in decisions with respect to the company. Often interpreted as requiring the board member to approach the affairs of the company in the same way that a "prudent man" would approach their own affairs. Liability under the duty of care is frequently mitigated by the business judgment rule." The OECD defines "duty of loyalty" as "The duty of the board member to act in the interest of the company and shareholders. The duty of loyalty should prevent individual board members from acting in their own interest, or the interest of another individual or group, at the expense of the company and all shareholders."

	<p>It is worthwhile noting that in practice, the CBR has a direct view on CG related issues via the presence of its AR assigned to banks. This resident inspector (AR) is allowed to attend at his/her own discretion board meetings (as an observer) as well as all relevant committees, including credit risk, audit, and remuneration committees. In the materials provided to the mission by CBR, evidence was found of active involvement of ARs in that matter. The analysis of a weekly report indicated that the AR attended a BoD meeting in which members approved the Remuneration Committee’s policy on remuneration, including for risk takers.</p>
<b>EC5</b>	<p>The supervisor determines that the bank’s board approves and oversees implementation of the bank’s strategic direction, risk appetite<sup>73</sup> and strategy, and related policies, establishes and communicates corporate culture and values (e.g., through a code of conduct), and establishes conflicts of interest policies and a strong control environment.</p>
Description and findings re EC5	<p>Through Regulation 119-T and Ordinance 3426-U discussed under EC1, the CBR has issued general guidance on CG in banks, reflecting many elements of international good practice, which includes recommendations for a bank’s board to approve and oversee implementation of the bank’s strategic direction, risk, and strategy.</p> <p>In particular, the banking law (Article 11.1.1), CBR regulations and Ordinance 3426-U emphasize the role of the board in setting strategies and requiring that risks be managed appropriately. As discussed under CP 15, the board and management contribute, in line with their duties and responsibilities, to defining the RM and the control policies, as well as the oversight of their proper implementation. Directors are expected to periodically review the level of risk limits to ensure that they are in line with the bank’s business strategy, activities and risk appetite. The board will also approve the procedure for the prevention of conflicts of interests and ensure that the bank is also subject to a strong control system, including through the analysis of periodic reporting.</p> <p>In practice, CBR assesses the compliance with these principles when it evaluates bank’s economic position. The CBR examiners pay due consideration to a series of indicators that reflects a bank’s strength or weakness in the following areas: (i) RM system (indicator PU4); (ii) conditions of internal control (PU5), managements of strategic risk (PU6), and remuneration management (PU7). Each indicator is based on a series of criteria to which a rating should be assigned by the examiner. In this process, CBR examiners will have to address CG related questions such as: “Have the members of the board any work experience in the field of finance? Do they meet the requirements established by the legislation of the Russian Federation? Does the bank’s BoD exert constant control over the bank’s activity? Are board members constantly informed about bank’s risk exposure? When determining the amount of remuneration of the employees, are the levels taken into account of the risk to which the bank is exposed (was exposed) as a result of their actions?”</p> <p>In the inspection files provided to the mission by CBR, evidence was found that this analysis is conducted by the supervisory department. Each question is addressed in detail, with comments from the examiners substantiating the scoring assigned to each criterion and the source of information used (e.g., inspection report, letter from the bank, report from the internal control of the bank).</p>

<sup>73</sup> “Risk appetite” reflects the level of aggregate risk that the bank’s board is willing to assume and manage in the pursuit of the bank’s business objectives. Risk appetite may include both quantitative and qualitative elements, as appropriate, and encompass a range of measures. For the purposes of this document, the terms “risk appetite” and “risk tolerance” are treated synonymously.

<b>EC6</b>	The supervisor determines that the bank's board, except where required otherwise by laws or regulations, has established fit and proper standards in selecting senior management, maintains plans for succession, and actively and critically oversees senior management's execution of board strategies, including monitoring senior management's performance against standards established for them.
Description and findings re EC6	<p>The competence of the BoD in overseeing senior management's execution of board strategy can be found in Article 11.1-1 of the banking law that stipulates that one of the missions of the board is to assess the compliance by senior management with strategies and procedures approved by its members.</p> <p>There are other detailed similar requirements in the CG code. It is recommended that the BoD should be responsible for decisions to appoint and remove [members] of executive bodies, including in connection with their failure to properly perform their duties. The BoD should also procure that the company's executive bodies act in accordance with an approved development strategy and main business goals of the company.</p> <p>Moreover, one of the most important functions of the BoD is to form efficient executive bodies of the company and exercise efficient control over their work. It should also be responsible for making timely and informed staffing decisions regarding the company's executive bodies, including decisions to dismiss any member thereof. Article 59 of the same code suggests that, in accordance with its existing criteria and indicators, the BoD should regularly monitor the implementation of the company's strategy and business plans by its executive bodies. In the same vein, the board is recommended to periodically hear reports of the one-person executive body and members of the collective executive body on the implementation of the strategy, with particular attention to conformance of the company's performance to target indicators set forth by the company's strategy (Article 60).</p> <p>The CBR indicated that the assessment of abovementioned powers is done during the evaluation of the RM framework (Chapter 4 of the Ordinance of the CBR 2005-U of April 30, 2008 "On Estimating Banks' Economic Position").</p>
<b>EC7</b>	The supervisor determines that the bank's board actively oversees the design and operation of the bank's and banking group's compensation system, and that it has appropriate incentives, which are aligned with prudent risk taking. The compensation system, and related performance standards, are consistent with long-term objectives and financial soundness of the bank and is rectified if there are deficiencies.
Description and findings re EC7	<p>The competence of the BoD includes approval of remuneration policy of the credit institution and control over its implementation. Powers of the board in terms of remuneration policy are established in clauses 2.1 and 2.2 of CBR Instruction 154-I of June 17, 2014. Instruction 154-I establishes requirements on the percentage ratio between the fixed and variable parts of the credit institutions for both risk-taking employees and employees of different subdivisions, responsible for internal control and RM.</p> <p>In accordance with Clause 2.1 of CBR Instruction 154-I of June 17, 2014, documents that set forth the procedure for establishing salaries and other types of compensation (including incentives) payable to the members of the executive body shall be approved by the board members and be appropriate to the nature and scope of bank operations, performance, and the level of risks taken.</p>

	<p>The CG Code also contains several references to the compensation system. As a general principle, a CG framework should contain recommendations on development of a remuneration system for members of management bodies and key managers of the company, including recommendations relating to various components of such remuneration system (short-term and long-term incentives, severance pay, etc.). It is also clearly stipulated that the board oversees the design and operation of the bank's and banking group's compensation system. It is also mentioned that the remuneration due to the executive bodies and other key managers of the company should be set in such a way as to procure a reasonable and justified ratio between its fixed portion and its variable portion that is dependent on the company's performance results and employees' personal (individual) contributions to the achievement thereof.</p> <p>The CBR told the mission that adequacy of the remuneration system is assessed in the course of onsite examinations. The CBR is also empowered to issue an order to eliminate violations identified in the remuneration systems (see CP 11 for more details).</p>
<b>EC8</b>	The supervisor determines that the bank's board and senior management know and understand the bank's and banking group's operational structure and its risks, including those arising from the use of structures that impede transparency (e.g., special-purpose or related structures). The supervisor determines that risks are effectively managed and mitigated, where appropriate.
Description and findings re EC8	<p>The legal framework in respect of establishing board and executive management responsibility for a bank's operational structure and risks is contemplated in several norms. Ordinance 3624-U assigns specific responsibilities to the board with respect to managing risks. For example, a bank's BoD is required to have an in-depth knowledge of its business model, and to ensure that the organizational structure is coherent with such model.</p> <p>The CG Code also provides several recommendations in that regard. For example, the BoD should determine the principles of and approaches to creation of the RM and internal control system in the company. It is also recommended that the board take required and sufficient measures to make the existing RM and internal control system of the company consistent with the principles of and approaches to its creation as set forth by the BoD, and that it operates efficiently.</p> <p>The mission however, could not find any specific provision requiring the board to understand the bank's and banking group's operational structure that impede transparency (e.g., special-purpose or related structures).</p>
<b>EC9</b>	The supervisor has the power to require changes in the composition of the bank's board if it believes that any individuals are not fulfilling their duties related to the satisfaction of these criteria.
Description and findings re EC9	<p>In the previous BCP assessments, it was observed that the CBR lacked the power to require changes in the composition of bank's board. New additions to the banking law have granted the power to act against banks when problems arise.</p> <p>Federal Law 146-FZ of July 2, 2013, on Amendments to Certain Legislative Acts of the Russian Federation made amendments to the banking law (Articles 11<sup>1</sup>, 14, and 16) and to the CBL (Articles 60, 61, 61<sup>1</sup>, and 75) that aimed to strengthen the mechanisms for evaluating the business reputation of persons serving in the management bodies, including major owners of credit institutions and to grant the CBR the authority to remove unprincipled persons from the management of a lending institution, as well as the right to maintain a database of said persons and to perform evaluations of their business reputation on an ongoing basis.</p>

	<p>In case the CBR finds any issue in connection with the reputation of a BoD member (the member no longer meets the reputation/qualification requirements), the CBR can issue an order to replace the member of the BoD within a particular timeframe (Regulation 408-P of October 25, 2013).</p> <p>CBR is also entitled to replace banks' employees, including members of the BoD, if a credit institution fails to fulfill CBR's order to eliminate a violation or if a transaction poses a serious threat to the interests of creditors (depositors).</p>
<b>Assessment of principle 14</b>	<b>Largely Compliant</b>
Comments	<p>Russia has taken several initiatives over the past years to improve governance in banks. The introduction in 2013 of Articles 11.1 and 11-1-1 in the banking law is an important step forward as it provides a clear articulation of what the role of the BoD should entail, especially with regard to the promotion of CG principles within each credit institution. In 2014, the profound revision of the CG Code<sup>74</sup> was also an important step forward, even though it is still a non-binding instrument. New regulations and ordinances have provided more leverage to the CBR to monitor and enforce CG related issues.</p> <p>In practice, CG is not a stand-alone theme in the CBR approach to supervision; it is mainly addressed by CBR examiners through the prism of internal control and RM. The CBR focuses on the role and powers assigned to the BoD and how they are exercised.</p> <p>Some aspects would deserve further consideration.</p> <p>The current regime for CG is governed by piecemeal regulations, which makes it difficult to understand. Moreover, the current norms are of different nature, some of them are binding, others are just optional (CG Code, CBR Letters) and as such not enforceable.</p> <p>It was not clear during the discussion with the CBR whether current regulations specifically require a bank's board to understand the bank's and banking group's operational structure that impedes transparency (e.g., special-purpose or related structures). This is an important aspect, especially in light of recent criminal cases that led to the revocation of licenses, and in which perpetrators used opaque structures to conceal fraudulent operations.</p> <p>Several important regulations pertinent to CG were issued in 2015, and some of them will not be enforceable before 2017. Thus, the current mission is not in a position to assess their effective implementation. Also, the deficiencies in governance policies are largely influenced by problems found in other areas, for example deficiencies in related party transactions, lending to affiliates on more preferable terms than those applied to non-affiliated parties, and the possibility for directors not to recuse themselves when the board is voting on their transactions.</p>

<sup>74</sup> Provisions of the Code are based on international practices of CG and on CG principles developed by the Organization for Economic Co-operation and Development (OECD).

	<p><b>Recommendations:</b></p> <ul style="list-style-type: none"> <li>• Include in relevant regulation a specific provision requiring a bank's board to understand the bank's and banking group's operational structure that impede transparency (e.g., special-purpose or related structures).</li> <li>• Convert existing CBR recommendations on CG into binding regulations.</li> </ul>
<b>Principle 15</b>	<p><b>RM process.</b> The supervisor determines that banks<sup>75</sup> have a comprehensive RM process (including effective board and senior management oversight) to identify, measure, evaluate, monitor, report and control or mitigate<sup>76</sup> all material risks on a timely basis and to assess the adequacy of their capital and liquidity in relation to their risk profile and market and macroeconomic conditions. This extends to development and review of contingency arrangements (including robust and credible recovery plans where warranted) that take into account the specific circumstances of the bank. The RM process is commensurate with the risk profile and systemic importance of the bank.<sup>77</sup></p>
<b>Essential criteria</b>	
<b>EC1</b>	<p>The supervisor determines that banks have appropriate RM strategies that have been approved by the banks' boards and that the boards set a suitable risk appetite to define the level of risk the banks are willing to assume or tolerate. The supervisor also determines that the board ensures that:</p> <ol style="list-style-type: none"> <li>a sound RM culture is established throughout the bank;</li> <li>policies and processes are developed for risk-taking, that are consistent with the RM strategy and the established risk appetite;</li> <li>uncertainties attached to risk measurement are recognized;</li> <li>appropriate limits are established that are consistent with the bank's risk appetite, risk profile and capital strength, and that are understood by, and regularly communicated to, relevant staff; and</li> <li>senior management takes the steps necessary to monitor and control all material risks consistent with the approved strategies and risk appetite.</li> </ol>
Description and findings re EC1	<p>The most important norms governing RM policies are laid out in Regulation 2005-U that conveys CBR's expectations to banks on RM and Ordinance 3624-U of April 15, 2015 "On the Requirements to the Risk and Capital Management System of the Credit Institution and the Banking Group." As stipulated in Article 1.1 of the Ordinance 3624-U, "<i>a credit institution shall establish a risk and capital management system by implementing internal capital adequacy assessment processes.</i>"</p> <p>In addition, the CBR has issued Ordinance 3883-U on December 15, 2015 that establishes the procedure for the CBR to assess quality of risk and capital management framework and capital adequacy of credit institutions and banking groups (SREP).</p>

<sup>75</sup> For the purposes of assessing RM by banks in the context of Principles 15 to 25, a bank's RM framework should take an integrated "bank-wide" perspective of the bank's risk exposure, encompassing the bank's individual business lines and business units. Where a bank is a member of a group of companies, the RM framework should in addition cover the risk exposure across and within the "banking group" (see footnote 19 under Principle 1) and should also take account of risks posed to the bank or members of the banking group through other entities in the wider group.

<sup>76</sup> To some extent the precise requirements may vary from risk type to risk type (Principles 15 to 25) as reflected by the underlying reference documents.

<sup>77</sup> It should be noted that while, in this and other Principles, the supervisor is required to determine that banks' RM policies and processes are being adhered to, the responsibility for ensuring adherence remains with a bank's board and senior management.



	<p>It is noteworthy that the RM regime has been strengthened in the wake of the 2011 BCP update, according to which the RM regulatory framework did not provide the foundation necessary for full implementation of supervision by risk. Until recently, the CBR did not have the legal power to set requirements for banks in the area of RM, which was a significant gap in the prudential regime. The revision of the CBL (Articles 57.1 and 57.2), and the banking law (Article 11.1-1 and 11.1-2) fill this gap.</p> <p>The main changes were made by Federal Law 146-FZ of July 2, 2013 that introduced new provisions in both the CBL and the banking law with a view to extending the range of powers of the CBR in the area of RM. The second important reform was made by Ordinance 3624-U mentioned above that sets detailed principles on RM systems through the ICAAP process, as described below.</p> <p>Ordinance 3624-U provides detailed requirements to banks on the key elements of the RM framework they need to put in place. The requirements are appropriately extensive, although there are areas for refinement such as on the application of the framework to financial holding companies.</p> <p>The same Ordinance (Articles 2.3, 2.4, 2.5, 4.1-4) establishes rules that make clear that a key responsibility of the BoD is to <i>“take part in the working out, approval and implementation of the ICAAP of the bank,”</i> this includes the following:</p> <ul style="list-style-type: none"> <li>• define and approve the strategies and the RM policies and periodically review them with respect to changes in activities and external environment;</li> <li>• define the system of internal controls and assess its consistency with the established risks appetite and strategies and with the evolution of the firm’s risk profile;</li> <li>• consider not less than once a year any change to be made to the RM strategy;</li> <li>• be informed through periodic reporting about any violation of limits and measures to be taken to correct the situation.</li> </ul> <p>The management body is required to set operational limits to risk exposures—taking into account the results of stress tests and the economic context—and clearly define the responsibilities and the tasks of the functions involved in the RM process, and prevent conflicts of interest. The RM function is involved in the definition of the bank’s risk appetite (Chapter 4 of the Ordinance) and in the formulation of the RM policies and process as well as in the identification of operational limits to the different risk exposures, consistently with the nature, size and complexity of the bank’s activities.</p> <p>Ordinance 3624-U provides that institutions must build a RM, supported by appropriate policy announcement. RM (including responsibilities, risk tolerance, and risk appetite) should be documented and updated (if needed), and the framework for RM should be subject to independent review. In the context of risk appetite and risk tolerance, particular attention is paid to the establishment of appropriate risk limits and RM models, including recognition of uncertainties with regard to quantitative and qualitative risk models. Bank staff must be made aware of RM requirements in a timely manner, however, the ordinance does not explicitly require banks to build a sound RM culture.</p>
<b>EC2</b>	<p>The supervisor requires banks to have comprehensive RM policies and processes to identify, measure, evaluate, monitor, report and control or mitigate all material risks. The supervisor determines that these processes are adequate:</p>

	<p>(a) to provide a comprehensive “bank-wide” view of risk across all material risk types;</p> <p>(b) for the risk profile and systemic importance of the bank; and</p> <p>(c) to assess risks arising from the macroeconomic environment affecting the markets in which the bank operates and to incorporate such assessments into the bank’s RM process.</p>
Description and findings re EC2	<p>Pursuant to the Ordinance 3624-U, banks must have in place risk policies and a RM process to identify, measure, evaluate, monitor, mitigate and communicate risks to the BoD and to the supervisory authorities. Also, in accordance with Regulation 242-P of December 16, 2003 for the organization of internal control in banks and banking groups, credit institutions are required to establish adequate management and control mechanisms in order to control all the risks to which they are exposed. Further, the above-mentioned arrangements cover all forms of risk in a manner consistent with the characteristics, size and complexity of the business conducted by the bank. RM processes and control over the function of RM have to be executed on a permanent basis (Articles 3.6 of Ordinance 3624-P and Article 3.3 of Regulation 242-p). Besides, the regulation requires that these strategies and processes shall be subject to regular internal review—at least once a year—to ensure that they remain comprehensive and proportional to the nature, scale and complexity of the activities of the banks.</p> <p>The supervisory board shall, with regard to the ICAAP, establish and approve the general structure of the process, ensure its prompt adaptation to significant changes in strategic policies, organizational arrangements and the business environment, and take steps to ensure the full use of the results of the ICAAP for strategic and decision-making purposes.</p> <p>Evaluation of the conformity with this EC is done onsite. RM, even before the enactment of Ordinance 3624-U, has been apprehended by the CBR as part of its supervisory process. The methodology for assisting RM is enshrined in Letter T-26 of March 23, 2007 that provides detailed guidance to CBR’s examiners for RM oversight purposes. The letter points to the need to verify the existence and comprehensiveness of RM policies and processes to ensure that a bank’s internal systems capture all forms of risk in a manner consistent with the characteristics, size, and complexity of the business conducted by the bank. In particular, attention will be paid to the role of the BoD (supervisory board) with regard to RM, to in-house procedures and policies for RM, and to internal reporting mechanisms to the board on the current state of the credit institution. This letter has not been revised since its issuance in 2007, and it is understood that a new letter will be issued in the future to take into consideration the new RM framework.</p>
<b>EC3</b>	<p>The supervisor determines that RM strategies, policies, processes and limits are:</p> <p>(a) properly documented;</p> <p>(b) regularly reviewed and appropriately adjusted to reflect changing risk appetites, risk profiles and market and macroeconomic conditions; and</p> <p>(c) communicated within the bank</p> <p>The supervisor determines that exceptions to established policies, processes and limits receive the prompt attention of, and authorization by, the appropriate level of management and the bank’s board where necessary.</p>
Description and findings re EC3	<p>Ordinance 3624-U requires that risk and capital management strategy and procedures should be documented, regularly (at least annually) reviewed and adjusted if necessary based on new conditions of the bank, changing aspects and scale of operations (Chapter 2).</p>

	<p>In accordance with clause 7.3 of the Regulation on RM, the documents developed by the credit institution within the framework of ICAAP shall be communicated to all relevant employees.</p> <p>In addition, the RM system should determine <i>inter alia</i> the procedure and frequency of notifying the board about any issue identified by risk managers; this includes breach of limits and measures taken to correct the problem (Chapter 7).</p> <p>The verification of compliance with this EC is done onsite. In that regard, CBR examiners ensure that exceptions to established policies, processes, and limits receive the prompt attention of the board. Inspectors also assess whether RM policies have been communicated within the bank; this is done in different ways including by requesting copies of emails, books with staff signatures, etc. Minutes of the board are also scrutinized. ARs assigned to banks (including D-SIBs) are also in a position to detect any RM related issue at the board level. As indicated elsewhere in this report, AR attend board meetings and also other relevant committee, at their discretion.</p>
<b>EC4</b>	<p>The supervisor determines that the bank's board and senior management obtain sufficient information on, and understand, the nature and level of risk being taken by the bank and how this risk relates to adequate levels of capital and liquidity. The supervisor also determines that the board and senior management regularly review and understand the implications and limitations (including the risk measurement uncertainties) of the RM information that they receive.</p>
Description and findings re EC4	<p>Ordinance 3624-U contains several provisions that aim to ensure adequate and timely information of the bank's board and senior management on the nature and magnitude of risks and on how these risks affect level of capital and liquidity. Chapter 6 identifies a series of reports—and their frequency—to be submitted to the BoD (either annually, quarterly, or monthly) for information and/or action.</p> <p>These reports cover a wide range of topics including, but not limited to, results of ICAAP, outcomes of stress testing, material risks, and observance of statutory ratios. Information about any shortcomings in the RM system or about non-observance of limits, for example, should be reported to the BoD and senior management as soon as problems arise. This allows the management of the bank to keep track of any developments that should provoke strategic decisions.</p> <p>These aspects are currently verified <i>in-situ</i> through CBR Letter 26-T (Article 2.3), which requires examiners to assess the role of the BoD in organizing bank's RM, and its capacity to exercise permanent control over the activities of the bank and to obtain on a permanent basis (daily) information on the risks undertaken as well as on the current state of the bank. The AR assigned to the bank also provides constant feedback to the chief directorate and the curator, including weekly reports, on any issue of particular relevance, including RM. Any meeting with senior management and board members can be convened at the discretion of the supervisory department; and these meetings are an opportunity to assess how much the board and senior management know about the nature and extent of risks.</p> <p>In the near future, and as part of its SREP, the CBR will also evaluate and test banks' ICAAP processes and documentation to determine whether the board and senior management receive adequate and appropriate information. This new supervisory approach to RM is set to start in 2017.</p>

<b>EC5</b>	The supervisor determines that banks have an appropriate internal process for assessing their overall capital and liquidity adequacy in relation to their risk appetite and risk profile. The supervisor reviews and evaluates banks' internal capital and liquidity adequacy assessments and strategies.
Description and findings re EC5	<p>As noted under EC2, the BoD has to ensure that the level and the allocation of capital and liquidity are consistent with the established risk appetite and RM policies and processes. Banks must develop strategies to be pursued and tools and procedures for determining the adequate capital—in terms of amount and composition—to cover all risks to which they are or could be exposed, including risks not subject to specific capital requirements.</p> <p>The RM function is required to monitor on an ongoing basis the evolution of the bank's risks and the respect of established limits to risk exposures. In accordance with Ordinance 3624-U, banks must also develop liquidity RM procedures which should include, inter alia, the establishment of liquidity limits, the methods for controlling compliance with such limits, and the existence of mechanisms for reporting to the management bodies breaches of those limits.</p> <p>The CBR reviews and analyzes the bank's risk profile, assesses the role of the governing bodies, the RM organizational framework and the internal control system, and evaluates banks' internal capital and liquidity adequacy assessments and strategies. These activities are conducted in consonance with the methodologies set forth in Letter 26-T and in Ordinance 3883-U.</p> <p>Based on the results of this assessment, CBR staff assigns each bank to one of five classification groups. Banks with low quality of RM assessment are to be referred to classification groups 3 to 5 depending on the seriousness of the flaws (e.g., banks whose shortcomings threaten depositors and creditors). Banks in groups 3 to 5 are subject to special supervisory attention and to enforcement measures stipulated in Article 74 of Law 86-FZ, including corrective measures in the form of organizational or capital adjustments (add-on).</p>
<b>EC6</b>	<p>Where banks use models to measure components of risk, the supervisor determines that:</p> <ul style="list-style-type: none"> <li>(a) banks comply with supervisory standards on their use;</li> <li>(b) the banks' boards and senior management understand the limitations and uncertainties relating to the output of the models and the risk inherent in their use; and</li> <li>(c) banks perform regular and independent validation and testing of the models.</li> </ul> <p>The supervisor assesses whether the model outputs appear reasonable as a reflection of the risks assumed.</p>
Description and findings re EC6	<p>Internal models are permitted for computing the economic capital for credit risk only, under the standardized approach. The CBR permits the use of the two potential Internal Ratings Based (IRB) approaches: foundation or advanced. One systemic bank, for example, uses the advanced approach for its retail portfolio and the foundation approach for corporate lending. Advanced approaches to market risk and OR are currently not applicable in Russia. Market risks and OR capital calculation is determined through the simplified approach and the basic indicators approach, respectively.</p> <p>The requirements for the bank's internal validation processes to be used for capital calculation are set forth in Chapter 14 of Regulation 483-P<sup>78</sup> of August 6, 2015. On the other hand, the approval</p>

<sup>78</sup> "On the Procedure for Calculating Credit Risk Based on Internal Ratings."

	<p>process by the CBR is contained in CBR Ordinance 3752-U,<sup>79</sup> also issued on August 6, 2015. As of today, no banks have yet been granted permission to use the IRB approach to credit risk calculation. In that regard, two banks have already submitted formal applications to the CBR and 4 have expressed their willingness to use the IRB methodology.</p> <p>As stipulated in Ordinance 3624-U, internal models are an integral part of internal RM processes.</p>
<b>EC7</b>	<p>The supervisor determines that banks have information systems that are adequate (both under normal circumstances and in periods of stress) for measuring, assessing and reporting on the size, composition and quality of exposures on a bank-wide basis across all risk types, products and counterparties. The supervisor also determines that these reports reflect the bank's risk profile and capital and liquidity needs, and are provided on a timely basis to the bank's board and senior management in a form suitable for their use.</p>
Description and findings re EC7	<p>Ordinance 3624-U contains several provisions in relation to information systems with the view to ensuring that measurement and assessment of all material risks and exposures are adequately captured and communicated in a timely manner to the bank's board and senior management. As stipulated in the ordinance, with respect to each of the material risks, banks "<i>shall establish requirements to the automated system(s) ensuring RM.</i>"</p> <p>A similar provision can be found in the same ordinance requiring banks to have an automated information system in place to ensure, among other things, that compliance with the liquidity limits is monitored and that all relevant reports are submitted to the management bodies in a timely fashion (including analysis of the current and future liquidity situation of the credit institution).<sup>80</sup> BCP assessors were told that during onsite inspections, CBR examiners evaluate if the bank's information systems are adequate for measuring, assessing, and reporting on all the bank's risks. The CBR also evaluates if the risk measurement and risk reports reflect the bank's actual risk profiles, including liquidity risk and capital requirements.</p>
<b>EC8</b>	<p>The supervisor determines that banks have adequate policies and processes to ensure that the banks' boards and senior management understand the risks inherent in new products,<sup>81</sup> material modifications to existing products, and major management initiatives (such as changes in systems, processes, business model and major acquisitions). The supervisor determines that the boards and senior management are able to monitor and manage these risks on an ongoing basis. The supervisor also determines that the bank's policies and processes require the undertaking of any major activities of this nature to be approved by their board or a specific committee of the board.</p>
Description and findings re EC8	<p>Several provisions of Ordinance 3624-U are relevant to this EC. Article 3.2 requires banks to establish a methodology for determining the risks material for the credit institution, which methodology shall be based on a system of indicators characterizing, among other things, the commencement of new types of operations. Further, in the area of market risk, Article 3.3 stipulates that the procedures for making decisions to commence operations with new types of financial</p>

<sup>79</sup> "On the Procedure for Obtaining Permits for the Use of Bank Credit Risk Management Methods and Credit Risk Quantification Models to Calculate the Capital Adequacy Ratios of the Bank and on the Procedure for Assessing Their Quality."

<sup>80</sup> Also, Regulation 510-P, Annex 1 requires banks to use automated information systems to ensure access to all information required for decisions on the sale of high quality liquid assets for liquidity management purposes. Regulation 421-P, which represents the basis for the LCR calculation according to Regulation 510-P, treats the internal information systems that are used for HQLA management as well.

<sup>81</sup> New products include those developed by the bank or by a third party and purchased or distributed by the bank.

	<p>instruments or entering new markets shall include a preliminary analysis of whether the bank has a methodology for managing the risks stemming from the new instrument; and the same procedure should also determine whether the bank has employees with the required qualifications. Also, the development of new products is one of the qualitative indicators used to determine the risk appetite of the bank. These procedures/methodologies/indicators must be approved by senior management.</p> <p>CBR Methodology 26-T for inspecting RM system in banks also provides indications on how to verify compliance with this EC. In particular, and according to what was indicated to the mission, CBR examiners will test and evaluate the effectiveness of bank RM in relation to new products or activities. Effectiveness of RM will be checked and assessed in the lines of activity that are new for the bank. A determination will be made as to whether bank’s managerial bodies have an idea of the objectives for pursuing a new line of activity and the expected results, and whether the bank takes measures to upgrade the qualification of the employees engaged in the new line of activity.</p> <p>The current regime, however, lacks some important features. It is not clear whether the principles described above on the impact of new products also apply to material modifications to existing products and to important management initiatives such as major acquisitions. In the same vein, the current regime does not explicitly require banks to undertake new activities only if sufficient resources are available to establish and manage the corresponding risks. The latter seems to apply only to market risks. Similarly, the text is silent on the degree of involvement of the risk control function in the process of approving new products or making significant changes to existing products—as a comprehensive and objective assessment of the risks associated with new activities in various scenarios—as well as identifying whether there may be vulnerabilities in the bank in terms of effectively managing these new risks.</p> <p>The role of the BoD could also be more explicit. It would be useful, for example, to require the supervisory board to ensure that the definition of the approval process for entering new products, services, activities, and markets, as well as the criteria for the identification of the major activities, be subject to the prior assessment of the RM function.</p> <p>The risk control unit should also have the power to require changes to existing products to undergo a formal approval of new products.</p>
<b>EC9</b>	<p>The supervisor determines that banks have RM functions covering all material risks with sufficient resources, independence, authority and access to the banks’ boards to perform their duties effectively. The supervisor determines that their duties are clearly segregated from risk-taking functions in the bank and that they report on risk exposures directly to the board and senior management. The supervisor also determines that the RM function is subject to regular review by the internal audit function.</p>
Description and findings re EC9	<p>The keystone requirements for the RM function in banks are set out in Ordinance 3426-U. The RM function should establish and maintain a RM function independent from the operational units which</p>

	<p>has sufficient authority and adequate access to the supervisory board or the BoD.<sup>82</sup> Regarding the segregation of duties from risk-taking functions, the current regime stipulates that the head of the RM function meet professional qualification requirements, is placed in an appropriate hierarchical position,<sup>83</sup> and directly reports to the bank's bodies.</p> <p>The methodology for assessing compliance in banks with risk and capital management (Ordinance 3883-U) recommends that CBR examiners pay due attention to segregation of duties. Periodic review is covered by the same Ordinance 3426-U, as well as by Regulation 242-P of December 16, 2003, which provide that the internal audit function must periodically review the RM systems, risk, and capital adequacy assessment. In particular, internal the audit service should examine, inter alia, the efficiency of risk assessment methodology and RM procedures stipulated by the credit institution's internal documents, and check that the requirements in these documents are implemented in full.</p> <p>In addition, Ordinance 3426-U contains several provisions requiring the board to be informed of all RM related issues. For example, a report on risk exposures shall be prepared by the RM service and submitted directly to the board and senior management with the periodicity stipulated in the text. Also, in consonance with the regulation on internal control, information on measures taken to follow the recommendations of the internal audit service and to eliminate the identified breaches are submitted to the board at least twice a year. Further, the head of the internal audit service must inform the board if he or she considers that the risk taken is unacceptable for the bank, or if risk control measures are not commensurate with the level of risk.</p> <p>It is not clear, however, whether the CBR ensures that RM functions are also properly resourced.</p>
<b>EC10</b>	<p>The supervisor requires larger and more complex banks to have a dedicated RM unit overseen by a CRO or equivalent function. If the CRO of a bank is removed from his/her position for any reason, this should be done with the prior approval of the board and generally should be disclosed publicly. The bank should also discuss the reasons for such removal with its supervisor.</p>
Description and findings re EC10	<p>In accordance with Ordinance 3624-U, all credit institutions irrespective of their size and complexity must have a RM department, overseen by a CRO (Clause 3.6–3.8). In effect, as stipulated in Article 3.6, <i>"a RM department shall be created at the credit institution. The RM department shall perform its functions on an ongoing basis. The RM department can consist of several divisions performing RM functions."</i><sup>84</sup></p> <p>Banks are required to notify the CBR of the appointment of their CRO (and the head of internal audit) within three days after the nomination. Similarly, the CBR has to be notified in case of removal, at the latest one day after the decision has been taken.</p>

<sup>82</sup> Article 3.6 stipulates that "the head of the RM department shall be appointed at the credit institution (the parent credit institution of the banking group) and shall be under direct control of the sole executive body of the credit institution (the parent credit institution of the banking group) or its deputy."

<sup>83</sup> See in particular CBR Ordinance 3223-U of April 1, 2014 "On Requirements for Heads of Risk Management, Internal Control and Internal Audit Services of a Credit Institution."

<sup>84</sup> In that case, the duties shall be distributed between these divisions.



	<p>The regulation, however, does not specify who nominates and revokes the CRO. In effect, the text of the ordinance states that <i>“a head of the RM department shall be appointed at the credit institution.”</i> According to the CBR, the decision belongs to the BoD.</p> <p>The mission was told that during onsite inspection the CBR examines the organization and the function of the dedicated RM entity, and also evaluates whether the CRO/RM department comply with the requirements set out in the regulations.</p>
<b>EC11</b>	The supervisor issues standards related to, in particular, credit risk, market risk, liquidity risk, interest rate risk in the banking book and OR.
Description and findings re EC11	<p>The CBR has issued detailed regulations regarding credit risk, market risk, liquidity risk, and OR. Chapters 2–7 of the Annex to Ordinance 3624-U define the requirements for managing these risks. Furthermore, prudential requirements for credit risk calculation are stipulated by Instruction 139-I of December 3, 2012 “On Banks’ Required Ratios” and Regulation 483-P of August 6, 2015 “On the Procedure for Calculating Credit Risk Based on Internal Ratings.” Prudential requirements for OR calculation can be found in Regulation 346-P of November 3, 2009 “On the Procedure for Calculating Operational Risk.”</p> <p>Requirements and criteria concerning the calculation and treatment of liquidity risk are set out in different norms, including Regulation 510-P of December 3, 2015 on “The Calculation of the Liquidity Coverage Ratio by Systemically Important Credit Institutions” and Instruction 139-I with domestic prudential liquidity ratios for all the banks. Lastly, the calculation and treatment of market risk are governed by Regulation 511-P of December 3, 2015.</p>
<b>EC12</b>	The supervisor requires banks to have appropriate contingency arrangements, as an integral part of their RM process, to address risks that may materialize and actions to be taken in stress conditions (including those that will pose a serious risk to their viability). If warranted by its risk profile and systemic importance, the contingency arrangements include robust and credible recovery plans that take into account the specific circumstances of the bank. The supervisor, working with resolution authorities as appropriate, assesses the adequacy of banks’ contingency arrangements in the light of their risk profile and systemic importance (including reviewing any recovery plans) and their likely feasibility during periods of stress. The supervisor seeks improvements if deficiencies are identified.
Description and findings re EC12	<p>According to the CBL, banks—including domestic systematically important credit institutions—should develop financial stability recovery plans in the case of severe distress and amend them as necessary. These plans should be submitted to the CBR. As indicated in the banking law, contingency and recovery plans of the credit institution should be approved by the BoD (Article 11.1.1 of the banking law). Other relevant provisions can be found in the “Regulation on Internal Control” (Article 3.7) and CBR Regulation N193-T on methodological recommendations on development of recovery plans, which provides details on contingency arrangements in the following areas: conditions of recovery plan development, structure of recovery plans, stress scenarios to be implemented, as well as early warning exercises and triggers for initiating the application of recovery plans.</p> <p>Recovery plans should be consistent with the business strategy of the credit institution and incorporated in the overall management process. They should also reflect the real business of a credit institution and include stress testing results. It is also recommended that credit institutions provide regular (on an annual basis) updates of recovery plans and that these plans be approved by the BoD (supervisory board) of a credit institution. Recovery plans are to be assessed by the CBR.</p>

	<p>With respect to liquidity, Clause 6.5 of Chapter 6 of the Annex to Ordinance 3624-U requires banks to develop a plan for financing their activities in case of unforeseeable liquidity loss. The main targets of these plans are to preserve liquidity and determine action plans, including the sources of liquidity replenishment. The plans shall be reviewed and updated on a regular basis (at least once a year).</p> <p>The mission was told that during an onsite inspection, the CBR will evaluate if the bank, in light of its risk profile and its systemic importance, has appropriate contingency arrangements and recovery plans, and whether their implementation is feasible during periods of stress. This is done by reviewing the contingency plans with the relevant senior executives.</p>
<b>EC13</b>	<p>The supervisor requires banks to have forward-looking stress testing programs, commensurate with their risk profile and systemic importance, as an integral part of their RM process. The supervisor regularly assesses a bank's stress testing program and determines that it captures material sources of risk and adopts plausible adverse scenarios. The supervisor also determines that the bank integrates the results into its decision-making, RM processes (including contingency arrangements) and the assessment of its capital and liquidity levels. Where appropriate, the scope of the supervisor's assessment includes the extent to which the stress testing program:</p> <ul style="list-style-type: none"> <li>(a) promotes risk identification and control, on a bank-wide basis</li> <li>(b) adopts suitably severe assumptions and seeks to address feedback effects and system-wide interaction between risks;</li> <li>(c) benefits from the active involvement of the board and senior management; and</li> <li>(d) is appropriately documented and regularly maintained and updated.</li> </ul> <p>The supervisor requires corrective action if material deficiencies are identified in a bank's stress testing program or if the results of stress tests are not adequately taken into consideration in the bank's decision-making process.</p>
Description and findings re EC13	<p>Regulation 2005-U and Ordinance 3883-U contains multiple provisions<sup>85</sup> in relation to stress testing that provide guidance to CBR examiners for assessing the extent to which stress testing is correctly and efficiently embedded into the RM system of a bank.</p> <p>The use of stress testing programs also has to be included in the ICAAP process. Ordinance 3624-U (Clause 5.4) establishes stress testing requirements for the assessment of capital adequacy. Among other conditions, the stress testing processes shall be used in the bank's assessment of its capital adequacy and shall be performed on a regular basis. Stress testing procedures should contain several key features: (i) types of stress tests and main objectives; (ii) frequency of stress testing depending on the type and aim of the stress test (at least once a year); (iii) a list of stress scenarios and the methodology used; (iv) a mechanism for reporting to the BoD the stress testing results and measures to mitigate associated risks, etc.</p> <p>Moreover, when selecting the stress testing scenario, the bank shall pay due consideration to the following elements: the stress testing shall (i) cover all the risks and areas of activity material for the</p>

<sup>85</sup> CBR examiners should among other things evaluate whether the credit institution's risk and capital management strategy determines stress testing scenarios; whether the credit institution has stress testing procedures approved by the management bodies; whether the stress testing scenario takes account of the stage of the business cycle; whether the board takes account of the results of stress testing in managerial decision making to limit each material risk and estimate the bank's capital requirements.

	<p>credit institution and (ii) account for events that may cause maximum damage to the credit institution. Banks are also required to regularly (at least once a year) assess the scenarios under consideration, the quality of data, the assumptions used for the stress testing exercises, and the compliance of the stress testing results with the bank's established goals.</p> <p>Banks are required to document their stress testing methodology and the assumptions underpinning the stress tests. Bank administrators are also expected to evaluate testing results and adjust RM strategies where necessary based on the results of the stress tests, at least once a year.</p>
<b>EC14</b>	The supervisor assesses whether banks appropriately account for risks (including liquidity impacts) in their internal pricing, performance measurement and new product approval process for all significant business activities.
Description and findings re EC14	The mission was told that CBR inspectors check during onsite examinations whether banks have proper mechanisms in place for their internal pricing and performance measurement and also whether the board and management have reviewed and approved the new activities and products before they are introduced by the bank.
<b>Assessment of Principle 15</b>	<b>Largely Compliant</b>
<b>Comments</b>	<p>In the past, the RM regime was not deemed to be sufficiently robust. To address the situation, the CBR initiated and completed several reforms aimed at improving the bank's RM regulatory regime. The most significant changes were made by Federal Law 146-FZ of July 2, 2013 that included new provisions in both the CBL and the banking law. The overarching objectives were to increase CBR's powers in relation to RM on the one hand, and fostering RM processes in banks on the other.</p> <p>Also, Ordinance 3624-U on risk and capital management is a major step forward as it defines more clearly the responsibilities of the BoD in developing and overseeing management of the banks' entire risk profile and the policies supporting the participation of (independent) directors in overseeing RM decision-making. Equally important, this ordinance empowers the CBR to impose Pillar II measures, including capital add-on.</p> <p>Furthermore, Ordinance 3223-U of April 1, 2014 obligates banks to notify the CBR when the head of RM has been appointed and sets the qualification requirements for the head of RM, internal control and internal audit functions, in particular the conditions to be met by the applicants in terms of academic background and professional expertise in relevant fields.</p> <p>In sum, Russia has made significant progress to improve the RM supervisory and operational framework. There is, however, a lack of perspective on the effective implementation of this new regime in banks owing to the fact that key aspects have not yet been implemented. The first ICAAP reporting should be submitted to the CBR upon the results of 2016. The CBR will assess ICAAP results of the largest credit institutions starting from 2017. Similarly, it is difficult to evaluate at this point how the CBR will use its new powers.</p> <p>There is also some room for improvement. The concept of risk appetite and its usage is a work in progress. It is not clear in the regulation who, between the board and senior management defines the risk appetite. Also, Ordinance 3624-U does not explicitly require banks to build a sound RM culture. Banks are at different stages of looking at these issues. Some of them have already begun,</p>

	<p>in particular D-SIBs,<sup>86</sup> but small and mid-size banks are still behind. Also, the mission did not get a clear view about whether the CBR pays special attention to the resources dedicated to RM and internal control during onsite visits.</p> <p><b>Recommendations:</b></p> <ul style="list-style-type: none"> <li>• Consider the proportion of resource dedicated to RM—and internal control—in onsite programs.</li> <li>• Perform a horizontal review across the system to ascertain the implementation of the new RM system, with a particular emphasis on the role of the board in developing and overseeing management of the bank’s entire risk profile.</li> </ul>
<b>Principle 16</b>	<b>Capital adequacy.</b> <sup>87</sup> The supervisor sets prudent and appropriate capital adequacy requirements for banks that reflect the risks undertaken by, and presented by, a bank in the context of the markets and macroeconomic conditions in which it operates. The supervisor defines the components of capital, bearing in mind their ability to absorb losses. At least for internationally active banks, capital requirements are not less than the applicable Basel standards.
<b>Essential criteria</b>	
<b>EC 1</b>	Laws, regulations or the supervisor require banks to calculate and consistently observe prescribed capital requirements, including thresholds by reference to which a bank might be subject to supervisory action. Laws, regulations or the supervisor define the qualifying components of capital, ensuring that emphasis is given to those elements of capital permanently available to absorb losses on a going concern basis.
Description and findings re EC1	<p>Since the last FSAP Update of 2011, the Russian framework for capital adequacy has been periodically updated to include Basel 2.5 and Basel III standards and was further amended by a series of reforms introduced in December 2015 (see below), most of which became effective in January 2016. All Russian banks are subject to Basel capital regulation on both standalone and consolidated levels. Capital adequacy standards applied on a consolidated basis are broadly consistent with those established on a solo level.</p> <p>The main domestic legal and regulatory provisions governing capital and RM and other rules on the methods of capital calculation can be found in the CBL. Pursuant to Article 62, the CBR is authorized to establish capital adequacy ratios for credit institutions and banking groups. Article 67 defines that a bank’s capital adequacy ratio is determined as the ratio between its capital and the sum of its risk weighted assets. Similarly, Article 72 of the law authorizes the CBR to establish methods for calculating the capital of a credit institution and for determining the ratios for a credit institution's capital, assets and liabilities. Banks are required to calculate and maintain at all times minimum own funds which cover: credit risk, trading book risk and OR.</p>

<sup>86</sup> Sberbank, for example, has described in detail the risk appetite of the group in a document with the title “Disclosure of Information on Accepted Risks, Procedures of Their Assessment, Risk and Capital Management of Sberbank Banking Group for the First Half of 2015 (from January 1 to June 30, 2015).”

<sup>87</sup> The CPs do not require a jurisdiction to comply with the capital adequacy regimes of Basel I, Basel II, and/or Basel III. The Committee does not consider implementation of the Basel-based framework a prerequisite for compliance with the CPs, and compliance with one of the regimes is only required of those jurisdictions that have declared that they have voluntarily implemented it.

The capital adequacy ratios of credit institutions are calculated using the methodology established by CBR Instruction 139-I of December 3, 2012 on statutory ratios for banks, amended by CBR Ordinance 3855-U of November 30, 2015.

As described in Section 2.2 of Instruction 139-I, the following capital adequacy ratios are set as follows:

- before 2016, the common equity Tier 1 capital adequacy ratio was set at 5 percent; however, with the adoption of Basel III, CET1 has been set at 4.5 percent from January 1, 2016 under Ordinance 3855-U of November 11, 2015;
- the Tier 1 capital adequacy ratio is set at 6 percent;
- as a result of Basel III implementation, the total capital adequacy ratio initially set at 10 percent has been lowered to 8 percent since January 1, 2016.

Banks' capital (or own funds) is defined by CBR Regulation 395-P<sup>88</sup> as the sum of Tier I and Tier II capital. Tier 1 includes common equity Tier I capital instruments and additional Tier I capital. CET1 comprises common shares and preference shares of certain types (see below). Tier II capital is defined in Article 3.1 of Regulation 395-P as the sum of a set of nine elements, which include, *inter alia*, certain types of preference shares, share premium of a credit institution in the legal form of a joint-stock company, the current year's profit not yet confirmed by an external auditing, and subordinated debts.

The items to be deducted before minimum capital adequacy is determined include in particular (i) goodwill and other intangibles; (ii) losses of the current year and previous years; (iii) investments in own capital instruments (deducted in full without netting of short positions with the same underlying exposures); (iv) investments in the capital instruments of financial entities (including reciprocal cross holdings of the capital of credit and other financial institutions which are deducted in full); and (v) deferred tax assets.

The capital adequacy ratio of credit institutions is calculated using the instruction established by CBR Instruction 139-I already mentioned, on the basis of which asset risk weightings are divided into five groups depending on risk significance, using the following coefficients:

- Group 1: 0 percent (e.g., claims on the CBR including deposit accounts on CBR books, investments in CBR bonds, cash and gold in banks depositories);
- Group 2: 20 percent (e.g., claims against the constituents of the Russian Federation, claims secured by guarantees received (issued) from (by) credit institutions that are resident of high income countries (members of the OECD or the Eurozone);
- Group 3: 50 percent (e.g., debt securities issued by local authorities of the Russian Federation, claims on banks incorporated in certain OECD countries);
- Group 4: 100 percent; and
- Group 5: 150 percent (credit claims as well as overdue claims against central banks or governments of countries with a country risk assessment of "7").

The requirements described above apply to all banks.

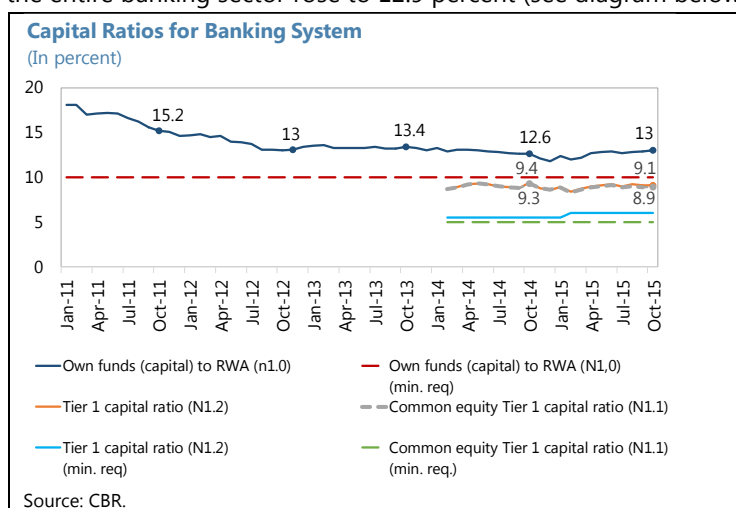
<sup>88</sup> On the methodology of determining the amount of own funds (capital) of the credit institutions ("Basel III").

On certain aspects of capital calculation, the Russian Federation has set a more conservative approach than Basel under Regulation 395-P. For example, it has a broader definition of the elements to be deducted from equity as indirect stakes in financial institutions. Also, investments in the credit institution's own capital instruments are deducted in full, without netting of short positions with the same underlying exposures. Also, general provisions are not recognized as Tier 2 capital, as such provisions are prohibited by CBR regulations.

While Basel III excludes preference shares from CET1, the CBR allows banks to include certain types of such shares in their CET1. This is the case for preference shares issued according to Federal law 173-FZ "On additional measures to support financial system of Russian Federation" or paid by the State Corporation Deposit Insurance Agency in the form of OFZ (ruble denominated government bond) according to Federal law 451-FZ.<sup>89</sup> These preferred shares are non-cumulative, do not carry voting rights and thus possess a high loss absorption characteristic. These instruments are meant to mitigate the impact of existing sanctions against the Russian Federation by permitting banks to be better capitalized.

There are a few deviations from the Basel capital calculation that are in fact being eliminated according to the CBR, starting on January 1, 2016. For example, the definition of significant investments in the capital of financial institutions does not take into account the criterion of their affiliation with a bank. For claims on sovereigns and central banks, a risk weight applied to claims on central banks or governments of Commonwealth of Independent States (CIS) countries with a country risk score "7" is 100 percent instead of 150 percent RW. For claims on corporates, claims on open joint stock companies that meet the criteria of natural monopolies are 50 percent risk-weighted instead of 100 percent.

According to the 2014 CBR annual report, the capital adequacy ratio decreased in the banking sector as a whole from 13.5 percent to 12.5 percent. The decline was conditioned by the outpacing growth of risk-weighted assets (RWA). In 2015, according to the discussion with the CBR, the average CAR for the entire banking sector rose to 12.9 percent (see diagram below).



<sup>89</sup> "On amendments to Article 11 of the Federal law "On Insuring Individuals' Deposits in Russian Federation Banks" and Article 46 of the Federal Law "On the CBR."

<b>EC2</b>	At least for internationally active banks, <sup>90</sup> the definition of capital, the risk coverage, the method of calculation and thresholds for the prescribed requirements are not lower than those established in the applicable Basel standards.
Description and findings re EC2	<p>The CBR prudential framework applies to all credit institutions, including commercial banking institutions and state-owned institutions, and it does not distinguish between internationally active banks and non-internationally active banks. Definitions of capital, risk coverage, method of calculation, and thresholds for the prescribed requirements are all defined in CBR Regulations 139-I and 395-P, and banks are subject to the same definition of own funds, the same method of calculation, and the same required ratio.</p> <p>Also, the CBR requirements apply to all banks, regardless of size, both at individual and consolidated level. It is worthwhile noting, but this is not a deviation from Basel, that the CBR has no authority to regulate and supervise the activities of a parent company which does not have the status of a bank. It can, however, ask for consolidated financial statements and impose restrictions on the relationship between the parent and the bank, for example in terms of transactions and dividends.</p>
<b>EC3</b>	The supervisor has the power to impose a specific capital charge and/or limits on all material risk exposures, if warranted, including in respect of risks that the supervisor considers not to have been adequately transferred or mitigated through transactions (e.g., securitization transactions) <sup>91</sup> entered into by the bank. Both on-balance sheet and off-balance sheet risks are included in the calculation of prescribed capital requirements.
Description and findings re EC3	<p>The CBL grants the CBR several powers to impose limits on all material risk exposures. This includes, inter alia, the restriction or suspension of certain bank operations, including lending activities. However, until 2015, the CBR lacked the legal authority to implement the Pillar 2 components, and in particular the capacity to impose specific capital charge. This weakness has been addressed with the adoption of CBR Ordinance 3624-U of April 15, 2015 "On the Requirements to the Risk and Capital Management System of the Credit Institution and the Banking Group" that sets forth the requirements to ICAAP as well as the framework for the supervisory review and evaluation process.</p> <p>Under this new regime, the CBR has the power to increase the prudential requirements, including higher CAR for individual banks and banking groups based on their risk profile and systemic importance if the SREP detects flaws in the bank's capital and RM. The Pillar 2 established in 2015 appears to be consistent with the Basel framework. However, as discussed below in the comments section, Pillar 2 is quite new in Russia. Banks are in the process of preparing their first ICAAP for a quality review by the CBR in 2017 upon the reporting data for 2016, and the CBR is still in the process of designing its SREP. As a result, the actual use by the CBR of its powers in this particular area remains to be assessed.</p>

<sup>90</sup> The Basel Capital Accord was designed to apply to internationally active banks, which must calculate and apply capital adequacy ratios on a consolidated basis, including subsidiaries undertaking banking and financial business. Jurisdictions adopting the Basel II and Basel III capital adequacy frameworks would apply such ratios on a fully consolidated basis to all internationally active banks and their holding companies; in addition, supervisors must test that banks are adequately capitalized on a stand-alone basis.

<sup>91</sup> Reference documents: "Enhancements to the Basel II Framework," July 2009 and: "International Convergence of Capital Measurement and Capital Standards: A Revised Framework - Comprehensive Version," June 2006.



	Both on-balance sheet and off-balance sheet risks are included in the calculation of capital requirements.
<b>EC4</b>	The prescribed capital requirements reflect the risk profile and systemic importance of banks <sup>92</sup> in the context of the markets and macroeconomic conditions in which they operate and constrain the build-up of leverage in banks and the banking sector. Laws and regulations in a particular jurisdiction may set higher overall capital adequacy standards than the applicable Basel requirements.
Description and findings re EC4	<p>Until recently, Russia had set a higher overall adequacy ratio, subjecting banks to a minimum CAR of 10 percent. This ratio has been lowered to 8 percent since January 1, 2016. With the adoption of the Basel III agreement, the Russian capital regime has been fostered and entails a capital conservation buffer and a countercyclical capital buffer as well as additional loss absorbency requirements for systemically important banks.</p> <p>Capital buffer requirements came into effect on January 1, 2016 in accordance with Ordinance 3855-U of November 30, 2015 (Chapter 21 of Instruction 139-I). The requirement for a capital conservation buffer has been phased-in gradually starting from January 1, 2016 at 0.625 percent and reaching 2.5 percent on January 1, 2019 in line with Basel III timetable implementation. The value of the countercyclical buffer has been set by the CBR at zero percent at the start of 2016.</p> <p>The buffer for systemically important banks has to be calculated in accord with CBR Ordinance 3737-U of July 22, 2015 "On the Methods for Defining Systemically Important Credit Institutions" and will be imposed gradually as follows: 0.15 percent in 2016; 0.35 percent in 2017; 0.65 percent in 2018; and 1 percent in 2019 (see diagram below).</p> <div data-bbox="444 1079 1414 1675" style="text-align: center;"> <p>The diagram illustrates the composition of capital requirements for two scenarios: Russia (2014) and Basel III (Fully Load). On the left, the 'Russia (2014)' stack consists of CET1 (5%), Additional Tier 1 (0.5%), and Tier 2 (4.5%), totaling 10%. On the right, the 'Basel III (Fully Load)' stack includes CET1 (4.5%), Additional Tier 1 (1.5%), Tier 2 (2%), a Capital conservation buffer (2.5%), and a Countercyclical buffer (0-2.5%), totaling 13%. Arrows indicate the total requirement for each side: 10% for Russia and 13% for Basel III.</p> </div>

<sup>92</sup> In assessing the adequacy of a bank’s capital levels in light of its risk profile, the supervisor critically focuses on, among other things (a) the potential loss absorbency of the instruments included in the bank’s capital base; (b) the appropriateness of risk weights as a proxy for the risk profile of its exposures; (c) the adequacy of provisions and reserves to cover loss expected on its exposures; and (d) the quality of its RM and controls. Consequently, capital requirements may vary from bank to bank to ensure that each bank is operating with the appropriate level of capital to support the risks it is running and the risks it poses.

<b>EC5</b>	<p>The use of banks' internal assessments of risk as inputs to the calculation of regulatory capital is approved by the supervisor. If the supervisor approves such use:</p> <ul style="list-style-type: none"> <li>(a) such assessments adhere to rigorous qualifying standards;</li> <li>(b) any cessation of such use, or any material modification of the bank's processes and models for producing such internal assessments, are subject to the approval of the supervisor;</li> <li>(c) the supervisor has the capacity to evaluate a bank's internal assessment process in order to determine that the relevant qualifying standards are met and that the bank's internal assessments can be relied upon as a reasonable reflection of the risks undertaken;</li> <li>(d) the supervisor has the power to impose conditions on its approvals if the supervisor considers it prudent to do so; and</li> <li>(e) if a bank does not continue to meet the qualifying standards or the conditions imposed by the supervisor on an ongoing basis, the supervisor has the power to revoke its approval.</li> </ul>
Description and findings re EC5	<p>a) So as to ensure the further development of credit risk assessment based on internal ratings as foreseen by Basel II, the CBR permits the use of the two potential IRB Approaches: foundation or advanced. Advanced approaches to market and ORs are currently not applicable in Russia. The market risks and OR capital calculations are through the standardized approach and the basic indicators approach, respectively.</p> <p>The requirements for the bank's internal validation processes to be used for capital calculation are set forth in Chapter 14 of Regulation 483-P<sup>93</sup> of August 6, 2015. On the other hand, the approval process by the CBR is contained in CBR Ordinance 3752-U,<sup>94</sup> also issued on August 6, 2015. As of today, no banks have been yet granted permission to use the IRB approach to credit risk calculation. In that regard, two banks have already submitted formal applications to the CBR and 4 have expressed their willingness to use the IRB methodology.</p> <p>Requirements for obtaining permission to use the IRB are identical to those set by the Basel Committee in terms of quality of RM, quality of data, and high level of CG. In effect, CBR Regulation 483-P sets the conditions that banks willing to use IRB approach should meet in terms of credit RM systems and credit risk modeling. To be qualified to use the IRB approach for any classes of exposure (corporate, sovereign, financial institutions, and retail), the bank's asset size should be more than RUB 500 billion (approximately US\$6.5 billion as of February 2016) and the bank must demonstrate that it has the internal capacity to use the IRB method. As stipulated in Article 1.6 of Regulation 483-P, the bank must have a credit risk management system in place and other key elements such as an internal rating system, a methodology for developing and operating a rating system, and a control mechanism to verify the quality of data used in the models. Further, a department in charge of performing validation of the model should be institutionally independent of the other divisions. The quality of the RM system, and the completeness and efficiency of the internal validation of ratings must be subject to internal audit review at least once a year. A bank must also produce an implementation plan, specifying to what extent and when it intends to roll out IRB approaches across its asset classes and business units over time.</p>

<sup>93</sup> "On the Procedure for Calculating Credit Risk Based on Internal Ratings."

<sup>94</sup> "On the Procedure for Obtaining Permits for the Use of Bank Credit Risk Management Methods and Credit Risk Quantification Models to Calculate the Capital Adequacy Ratios of the Bank and on the Procedure for Assessing Their Quality."

CBR Regulation 483-P also contains provisions for CG and internal control stipulating that the BoD of the bank shall approve the procedures for managing credit risk and the quantification of credit risk parameters, including methodologies for assigning ratings. These processes include in particular the submission to the board, at least once a year for review, of the internal reports on the internal rating system.

To calculate capital requirements on the basis of the IRB approach, a bank must meet other conditions, such as segmentation of banking book assets into several categories defined by regulation, be in compliance with the regulatory definition of default, have a minimum data history to estimate probability of default, loss given default and exposure at default (Regulation 483-P), and the models should have good predictive power. It is noteworthy that the CBR has the power to set additional conditions on a given bank, on a case by case basis, before approving the model.

b) Any material modification of the bank's IRB should be notified to the CBR. In effect, banks that have received permission to use the IRB approach for the purpose of calculating capital ratios are obliged to report back to the CBR in writing of any changes made to the rating systems at least once every six months (Article 1.18 of Regulation 483-P). Moreover, the introduction of any material changes to the rating system in relation to which the IRB permission was granted requires an additional permission of the CBR (Article 1.17). Regulation 483-P defines the criteria of materiality of changes in the risk quantification models (e.g., any change in the methods of estimating the probability of default, change in the procedure for mapping internal ratings, and amendments to the methods for assigning grades to borrowers).

c) The CBR has developed a framework to evaluate a bank's internal assessment process in order to determine that the relevant qualifying standards are met. This comprehensive assessment is based on the documents and information provided by the bank in accordance with CBR Ordinance 3752 of June 8, 2015.<sup>95</sup> Some preliminary tests have already been performed with three major banks. In order to assess and validate a bank's internal credit risk models and grant the permission to use them, the CBR has set up a dedicated supervisory group within its supervisory department comprising fifteen staff from both the SIFI and regulatory departments. Several specialists with economic and quantitative backgrounds are specifically assigned to evaluate the models' methodology, performing quantitative tests and writing assessment reports. Furthermore, three managers with mathematical and economical background are responsible for approving the assessment made by staff. The CBR is also in the process of hiring external experts with modeling skills to reinforce its current manpower for IRB validation.

d and e) The CBR has the power to impose conditions on its approvals if deemed necessary. If a bank does not continue to meet the qualifying standards or the conditions imposed by the CBR, the CBR has the power to revoke its approval based on Regulation 3883-U.

<sup>95</sup> "On the Procedure for Obtaining Permits for the Use of Bank Credit Risk Management Methods and Credit Risk Quantification Models to Calculate the Capital Adequacy Ratios of the Bank and on the Procedure for Assessing Their Quality"

<b>EC6</b>	<p>The supervisor has the power to require banks to adopt a forward-looking approach to capital management (including the conduct of appropriate stress testing).<sup>96</sup> The supervisor has the power to require banks:</p> <ul style="list-style-type: none"> <li>(a) to set capital levels and manage available capital in anticipation of possible events or changes in market conditions that could have an adverse effect; and</li> <li>(b) to have in place feasible contingency arrangements to maintain or strengthen capital positions in times of stress, as appropriate in the light of the risk profile and systemic importance of the bank.</li> </ul>
Description and findings re EC6	<p>Pursuant to Articles 12.22 and 12.23 of Regulation 483-P, stress testing methodologies ensure identification of possible events or future changes in economic conditions that could have adverse effects on exposures of the bank and models for the quantification of credit risk parameters. The bank performs stress testing based on its own scenarios and on the basis of the scenarios proposed by the CBR (regulatory stress testing) (see Article 12.23 of Regulation 483 P).</p> <p>Banks' in-house stress testing shall be conducted at least once a year, as well as upon each material change in the conditions of external factors. Stress testing shall cover all classes of exposure. Based on the results of these stress tests, adjustments to a bank's capital adequacy should be made to reflect the possible impact of adverse scenarios. The results of stress testing shall be reflected in the internal documents of the bank and be submitted for approval by the executives and the BoD (supervisory board) of the bank (see Article 12.25 of Regulation 483 P).</p> <p>When selecting the stress testing scenario, the credit institution (the parent credit institution of the banking group) shall consider the following:</p> <ul style="list-style-type: none"> <li>• the stress testing shall cover all the risks and areas of activity material for the credit institution (banking group);</li> <li>• the stress testing scenarios shall account for events that may cause maximum damage to the credit institution (banking group, members of the banking group) or entail the loss of good will.</li> </ul> <p>Also, in accordance with Ordinance 3624-U, credit institutions must establish RM system aimed at, inter alia, (i) capital planning based on the results of a comprehensive assessment of material risks and (ii) testing the resistance of the credit institution with regard to internal and external risk factors, in light of the development strategy designed by the bank.</p> <p>Ordinance 3624-U also stipulates that a credit institution should determine the targeted capital level, planned capital structure and its sources, the level of capital adequacy in accordance with the risk appetite as defined by the board, and the need to raise additional capital for implementing the development strategy according to stress test results (Chapter 4 of Ordinance 3624-U).</p> <p>Banks are also required to have in place contingency arrangements to maintain or strengthen capital positions in times of stress. With the adoption of Regulation 3624-U, major credit institutions are required to adopt contingency plans for restoring their financial stability in the event of a general economic deterioration. These new provisions oblige banks to create, renew, or expand</p>

<sup>96</sup> "Stress testing" comprises a range of activities from simple sensitivity analysis to more complex scenario analyses and reverses stress testing.

	plans to ensure that their financial well-being would be re-established swiftly, guaranteeing that they would operate properly even under severe conditions. According to the CBR, this important reform is intended to ensure the financial soundness of credit institutions, including SIFIs, and to strengthen the stability of the banking system as a whole.
<b>Assessment of Principle 16</b>	<b>Largely Compliant</b>
<b>Comments</b>	<p>During the last FSAP Update in 2011, it was observed that capital adequacy rules generally meet Basel II, Pillar 1 guidelines but that the CBR lacked a legal authority to implement the Pillar 2 component. The standardized, simplified approach was being implemented at that time but the CBR did not have the regulatory authority to implement the supervisory review process prescribed by Pillar 2.</p> <p>Over the past few years, Russia has made significant progress in bringing its capital adequacy regime in line with international standards. In effect, the Russian capital framework has benefited from a number of critical reforms in the area of credit risk<sup>97</sup>, market risk<sup>98</sup> and OR.<sup>99</sup> The most critical ones are the adoption of CBR Ordinance 3883-U of December 7, 2015<sup>100</sup> on the ICAAP/SREP regime for banks that provides the CBR with additional Pillar II instruments, including enforcement powers and Ordinance 3624-U of April 2015—and subsequent amendments—that set the requirements for risk and capital management systems for banks and banking groups. Some non-material deviations from the Basel capital adequacy framework have also been or are being addressed. Additional reforms relevant to this Core Principle have also been introduced in the area of compensation, CG, and disclosure (Pillar 3).<sup>101</sup></p> <p>Moreover, in 2015/2016 the Russian Federation underwent an assessment by the BCBS of its domestic adoption of the Basel risk-based capital standards (Basel II, 2.5, and III). According to the information provided to the BCP assessors by the CBR, the preliminary findings of the RCAP process did not raise any serious deviation with the Basel capital adequacy framework.</p> <p>While praising the Russian authorities for their important achievements in fostering the national capital adequacy regime, the mission also recognizes the remaining challenges that the CBR and the banking sector alike will face in the years to come. Moreover, given the fact that many critical reforms have been passed only recently as described above, the BCP assessors have not been able</p>

<sup>97</sup> E.g., CBR Instruction 139-I of December 3, 2012 “On Statutory Ratios for Banks” on the simplified standardized approach; CBR Regulation 483-P of August 6, 2015 “On Calculation of Credit Risk Based on Internal Ratings-Based Approach” (IRB Regulation).

<sup>98</sup> E.g., CBR Regulation 511-P of December 3, 2015 “On the Procedure for Credit Institutions to Calculate Market Risk,” on calculating the market risk capital charge.

<sup>99</sup> CBR Letter 69-T of May 16, 2012 “On the Recommendations of the Basel Committee on Banking Supervision Principles for the Sound Management of Operational Risk.”

<sup>100</sup> “On the Assessment of Quality of Risk and Capital Management Framework and Capital Adequacy of Credit Institutions and Banking Groups Performed by the CBR.”

<sup>101</sup> E.g.: CBR Ordinance 3081-U of October 25, 2013 “On Information Disclosure by Credit Institutions about Their Activities;” CBR Ordinance 3876-U of December 3, 2015 “On Forms, Procedure, and Terms of Information Disclosure by Parent Credit Institutions on Accepted Risk, Risk Evaluation Procedures, and Risk and Capital Management Procedures.”

	<p>to evaluate the effectiveness of the new tools at the disposal of the CBR. There are other areas that deserve careful attention.</p> <p><i>1-The effectiveness of the new ICAAP/SREP regime remains to be assessed</i></p> <p>Pillar 2 has not been yet fully and thoroughly implemented. The ICAAP process is under way, and the CBR is still in the process of completing the first SREP cycle, which will take some time before being fully operational. According to the timetable set by the CBR, SIFIs will have to submit their ICAAP by the end of 2016, and the CBR will start reviewing their quality in 2017.</p> <p>The CBR now has the power to require banks to adopt a forward-looking approach to capital management. In particular, CBR is legally equipped with the power to impose higher CAR using its supervisory judgment, especially if the capital base of a given bank is not aligned with its risk profile. However, these Pillar II powers have not been yet utilized and their effectiveness is to be tested.</p> <p><i>2-Banks need to get acquainted with the new prudential regime</i></p> <p>The ICAAP process is a new framework that Russian banks need to become familiar with. This will require a great deal of preparation and adaptation, and banks will need to address a number of problems in terms of (i) reaching an in-depth understanding of approaches to RM and calculation of capital adequacy under the new regime, (ii) improving the quality of risk assessment models, (iii) refining the quality of data and IT infrastructure, (iv) recruiting highly qualified staff, including in the area of modeling, (v) providing adequate training to staff, and (vi) reviewing and adjusting internal policies.</p> <p>In the same vein, while the IRB framework appears consistent with the Basel requirements, no Russian bank has to date received permission to use this approach. There is therefore a lack of perspective on the way the new regime is being implemented by banks, and on how the CBR exercises its due diligence in the ambit of internal model approaches.</p> <p>In conclusion, the impact of the prudential framework will depend to the greatest extent on the way banks will meet their new obligations and how the CBR will monitor and supervise them. These are critical challenges that remain to be evaluated going forward.</p>
<b>Principle 17</b>	<b>Credit risk.</b> <sup>102</sup> The supervisor determines that banks have an adequate credit RM process that takes into account their risk appetite, risk profile and market and macroeconomic conditions. This includes prudent policies and processes to identify, measure, evaluate, monitor, report and control or mitigate credit risk <sup>103</sup> (including counterparty credit risk) <sup>104</sup> on a timely basis. The full credit

<sup>102</sup> Principle 17 covers the evaluation of assets in greater detail; Principle 18 covers the management of problem assets.

<sup>103</sup> Credit risk may result from the following: on-balance sheet and off-balance sheet exposures, including loans and advances, investments, inter-bank lending, derivative transactions, securities financing transactions, and trading activities.

<sup>104</sup> Counterparty credit risk includes credit risk exposures arising from OTC derivative and other financial instruments.

	lifecycle is covered including credit underwriting, credit evaluation, and the ongoing management of the bank's loan and investment portfolios.
<b>Essential criteria</b>	
<b>EC1</b>	Laws, regulations or the supervisor require banks to have appropriate credit RM processes that provide a comprehensive bank-wide view of credit risk exposures. The supervisor determines that the processes are consistent with the risk appetite, risk profile, systemic importance and capital strength of the bank, take into account market and macroeconomic conditions and result in prudent standards of credit underwriting, evaluation, administration and monitoring.
Description and findings re EC1	<p>The CBR expresses its expectations in respect of credit RM processes through a number of ordinances, instructions, and regulations, chief among which, for the purposes of setting the expectations for the nature of credit RM processes, is Ordinance 3624 -U, notably Chapters 1 and 2, as well as Chapters 1 and 2 of the Annex. Also relevant is Regulation 254-P, which, while directed at provisioning, also addresses credit risk assessment. Particular requirements in relation to RM systems, CG, and internal models for banks with internal rating approvals are set out in Regulation 483-P, and Instruction 139-I addresses, inter alia, the procedure for the CBR to supervise compliance with risk standards. In addition, the CBR uses the methodology set out in Ordinance 2005-U—as discussed in CP8—to assess credit risk in banks.</p> <p>The CBR determines whether the credit risk processes are appropriate or deficient through its onsite inspection processes, although there is also an offsite review process to assess documentation and to perform checks.</p>
<b>EC2</b>	The supervisor determines that a bank's board approves, and regularly reviews, the credit RM strategy and significant policies and processes for assuming, <sup>105</sup> identifying, measuring, evaluating, monitoring, reporting and controlling or mitigating credit risk (including counterparty credit risk and associated potential future exposure) and that these are consistent with the risk appetite set by the board. The supervisor also determines that senior management implements the credit risk strategy approved by the board and develops the aforementioned policies and processes.
Description and findings re EC2	<p>Ordinance 3624-U sets the requirement that the bank's board should approve and review the credit risk strategy and processes (Section 2.3 of Chapter 2). Similarly, the ordinance sets the requirement that the executive management implements the RM strategy, consistent with the risk appetite set by the board (supervisory board). Ordinance 3624-U establishes standards for the nature and frequency of reports that should be made to the board (supervisory board). For banks with IRB approval—although no bank has yet received such an approval—Regulation 483-P sets the requirements for a bank's BoD to review at least once a year whether processes relating to CG, internal controls, and RM (including rating models) implemented by the bank successfully achieve the objectives specified by the board.</p> <p>At the time of the assessment, the CBR had received two formal applications for the use of the internal ratings based approach to capital and was developing an internal validation framework to set the rules and instructions for the CBR to validate internal credit risk models and processes. Please also see CP16.</p>
<b>EC3</b>	The supervisor requires, and regularly determines, that such policies and processes establish an appropriate and properly controlled credit risk environment, including:

<sup>105</sup> "Assuming" includes the assumption of all types of risk that give rise to credit risk, including credit risk or counterparty risk associated with various financial instruments.



	<ul style="list-style-type: none"> <li>(a) a well-documented and effectively implemented strategy and sound policies and processes for assuming credit risk, without undue reliance on external credit assessments;</li> <li>(b) well defined criteria and policies and processes for approving new exposures (including prudent underwriting standards) as well as for renewing and refinancing existing exposures, and identifying the appropriate approval authority for the size and complexity of the exposures;</li> <li>(c) effective credit administration policies and processes, including continued analysis of a borrower's ability and willingness to repay under the terms of the debt (including review of the performance of underlying assets in the case of securitization exposures); monitoring of documentation, legal covenants, contractual requirements, collateral and other forms of credit risk mitigation; and an appropriate asset grading or classification system;</li> <li>(d) effective information systems for accurate and timely identification, aggregation and reporting of credit risk exposures to the bank's board and senior management on an ongoing basis;</li> <li>(e) prudent and appropriate credit limit, consistent with the bank's risk appetite, risk profile and capital strength, which are understood by, and regularly communicated to, relevant staff;</li> <li>(f) exception tracking and reporting processes that ensure prompt action at the appropriate level of the bank's senior management or board where necessary; and</li> <li>(g) effective controls (including in respect of the quality, reliability and relevancy of data and in respect of validation procedures) around the use of models to identify and measure credit risk and set limits.</li> </ul>
Description and findings re EC3	<p>As discussed in CP15, Ordinance 3624-U sets out the requirements covering credit RM. The expectations around credit risk are in Chapter 2 (Credit Risk) of the Annex, and documentation requirements are set in Chapter 7 of the main ordinance. Strategy and processes must be documented and reviewed, at a minimum, on an annual basis. Some of the most relevant provisions in relation to this criterion are noted below:</p> <ul style="list-style-type: none"> <li>(a) Sound policies and processes: see Ordinance 3624-U, Annex Chapter 2, Sections 2.1 to 2.3.</li> <li>(b) Approving and renewing exposures: see Ordinance 3624-U, Annex Chapter 2, Section 2.1—although the ordinance is not explicit with respect to identifying the appropriate approval authority for the size and complexity of the exposures, inspectors who met with the assessors noted that this issue formed part of the onsite reviews as well as being considered—through documented policies—by the offsite teams.</li> <li>(c) Credit administration policies and processes are established through Regulation 254-P, notably in Chapter 3, which is prefaced by the requirement for the bank to conduct a regular credit risk assessment for each exposure.</li> <li>(d) Information systems: see Ordinance 3624-U, Chapter 4, Sections 4.12 and 4.14 and also Chapter 6, Section 6.2.</li> <li>(e) Credit limits: see Ordinance 3624-U, Chapter 4, Sections 4.12.</li> <li>(f) Exception tracking: see Ordinance 3624-U, Chapter 4, Section 4.14 and Chapter 6, Section 6.4.</li> <li>(g) Controls around models: Regulation 242-P regarding the organization of internal controls sets standards on the quality, timeliness, control and management of information within the bank and banking group. See Section 3.5.1 in particular. This section also requires that information shall be provided in a form that takes into account the needs of the specific recipient.</li> </ul>

	<p>The discussions with the CBR included the approaches taken by the offsite function and the inspectors to develop a reliable risk profile of an institution. The offsite function makes an assessment of the credit risk portfolio to check whether it complies with the banks' internal documents; checks the quality of assets and can lead to investigations into the valuation by banks of their assets. At a systemic level, the CBR conducts stress testing and has in the past conducted portfolio specific stress tests and imposed provisioning requirements when high growth rates in portfolios/sectors are identified. The inspectors' first task is to look at procedures: how they are carried out and whether they are in conformity with internal control documents. A range of checks are performed to drill down into the substance of loans. This will include examining borrowers' financial statements and payment structures, and portfolios are subjected to statistical analysis. The objective is to see how the bank is faring in terms of its business, the sectors in which it is active, and whether these sectors have economic viability. Indicators are checked against sectoral and regional averages. Extension of maturity on credit facilities attracts particular notice with both the offsite function and the inspectors seeking to substantiate that true credit checks and assessments have taken place, and that it is not a form of soft restructuring or evergreening.</p>
<b>EC4</b>	<p>The supervisor determines that banks have policies and processes to monitor the total indebtedness of entities to which they extend credit and any risk factors that may result in default including significant unhedged FX risk.</p>
Description and findings re EC4	<p>Ordinance 3624-U (Annex Chapter 2, Section 2.1) sets the requirements for procedures for managing risk arising due to the possibility of failure to perform the contractual obligations by the borrower or counterparty to the credit institution and shall include the methodology of risk assessment per counterparty, including the methodology of assessing the solvency/ financial situation of counterparties (borrowers), loan quality, and determination of the amount of equity (capital) requirements.</p> <p>CBR Instruction 139-I establishes methods of credit risk assessment (or rather statutory ratios for the calculation of maximum amounts of credit risk), but the bank has the latitude to use its own assessment methods (Ordinance 3624-U, Annex Chapter 2, Section 2.2).</p> <p>CBR regulations require that RM processes, practices, procedures, and policies at a bank shall be robust enough to determine and monitor the total indebtedness of entities to which the bank extends credit. As of December 2015, there are 21 state registered credit bureaus which have information that banks can consult to assist them in this process.</p> <p>As noted in CP22, the CBR treatment of FX risk sets a net open position cap at 10 percent for each individual currency and 20 percent in aggregate.</p> <p>At the time of the ruble devaluation in December 2014, inspections were carried out on an extraordinary basis to examine open positions, not only in terms of size but of the structure of the exposures. In the view of inspectors who were involved in this exercise, management skills in relation to FX risk have been driven up across the sector as a result of the market shock. Many if not most banks with FX portfolios restructured their exposures with clients in 2015.</p>
<b>EC5</b>	<p>The supervisor requires that banks make credit decisions free of conflicts of interest and on an arm's length basis.</p>
Description and findings re EC5	<p>Regulation 254-P requires a bank's terms of lending to be consistent with general terms of lending, including the general provisions which require the bank to exercise objectivity and</p>

	<p>impartiality in its credit granting. Requirements in relation to the classification of bad loans make explicit reference to the need for avoiding conflicts of interest for the bank (Section 8.6).</p> <p>While there is no explicit requirement for credit decisions to be free of conflicts of interest and on an arms-length basis, the regulation notes potential areas of sensitivity. The internal audit function (Section 3.6) is required to pay particular attention to any exposure to a party connected to the bank if the exposure exceeds one percent of the equity of the bank.</p> <p>Restrictions and limits also apply in respect of any lending to a party connected with the bank. Instruction 139-I establishes limits (the N9.1 and N10.1 ratios), and Letter 2-T in relation to risks associated with related party transactions recommends that intercompany/ intergroup loans be conducted on an arm's-length basis.</p>
<b>EC6</b>	The supervisor requires that the credit policy prescribes that major credit risk exposures exceeding a certain amount or percentage of the bank's capital are to be decided by the bank's board or senior management. The same applies to credit risk exposures that are especially risky or otherwise not in line with the mainstream of the bank's activities.
Description and findings re EC6	<p>As discussed above, banks have to set various policies re credit risk, including exceptions to policy provisions and reporting lines, in business rules subject to CBR approval, and Ordinance 3624-U (e.g., Section 4.2) describes the expectations for reports to the board (supervisory board). While it is not explicit that particular (e.g., risky or non-standard) exposures need to be reported to the board, discussions with inspectors indicated that board reporting and policies for which exposures require board approval are a focus of the onsite reviews. Checks are routinely performed on the information packages that are submitted to the boards.</p> <p>Thresholds of approval—namely loans that need board sign-off—attract the attention of the AR, and the AR must track all loans that are in violation of the bank's internal processes and procedures. In addition, representatives of the inspectorate with whom the assessors met observed that losses tended to be proportionally higher in relation to board approved loans than to other loan categories. This feature of lending appears to be a consistent risk across jurisdictions in the inspectors' experiences.</p>
<b>EC7</b>	The supervisor has full access to information in the credit and investment portfolios and to the bank officers involved in assuming, managing, controlling and reporting on credit risk.
Description and findings re EC7	<p>The CBL grants the CBR the right to obtain information from the supervised entities (Article 57). The right of access to information also supports the position of the AR who has the right to attend the Management and risk committees of an institution to which she or he has been appointed. The assessors saw reports that commented in detail on such portfolios and which had reflected interactions with the bank officers.</p> <p>Rights of access of inspectors to banks and to records is further articulated in the CBL Article 73, which confirms that the inspectors shall have the right to receive and examine accounting reports and other documents of credit institutions (or their branches) and, if necessary, make copies of the corresponding documents to attach them to inspection materials.</p> <p>An AR appointed under CBL Article 76 has the right to participate (without voting rights) in the bank's management bodies as well as in the committees responsible for credit and asset liability management. The AR shall receive from the bank information and documents relating to the</p>

	credit institution's lending operations and operations to provide guarantees, and manage assets and liabilities (claims and obligations).
<b>EC8</b>	The supervisor requires banks to include their credit risk exposures into their stress testing programs for RM purposes.
Description and findings re EC8	<p>Chapter 5 of Ordinance 3624-U imposes stress testing requirements on banks, and the CBR methodology for assessing compliance is set out in Ordinance 3883-U which considers, for example: stress testing scenarios, whether the credit institution (banking group) has stress testing procedures approved by its management bodies, including those determining types of stress testing objectives, frequency, methodology for choosing applicable scenarios, taking stressed environments into account. The CBR also expects the executive boards of the banks to take the results of the stress tests into account when deciding risk limits. It was noted in discussion with the members of the inspectorate that banks' ability to define meaningful scenarios has improved in the last few years, not least as a result of needing to adjust to more stressful economic conditions.</p> <p>Please also see EC13 of Principle 15.</p>
<b>Assessment of Principle 17</b>	<b>Compliant</b>
Comment	<p>The assessment of this principle does not take into consideration the CBR's regulations and practices in relation to the identification and management of problem assets, concentration risk, related party lending, or country/transfer risk. These dimensions of credit risk are discussed, assessed and graded in their respective principles and not commented on here.</p> <p>The CBR has a comprehensive approach to its supervision of credit risk that combines offsite scrutiny with onsite investigation. The CBR performs its own stress tests on the portfolios, monitors regional and sectoral trends, and performs considerable cross checking of information on major exposures.</p> <p>While RM standards around credit risk, as with the other risk areas, are still in the process of being fully implemented, the assessors consider that the work of the Chief Inspectorate, coupled with the analysis of the curators and the work carried out on stress testing, puts the supervision of credit risk in a more advanced and developed position than other risks which have been more reliant on Ordinance 3624-U to better articulate the supervisory expectations and requirements.</p> <p>The determination of the quality of banks' credit risk practices and control environment rests on the inspections and, for the banks for which this is relevant, the position of AR. Regulations addressing how an inspection is conducted and how an AR bring banks' attention to the need to meet sound credit standards are in place. Nonetheless, it is recommended that formal requirements be introduced to ensure that banks' credit policies must identify size and risk thresholds above which approval must be granted by the board or senior management.</p>

<b>Principle 18</b>	<b>Problem assets, provisions and reserves.</b> <sup>106</sup> The supervisor determines that banks have adequate policies and processes for the early identification and management of problem assets, and the maintenance of adequate provisions and reserves. <sup>107</sup>
<b>Essential criteria</b>	
<b>EC1</b>	Laws, regulations or the supervisor require banks to formulate policies and processes for identifying and managing problem assets. In addition, laws, regulations or the supervisor require regular review by banks of their problem assets (at an individual level or at a portfolio level for assets with homogenous characteristics) and asset classification, provisioning and write-offs.
Description and findings re EC1	<p>The requirements for assets valuation and loan loss provisioning and write-offs are contemplated in the Banking law, the CBR law and CBR norms. The CBR has set out detailed rules in Regulations 254-P and 283-P that require banks to formulate policies and processes for identifying and managing problem assets. The same regulations require banks to regularly review problem assets, at an individual level, or portfolio level for assets with homogenous characteristics, to assess whether the loan or the group of loans is subject to objective evidence of impairment.</p> <p>Regarding asset classification, banks are required by CBR regulation 254-P (Article 1.7) to classify their assets according to fixed categories: standard, “non-standard,” doubtful, non-performing and bad loans. The regulation also defines the financial conditions that need to be met. Loans are treated as NPLs if they are classified into the categories IV and V (the so called “problem” and “bad” loans categories) on individual basis and homogeneous loans to households (individuals) and SMEs that are 90+ calendar days past due.</p> <p>Banks are required to classify the loans in these categories by using a combination of classification criteria, the borrower’s financial position on the one hand, the debt service quality on the other, which includes days of arrears<sup>108</sup> (see matrix below).</p>

<sup>106</sup> Principle 17 covers the evaluation of assets in greater detail; Principle 18 covers the management of problem assets.

<sup>107</sup> Reserves for the purposes of this Principle are “below the line” non-distributable appropriations of profit required by a supervisor in addition to provisions (“above the line” charges to profit).

<sup>108</sup> A loan debt service may be considered good if principal debt and interest payments are made in a timely fashion and in full; loan debt service may not be considered good if, for example, the loan has been restructured or there is an occurrence (occurrences) of overdue principal debt and/or interest payments over the last 180 calendar days (for loans granted to legal entities—up to 30 calendar days inclusive, for loans granted to individuals—up to 60 calendar days inclusive). Debt service is considered as bad if payments of the principal debt and/or interest have been overdue over the last 180 calendar days. The conditions for classifying loans in category III are as follows:

- a) when payments (principal and/or interest) are more than 30 days past due for loans to legal entities and more than 60 days for loans to individuals, if the financial condition of the borrower is considered good;
- b) when payments (principal and/or interest) are from 5 to 30 days past due for loans to legal entities and from 30 to 60 days for loans to individuals, if the financial condition of the borrower is considered average;
- c) when payments (principal and/or interest) are less than 5 days past due for loans to legal entities and less than 30 days for loans to individuals, if the financial condition of the borrower is considered weak.

Debt Service/ Financial Position	Good	Average	Inadequate
	Good	Standard (quality category I)	Non-standard (quality category II)
Average	Non-standard (quality category II)	Doubtful (quality category III)	Problem (quality category IV)
Bad	Doubtful (quality category III)	Problem (quality category IV)	Bad (quality category V)

Source: CBR regulation 254-P.

Regarding provisioning, banks are required to continuously evaluate the credit risk and establish reserves to cover losses, on the basis of its classification and estimates and internal methods of credit risk assessments. The table below indicates the level of provisions (in percentage) that corresponds to each asset quality category.

Quality Category	Name	Amount of Calculated Provisions as a Percentage of the Principal Debt
Quality category I (highest)	Standard	0 %
Quality Category II	Non(sub)-standard	1–20 %
Quality Category III	Doubtful	21–50 %
Quality Category IV	Problem	51–100 %
Quality category V (lowest)	Bad	100 %

Source: CBR regulation 254-P.

As indicated by the CBR regulations, asset classification is based on “professional judgment” (except for loans grouped in portfolio of similar loans) and at bank’s own discretion (254-P, Article 2.2). Professional judgment shall be made based on the results of impartial, comprehensive analysis of the borrower’s activity, taking into account a wide range of information, including data on the borrower’s external obligations and the functioning of the market(s) where the borrower is operating. To assist banks in making this determination, the current regulations contain provisions that assist banks in making their determination, including factors that may be material factors that can affect the Bank’s decision on classification of loans to a lower category.<sup>109</sup>

The classification of assets and determination of loan loss provisions are to be reported monthly to the CBR. In effect, in accordance with regulation 254-P (chapter 2), banks must disclose information on their credit policy (rules, procedures, methods) applied for classifying loans and creating

<sup>109</sup> E.g., the borrower’s failure to use the loan for the purpose stipulated in the contract under which the loan is issued; information about non-performance (improper performance) by the borrower of obligations related to loans (comparable by amount and term with the classified loan) provided by other credit institutions; deterioration of the economic situation in the country of the borrower’s residence and/or where the credit institution’s borrower performs its activities.

	provisions for the respective types of loans, including industry-specific, regional and other aspects, as well as for portfolios of similar loans.
<b>EC2</b>	The supervisor determines the adequacy of a bank's policies and processes for grading and classifying its assets and establishing appropriate and robust provisioning levels. The reviews supporting the supervisor's opinion may be conducted by external experts, with the supervisor reviewing the work of the external experts to determine the adequacy of the bank's policies and processes.
Description and findings re EC2	<p>The CBR evaluates the adequacy of the bank's internal framework during onsite examinations. An important part of this evaluation is to determine if the loan classification and provisioning is compliant with Regulation 254-P and 283-P (see EC1). For this purpose, a sample of files to be reviewed is selected by CBR inspectors. The CBR inspectors will pay particular attention to the quality of information about the borrower and collateral used by the credit institution for assessing the loan and determining provisions.</p> <p>CBR's inspection methodology for checking loans (Letter 102-T of July 25, 2006) serves to guide the onsite inspection of banks to determine the soundness of the loan classification review process and the adequacy of assigned loan loss provisions. In particular, the methodology in its Article 1.4 stipulates that, in order to achieve the goals set in the audits of loans, CBR staff are advised to obtain and analyze supervisory information, including, but not limited to, internal documents delineating the credit institution's policy vis-à-vis the classification of loans and provisions, including for portfolios with homogeneous characteristics.</p> <p>The same methodology stipulates in Article 3.4 that CBR staff have to pay special attention to the quality of information (see also Regulation 254-P) and methods used to determine borrowers' financial position and the approaches for estimating borrowers' capacity to service the debt. Along the same lines, CBR methodology contains guidance for assessing the so-called "substantiation of the classification of loans." Article 4.1 requires CBR staff to assess whether the classification is pertinent, well substantiated, and whether the bank has taken into account other essential factors capable of exerting an impact upon the classification of the loan.</p> <p>In that regard, failure to submit the required information to the CBR, or submission of insufficient information, is grounds for assigning the loans to a lower quality category than provided for by the governing body of the bank.</p> <p>Information used by the credit institution for the assessment of loan quality, including the assessment of the borrower's financial position, shall be available to CBR supervisors. Also, the CBR reviews auditors' reports on the banks.</p> <p>Russian law does not allow for the supervisor to engage external specialists in the inspection of credit institutions for the purpose of confirming the adequacy of asset classification and of provisioning procedures and methods.</p>
<b>EC3</b>	The supervisor determines that the bank's system for classification and provisioning takes into account off-balance sheet exposures. <sup>110</sup>

<sup>110</sup> It is recognized that there are two different types of off-balance sheet exposures: those that can be unilaterally cancelled by the bank (based on contractual arrangements and which therefore may not be subject to provisioning), and those that cannot be unilaterally cancelled.



Description and findings re EC3	In accordance with the requirements of Regulation 283-P, Chapter 3, banks are to establish loan loss provisions for contingent liabilities, which are to be classified according to their credit equivalence. Discussions with the authorities indicate that loan portfolio assessment (which, in general, is a standard part of the CBR supervisory program) includes checking the off-balance sheet exposures.
<b>EC4</b>	The supervisor determines that banks have appropriate policies and processes to ensure that provisions and write-offs are timely and reflect realistic repayment and recovery expectations, taking into account market and macroeconomic conditions.
Description and findings re EC4	<p>Regulation 254-P (Article 1.2 and Chapter 8) requires banks to perform “timely classification” of loans and provisions and to have policies in place to remove bad loans from their balance sheet.</p> <p>The conditions under which timely provisions and write-offs are made are evaluated in the course of onsite visits. The CBR inspectors verify that banks’ internal procedures are in line with the domestic framework. In analyzing a selected sample of individual loans, inspectors assess whether banks have appropriate policies and procedures to ensure that loan-loss provisions and write-offs reflect realistic repayment expectations.</p> <p>According to the interviews with the CBR, inspectors look at a bank’s internal documentation setting out rules, policies, and procedures for management of lending, including conditions for granting, negotiating, and restructuring loans, as well as rules for the evaluation and provisioning of risk exposures, and collateral policy.</p> <p>According to the discussions with the CBR, attention is given not only to the adequacy of provisions at a certain point in time but also to their relevance over time. In accord with Regulation 254-P, the provisions for a loan have to be updated owing to a change in the credit risk level, a change in the principal debt amount, including a change due to a fluctuation in the official exchange rate of the loan currency against the ruble (a scenario that is currently happening; see discussion on forbearance below in comments section), and a change of the quality of collateral.</p> <p>Inspectors will pay attention to these aspects. As indicated by the authorities, a bank’s provisioning practices are under close scrutiny during an onsite visit, and when CBR examiners identify instances of improper asset classification, the CBR will send the credit institution a request to reclassify the loan and constitute provisioning accordingly.</p> <p>Inspectors also focus on write-offs in order to evaluate the reasonableness of management’s valuation of these positions. In practice, CBR examiners will assess the profile of the borrower and the situation preventing him from servicing the debt. Examiners also consult external databases to collect additional information (e.g., whether the borrower has been involved in any legal proceeding as a plaintiff or defendant, or whether a borrower’s debtors or creditors are involved in any court proceeding).</p> <p>In addition, the mission was told that CBR staff review the quality of internal control and whether it ensures that decisions made by the relevant units adhere to the bank’s policies. Particular attention will also be paid to write-offs and especially to the rationale and decision-making process leading to the writing-off of bad loans.</p>

	The amount of provisions is to be determined regularly, at the same time as the assessment of loan credit risks made by the credit institution.
<b>EC5</b>	The supervisor determines that banks have appropriate policies and processes, and organizational resources for the early identification of deteriorating assets, for ongoing oversight of problem assets, and for collecting on past due obligations. For portfolios of credit exposures with homogeneous characteristics, the exposures are classified when payments are contractually in arrears for a minimum number of days (e.g., 30, 60, 90 days). The supervisor tests banks' treatment of assets with a view to identifying any material circumvention of the classification and provisioning standards (e.g., rescheduling, refinancing or reclassification of loans).
Description and findings re EC5	<p>Requirements for the monitoring and management of credit risks are spelled out in Regulations 254-P and 242-P. Banks are required to have appropriate policies and processes to ensure the early identification of deteriorating assets, ongoing oversight of problem assets, and for collecting past due obligations. In the course of the supervision and inspection of credit institutions, the CBR evaluates the presence, quality, and level of fulfillment by a bank of its diligence relating to the classification of loans for the purpose of early detection of NPLs, their current monitoring, and prospects of past-due loan repayment.</p> <p>As discussed above, Regulation 254-P sets requirements for the quality of information used by credit institutions to evaluate borrowers' financial standing, which must be full, relevant, accurate, and consistent with the information submitted by the borrower. For these purposes, Clause 3.1 of Regulation 254-P contains a requirement for risk assessment and classification and evaluation of loans on an ongoing basis.</p> <p>Furthermore, a credit institution must document professional judgment on the credit risk level of a loan, information on the analysis based on which such professional judgment was given, the statement on the results of evaluation of the borrower's financial standing, and calculation of the provision to be included in the borrower's file at least once per quarter as of the reporting date for loans issued to legal entities (other than credit institutions) and individuals, and at least once per month as of the reporting date for loans issued to credit institutions. Similar requirements are contained in Clause 1.8 of Regulation 283-P for other assets and credit contingencies.</p>
<b>EC6</b>	The supervisor obtains information on a regular basis, and in relevant detail, or has full access to information concerning the classification of assets and provisioning. The supervisor requires banks to have adequate documentation to support their classification and provisioning levels.
Description and findings re EC6	<p>Banks are obliged to submit information on asset classification and provisioning as per Regulations 254-P and 283-P to the CBR regional branches that supervise their activity. The information is reported on a monthly basis. The reporting forms provide information on assets quality as well as on the instruments recorded in off-balance sheet.</p> <p>There are three types of monthly reports. Form #117 provides details on the largest loans, interest rate, collateral used, capital provision, and on classification. Moreover, the form contains information on restructured loans that allows the CBR to track down any misclassification when performing onsite visits. Form #118 provides information on concentration risks, relations with connected parties, and borrowers with the largest exposures. Form #115 provides a wider view on assets broken down according to the five categories discussed under EC1. It captures overdue debts and the time of arrear as well as provisions set aside.</p>

	<p>The CBR enjoys full access to the information. Pursuant to the regulations above, a credit institution shall disclose the policies (rules, procedures, and methods) used for the purpose of asset classification, including all relevant materials about the provisions made on a single borrower as well as for portfolios of similar claims. Supporting documentation is reviewed in the context of onsite inspections.</p>
<b>EC7</b>	<p>The supervisor assesses whether the classification of the assets and the provisioning is adequate for prudential purposes. If asset classifications are inaccurate or provisions are deemed to be inadequate for prudential purposes (e.g., if the supervisor considers existing or anticipated deterioration in asset quality to be of concern or if the provisions do not fully reflect losses expected to be incurred), the supervisor has the power to require the bank to adjust its classifications of individual assets, increase its levels of provisioning, reserves or capital and, if necessary, impose other remedial measures.</p>
Description and findings re EC7	<p>The CBR indicated that banks' treatment of assets is tested with a view to identifying any material circumvention of the classification and provisioning standards (e.g., rescheduling, refinancing, or reclassification of loans). To that end, the pre-inspection stage is an important moment of the examination process. Information will be collected in order to narrow down the list of borrowers the CBR wants to focus on. Also, the team will check the findings of previous inspections. Particular attention will be given to any change in the terms of the loan agreement and in the borrower's source of funds that service the debt. Examiners also assess any material change to the original contractual conditions of the loan (e.g., adjustment in the maturity date, change in the payment, or in the interest rate) and will enquire about their justification. Further analysis will be conducted to determine if the borrower pays tax or less tax than his peers; if his profile deviates from the average of his peers in the same category; whether he has any shady activity, and whether the conditions applied to his loan are comparable to the same loans granted to his peers. These diligences will allow CBR examiners to emit an opinion about possible reclassification and additional provision to be made.</p> <p>In effect, according to Regulation 254-P, when the CBR assesses that the classification is not correct, a change of the classification and provisioning is requested, and the motivation is substantiated and documented in the inspection report. The CBR is authorized to apply sanctions to banks, which may include an order requiring the bank to add additional loan loss provisions and/or place the asset in a different classification category, or to eliminate inconsistencies in the bank's internal policies (Regulation 254-P, Article 9.3).</p>
<b>EC8</b>	<p>The supervisor requires banks to have appropriate mechanisms in place for regularly assessing the value of risk mitigants, including guarantees, credit derivatives and collateral. The valuation of collateral reflects the net realizable value, taking into account prevailing market conditions.</p>
Description and findings re EC8	<p>Collateral values are reported in the calculation of loan loss provisions at fair (realizable) value, which is to be determined by a bank at least once per quarter, using either its own staff or an independent appraiser. Furthermore, CBR Regulation 254-P requires that collateral pledged be considered by banks in the calculation of its loan loss provisions.</p> <p>As already observed in the BCP 2008 and confirmed during the present assessment, for the purpose of calculating a loan loss provision, collateral is divided into two quality categories, based on its liquidity. The most liquid types of collateral, deemed to be in the first category, are recognized at their full value for the calculation of the reserve. Less liquid forms of collateral, deemed to be in the second category, are only eligible to be included at one-half the recorded value.</p>

	<p>As part of their credit files analysis, CBR examiners pay particular attention to the valuation of credit risk mitigants. They will review a set of documents, including collateral documentation (mortgage, encumbrance certificate, pledge contract, financial collateral arrangement, etc.) and an appraisal of the collateral.</p> <p>CBR Regulation 254-P, Article 6 defines the list of eligible collateral. In that respect, real estate is not the preferred form of collateral in Russia, mainly owing to the fact that the process for repossessing property is lengthy and costly. Most importantly, the valuation of property is not reliable (see below in the comments section).</p> <p>Lastly, the scope of coverage depends on the size of the bank to be inspected. On average, the inspection examines about 70 percent of the credit portfolio. As indicated by the CBR, most problem loans tend to be non-large claims; large loans are usually monitored offsite.</p>
<b>EC9</b>	<p>Laws, regulations or the supervisor establish criteria for assets to be:</p> <ul style="list-style-type: none"> <li>(a) identified as a problem asset (e.g., a loan is identified as a problem asset when there is reason to believe that all amounts due, including principal and interest, will not be collected in accordance with the contractual terms of the loan agreement); and</li> <li>(b) reclassified as performing (e.g., a loan is reclassified as performing when all arrears have been cleared and the loan has been brought fully current, repayments have been made in a timely manner over a continuous repayment period and continued collection, in accordance with the contractual terms, is expected).</li> </ul>
Description and findings re EC9	<p>Regulations 254-P and 283-P define the conditions under which a loan should be considered impaired. The criteria for identifying an asset as a problem asset can be found in Chapter 1 of Regulation 254-P.</p> <p>All loans and contingent liabilities are to be classified in one of five quality categories (from I to V), and for each category of asset a corresponding loan loss provision is determined within a defined range (see EC 1). The CBR views as impaired those loans placed in Category II or lower.</p> <p>Under the existing regulation, loan classification is based on different factors: financial strength of a borrower, quality of debt service, and on any risks of the borrowers, including data on the borrower's external obligations and the functioning of the market where the client is operating.</p> <p>The financial position of the borrower will be assessed as good, average, or bad based on certain criteria. The asset will be qualified as average if, for example, there are no direct threats to the current financial position, but there are negative developments (trends) in the borrower's operations which may cause financial problems in the foreseeable future if the borrower does not take measures for improvement. An asset will be assessed as "bad" if the borrower is deemed insolvent or there are negative developments which are likely to cause the borrower's insolvency or continuous inability to pay. There are other circumstances in the regulation by which the financial position of a borrower <i>may not be assessed as good</i>; for example, "considerable outstanding payment" (for legal entities).</p> <p>Following the same logic (Article 3.7.1), loans are assigned to one of the three categories, depending on the quality of debt service. Loan debt service is good if principal debt and interest</p>

	<p>payments are made in a timely fashion and in full. The same holds true when there is an event of overdue principal debt and/or interest payment during the last 180 calendar days with a delay in payment up to 5 calendar days (for loans granted to legal entities) and up to 30 calendar days (for loans granted to individuals). Loan debt service is considered as average when, for example, the loan has been restructured or the principal or interest are overdue up to 30 calendar days (for loans granted to legal entities) and up to 60 calendar days (for loans granted to individuals).</p> <p>Lastly, the debt service will be considered as bad if payments of the principal debt and/or interest have been overdue over the last 180 calendar days (for loans granted to legal entities—or more than 60 calendar days, for loans granted to individuals).</p>
<b>EC10</b>	The supervisor determines that the bank's board obtains timely and appropriate information on the condition of the bank's asset portfolio, including classification of assets, the level of provisions and reserves and major problem assets. The information includes, at a minimum, summary results of the latest asset review process, comparative trends in the overall quality of problem assets, and measurements of existing or anticipated deterioration in asset quality and losses expected to be incurred.
Description and findings re EC10	<p>CBR Regulation 254-P, Section 3.1.3 requires that information used by a bank to evaluate the quality of loans (including an assessment of the borrower's financial condition) be made available to the BoD. In accordance with Regulation 242-P, the CBR onsite supervisor determines that asset quality information is regularly reported to the bank's BoD.</p> <p>As indicated by the authorities in their self-assessment and during the interviews, banks' credit RM is assessed during onsite visits. Pursuant to CBR recommendation 26-T, examiners should consider the following:</p> <ul style="list-style-type: none"> <li>• the presentation of reports to the BoD on the implementation of credit policies at the bank;</li> <li>• the internal control function's proper classification of loans and similarly, justification for the level of provisioning;</li> <li>• the scope, quality, and frequency of credit risk reporting to the executive board and BoD.</li> </ul>
<b>EC11</b>	The supervisor requires that valuation, classification and provisioning, at least for significant exposures, are conducted on an individual item basis. For this purpose, supervisors require banks to set an appropriate threshold for the purpose of identifying significant exposures and to regularly review the level of the threshold.
Description and findings re EC11	As already observed in the 2008 BCP report, Regulation 254-P allows for the valuation, classification, and provisioning of loans both on an individual basis (for larger loans) and on a portfolio basis (for smaller loans). Banks may establish a loan loss provision on a portfolio of small, uniform loans (the CBR establishes a limit in Article 5 of 254-P of 0.5 percent of a bank's capital for each such loan).
<b>EC12</b>	The supervisor regularly assesses any trends and concentrations in risk and risk build-up across the banking sector in relation to banks' problem assets and takes into account any observed concentration in the risk mitigation strategies adopted by banks and the potential effect on the efficacy of the mitigant in reducing loss. The supervisor considers the adequacy of provisions and reserves at the bank and banking system level in the light of this assessment.

Description and findings re EC12	The CBR conducts ongoing offsite surveillance and analysis based on reporting from the banks. Trends and risk identification across the banking sector, as well as the macro-economic outlook, are taken into account. Attention has been paid to the build-up of risks and the emergence of excessive risk concentration in the market (e.g., bubbles). One example of this is the risks stemming from the excessive increase of banks' unsecured consumer loans portfolios volume in 2012–13. Individual measures were also applied to some banks specializing in unsecured consumer loans, including restriction of certain operations. Another matter of concern is the depreciation of the ruble and its spillover effects on the banking sector that led the authorities to take temporary forbearance measures in 2014–15.
<b>Assessment of Principle 18</b>	<b>Largely Compliant</b>
Comments	<p>Asset quality has deteriorated over the past months. NPLs have grown at a fast pace (especially in the household sector), and the depreciation of the ruble led the CBR to take forbearance measures through the issuance of three letters of temporary nature. These measures were introduced in December 2014 to help banks weather problems stemming from the decline in global oil prices, the Western sanctions over the Ukraine conflict, and the depreciation of the ruble. Some of these measures aimed to allow banks to restructure loans without making provisions or not to requalify borrowers in a lower category, under certain conditions (e.g., if the problem of servicing the debt arose from the deterioration of the macro-economic conditions). These regulatory concessions expired in December 2015, but in 2016 credit institutions were given the opportunity not to reclassify the borrower until the borrower has paid back the entire amount of the loan. In that context, it seems realistic to assume that a certain portion of rescheduled loans currently sits in a lower loan category. Only an Asset Quality Review would permit a clear assessment of the current NPL situation.</p> <p>Favorable exchange rates for banks to value their foreign-currency assets were also permitted. The CBR allowed banks to convert foreign-currency (mostly denominated in U.S. dollars) assets (about 25 percent of the total sector assets) into rubles from end-2014 using more favorable end-September exchange rates. This prevented a significant swelling of RWA in ruble terms, triggered by depreciation of the currency against the U.S. dollar in the fourth quarter of 2014 and early 2015.<sup>111</sup></p> <p>In total, the relaxations have helped banks save as much as 2 percentage points of their capital adequacy levels, according to the central bank.<sup>112</sup></p> <p>Poor practices have been detected and led to enforcement action. The CBR inspections reveal an important number of violations during assessments of assets quality, including lending to shell companies, overvaluation of collateral, misreporting, and unreliable financial statements. In reviewing a sample of interim inspection reports, the BCP team also noted overvaluation of collateral, distorted reporting, and deficient procedures for provisioning among the most salient poor practices detected by the CBR staff. These outcomes have led the CBR to revoke multiple licenses over the past couple of years (see CP 11 for details). The CBR has also been persistent in imposing requirements on banks to reclassify loans or to increase the reserve to cover possible loan losses, as shown in the table below.</p>

<sup>111</sup> [https://www.fitchratings.com/gws/en/fitchwire/fitchwirearticle/Most-Russian-Banks?pr\\_id=983950](https://www.fitchratings.com/gws/en/fitchwire/fitchwirearticle/Most-Russian-Banks?pr_id=983950)

<sup>112</sup> <http://in.reuters.com/article/us-imf-russia-banking-idINKBN0TC1ZY20151123>

			Number of banks against which actions were taken:	
			To reclassify the loan debt	To increase the reserves to cover possible loan losses
2011	Total		305	348
	ranked by assets as of 01.01.2011	1- 100	38	46
		101-500	131	142
		>500	136	160
2012	Total		284	306
	ranked by assets as of 01.01.2012	1-100	36	43
		101-500	134	146
		>500	114	117
2013	Total		344	378
	ranked by assets as of 01.01.2013	1- 100	39	41
		101-500	152	162
		>500	153	175
2014	Total		334	370
	ranked by assets as of 01.01.2014	1- 100	40	47
		101-500	162	175
		>500	132	148
2015	Total		376	409
	ranked by assets as of 01.01.2015	1- 100	53	53
		101-500	186	211
		>500	137	145

Source: CBR, 2016.

Collateral valuation is another challenge. According to the discussion with both the CBR and market participants, the valuation of certain collateral, and in particular real estate, is a difficult task in Russia. Appraisals are not reliable and external appraisers have not been trustworthy for many years.<sup>113</sup> Low professional standards may also lead in certain circumstances to some form of collusion between appraisers and bankers. This problem is not limited only to Moscow; expertise is needed across the country. Discussions with market participants showed that fair-value determination is a big issue for the industry, even more so in a volatile environment. As a result, there is a concern that the existing valuation of collateral in the industry does not reflect the net realizable value, taking into account prevailing market conditions.

The CBR is fully aware of the problem and has taken two important initiatives. First, the CBR has set up its own dedicated appraiser team and is in the process of hiring a certified assessor who will assist inspectors in performing swift valuation in the course of onsite visits. Second, the CBR is considering an amendment to the law that will oblige banks to provision loans secured by real estate on the basis of the valuation performed by the CBR.

This reform will also empower the CBR to legally challenge the evaluation of real estate made by external appraisers. Currently, if the CBR disagrees with the assessment, it can only request the bank to run another evaluation or to hire a different appraiser. With the new law, the CBR will be able to use its own appreciation.

The execution of collateral is also problematic. According to the discussion with the CBR and market participants, it is easy to obtain real estate as collateral but difficult and time-consuming for banks to seize collateral. Repossession of property is indeed a lengthy and costly process, particularly owing to the lack of efficiency in the judiciary system, according to market participants. It may take

<sup>113</sup> The CBR cited the appraisal of the Kremlin that was estimated in 1996 at only US\$2 billion.



	<p>two years after a court decision in order for a bank to be able to acquire the collateral. In the meantime, the collateral may deteriorate in value and banks may be asked to create reserves. Moreover, the law includes certain restrictions for banks to take possession of mortgages in case of default of the borrower. This is, for example, the case for households with under-age children.</p> <p><b>Recommendation:</b></p> <ul style="list-style-type: none"> <li>Accelerate the process of amending the law to provide the CBR with additional legal tools in the areas of provisioning and collateral valuation.</li> </ul>
<b>Principle 19</b>	Concentration risk and large exposure limits. The supervisor determines that banks have adequate policies and processes to identify, measure, evaluate, monitor, report and control or mitigate concentrations of risk on a timely basis. Supervisors set prudential limits to restrict bank exposures to single counterparties or groups of connected counterparties. <sup>114</sup>
Essential criteria	
EC1	Laws, regulations or the supervisor require banks to have policies and processes that provide a comprehensive bank-wide view of significant sources of concentration risk. <sup>115</sup> Exposures arising from off-balance sheet as well as on-balance sheet items and from contingent liabilities are captured.
Description and findings re EC1	<p>Principles on concentration risk and large exposures limits are laid out in Article 62 of the CBL and in CBR Instruction 139-I. Further details can be found in Ordinance 3624-U of April 15, 2015 on the requirements for the risk and capital management system of banks and CBR Letter 26-T. Moreover, Regulation 2005-U on the estimation of banks' financial position contains new features in relation to concentration risks.</p> <p>Under the current regime (Article 65 of the CBL), an exposure to a single customer exceeding 5 percent of the bank's capital is considered as a large exposure (high credit risk). Moreover, a bank's exposure (including off-balance sheet guarantees) to a counterparty or a group of connected counterparties cannot exceed 25 percent of the eligible capital. This ratio will be set at 20 percent from January 1, 2017. To complement the individual large exposure limits, the CBR also applies an aggregate limit of all large exposures to eight times the bank's equity capital.<sup>116</sup></p> <p>According to Ordinance 3624-U mentioned above, credit institutions are expected to adequately address concentration risk in their RM frameworks, to assign clear responsibilities, and to develop policies and procedures for the identification, measurement, management, monitoring, and reporting of concentration risk, among other risks.</p>

<sup>114</sup> Connected counterparties may include natural persons as well as a group of companies related financially or by common ownership, management, or any combination thereof.

<sup>115</sup> This includes credit concentrations through exposure to: single counterparties and groups of connected counterparties both direct and indirect (such as through exposure to collateral or to credit protection provided by a single counterparty), counterparties in the same industry, economic sector or geographic region and counterparties whose financial performance is dependent on the same activity or commodity as well as off-balance sheet exposures (including guarantees and other commitments) and also market and other risk concentrations where a bank is overly exposed to particular asset classes, products, collateral, or currencies.

<sup>116</sup> The maximum amount of high credit risks shall not exceed 800 percent of the own funds (capital) of a credit institution (banking group); Article 65 of the CBL.

	<p>In consonance with Chapter 7 of this text, banks are required to establish RM procedures aimed at informing the BoD and executive bodies of the bank (and the parent company in case of a banking group) of the amount of concentration risk accepted by the credit institution and of any violations of the concentration limits and the procedure for their rectification.</p> <p>The same ordinance requires the management body to understand and review how concentration risk derives from the overall business model of the institution. This should result from the existence of appropriate business strategies and RM policies. In effect, as stipulated in Chapter 7 <i>"procedures for management of the concentration risk adopted (by the bank or the group) shall comply with the business model of the credit institution and complexity of the operations, shall be timely reviewed and cover different forms of risk concentration (including by geographic and economic sector and currency)."</i></p> <p>Concentration limits apply at the group level. As indicated in Ordinance 3624-U, procedures for managing concentration risk of a subsidiary credit institution <i>"shall be defined on the basis of approaches to the concentration RM established at the banking group level"</i> and in agreement with the parent credit institution of the banking group.</p> <p>While Russian legislation does not provide for any special limit applicable to lending to economic sectors, geographical areas, or common types of collateral, Ordinance 3624-U requires banks to define a system of limits that makes it possible to restrict the concentration risks on either certain major counterparties (groups of related counterparties) and counterparties belonging to one economic sector or geographic area.<sup>117</sup></p> <p>With regard the definition of connectedness, the exceptions for the purpose of calculating the statutory ratio N-6 (25 percent) apply to government bodies, local government bodies, and state corporates that do not qualify as group of related borrowers.</p>
EC2	<p>The supervisor determines that a bank's information systems identify and aggregate on a timely basis, and facilitate active management of, exposures creating risk concentrations and large exposure<sup>118</sup> to single counterparties or groups of connected counterparties.</p>
Description and findings re EC2	<p>According to the current regulation described under EC1, banks are required to have in place internal policies and procedures for the purpose of recording large exposures and subsequent changes to them, as well as for monitoring these exposures in the light of the bank's exposure policy. Banks are also obliged to submit a monthly report to the CBR, signed by the chief executive or chief financial officer, detailing their concentration risks to single counterparties and group of connected counterparties and broken down by economic sector, geographic areas, etc. The verification of the existence of management information systems concerning these exposures is part of the supervisory process of the CBR.</p>

<sup>117</sup> This system of limits shall be brought by the parent company of the banking group to the knowledge of its subsidiaries.

<sup>118</sup> The measure of credit exposure, in the context of large exposures to single counterparties and groups of connected counterparties, should reflect the maximum possible loss from their failure (i.e., it should encompass actual claims and potential claims as well as contingent liabilities). The risk weighting concept adopted in the Basel capital standards should not be used in measuring credit exposure for this purpose as the relevant risk weights were devised as a measure of credit risk on a basket basis and their use for measuring credit concentrations could significantly underestimate potential losses (see *"Measuring and controlling large credit exposures"*, January 1991).

	<p>In effect, the CBR has established procedures to verify that a bank's information systems provide adequate information on risk concentration and exposures limitations. These diligences are performed at both offsite and onsite levels.</p> <p>During the pre-inspection phase, the offsite department of the banking supervision department will define the scoping of the mission. The CBR inspection will request the bank to provide a summary report of all types of limits by economic sectors/industries, by clients and groups of connected clients, by type of products, by type of collateral, etc.</p> <p>Discussions with the CBR indicate that during the onsite mission, the inspection team assesses the quality of the process of identification, ongoing monitoring, risk analysis and control of different types of risks, including concentration risk. Inspectors also determine whether accuracy, timeliness and efficiency of the management information and risk monitoring systems are appropriate for the size and complexity of the structure, and the risk profile of the bank. They also ensure availability of internal systems for identification of large exposures and their adequacy to the limits set by the bank.</p> <p>Further, according to Regulation 242-P, the adequacy of these procedures has to be reviewed by the bank's internal audit department and the latter has to inform the BoD of deficiencies or violations discovered regarding the management of risks and effectiveness of measures taken to mitigate such concentration. Article 42 of the banking law also requires external auditors to check compliance of internal controls and RM systems in a credit institution with the requirements set by the CBR with regard to methodologies for identifying and managing material risks, stress testing systems, and systems of reporting on material risks.</p>
EC3	<p>The supervisor determines that a bank's RM policies and processes establish thresholds for acceptable concentrations of risk, reflecting the bank's risk appetite, risk profile and capital strength, which are understood by, and regularly communicated to, relevant staff. The supervisor also determines that the bank's policies and processes require all material concentrations to be regularly reviewed and reported to the bank's board.</p>
Description and findings re EC3	<p>RM and control procedures for concentration risk are required to be integrated into a bank's RM system and aligned with capital adequacy. A bank's limit structure to credit concentration risk and capital strength are captured in the ICAAP. In this regard, and in consonance with Ordinance 3614-U, banks are required to assess their capital needs with regard to concentration risk and adjust capital adequacy as necessary to mitigate those risks.</p> <p>Further, as stated in this ordinance, credit institutions should determine their risk appetite based on several indicators (see Article 4.4.2) and their level of concentration risk arising from the different exposures they are willing to accept, with regard to institution's business model. Reports on material risks including concentration risks should be reported to the bank's board on a quarterly basis (ICAAP reporting, Ordinance 3624-U Article 6.4).</p> <p>The assessment of conformity with these principles is mostly done onsite. The CBR methodology for controlling risk management in banks (CBR Letter 26-T of March 23, 2007) indicates that prior to their onsite visits, inspectors will identify the activities giving rise to risk concentrations through the analysis of specific reporting (form 0409118 on "Data on large loans"; form 0409135 on "Information</p>

	<p>on mandatory ratios" and form 0409302 on risk concentration broken down by economic sector, currency, etc.). According to the discussion with the authorities, inspectors also collect, ahead of the mission, all internal documents regulating bank's RM, including the procedures for assessing banking risks and indicators used in this case. Attention is also given to any high risk area stemming from large exposures identified by a bank's internal audit.</p> <p>Further, BCP assessors were told that in the course of onsite inspections, CBR inspectors will confirm that a bank's RM processes clearly define and limit large exposures and reports accordingly all material concentration risk, and that RM policies are communicated to the staff. To this end, CBR staff review minutes of board meetings, including approvals of "large operations," and check the completeness and usefulness of the management information system for the effective management of bank operations. The CBR staff will also cover on-going monitoring and control of concentration risks and their effective application. Moreover, it should be mentioned that ARs who are assigned to a specific bank—including D-SIBs—have access on an ongoing basis to all relevant information. They can attend board meetings and verify that material concentrations are regularly reviewed and reported to the bank's board.</p>
EC4	<p>The supervisor regularly obtains information that enables concentrations within a bank's portfolio, including sectoral, geographical and currency exposures, to be reviewed.</p>
Description and findings re EC4	<p>A national register of "high credit risks" is maintained by the CBR according to Article 65 of the CBL. In addition, specific reporting obligations in relation to concentration risk and large exposure limits are explicitly defined in Regulation 139-I. Banks are required to submit, on a monthly basis, detailed information on their concentration risk, broken down by sector, geographical, and currency exposures. In particular, the ratio N-6 details the aggregate size of loans to any one borrower and/or connected group of borrowers. Ratio N-7 provides data on the aggregate large credit exposures limited to 800 percent of a bank's capital. Ratio N-25 is also an important new statutory ratio that will enter in force on January 1, 2017 and provides data on the aggregate size of loans to any one borrower and/or connected group of borrowers related to a credit institution (see CP 20 for details). Banks are already reporting under N-25, but any breach of limits cannot be enforced before 2017.</p> <p>These reports allow the CBR to (i) assess concentration within a bank portfolio; (ii) calculate the required ratios; and (iii) determine conformity with prudential limits. All information emanating from these forms is captured in a CBR database available to all of CBR's territorial units and head offices. According to the CBL, any violation of the large exposure limits is subject to sanctions.</p> <p>Furthermore, banks are obliged (in accordance with CBR Regulation 3080-U of October 2013) to disclose information on significant risks they are facing, including credit risks.</p> <p>In accordance with Instruction 139-I, the CBR offsite supervision regularly monitors banks' compliance with the required ratios—including on LEL—through the usage of specific software (ASFB-Analysis of Financial Standing of Banks) available to all of CBR's territorial and regional offices.</p> <p>Pursuant to Chapter 10 of Instruction 139-I, should a bank fail to comply with a required ratio for six or more business days during any consecutive 30 business days, the CBR may take enforcement action against the bank. In that regard, the 2014 CBR BSR indicates that the entire range of</p>

	supervisory tools was used to reduce the concentration of banks' risks on the owner's business, and banks actively developed and implemented action plans to reduce their exposures in that area.
EC5	In respect of credit exposure to single counterparties or groups of connected counterparties, laws or regulations explicitly define, or the supervisor has the power to define, a "group of connected counterparties" to reflect actual risk exposure. The supervisor may exercise discretion in applying this definition on a case by case basis.
Description and findings re EC5	<p>For the purpose of assessing risk concentration exposures, Russia refers to several sources to apprehend groups of connected counterparties. The first source can be found in Article 64 of the CBL, which defines related borrowers as dependent upon one another or having a parent-subsidary relationship. Instruction 139-I also enables the CBR to consider borrowers as "connected" in several circumstances, for example if one of the borrowers can influence decisions made by the management body of the entity, or if the said borrower can influence the election of more than 50 percent of board members. The concept of "relatedness" is therefore currently based on legal relationships.</p> <p>However, the concept of "connectedness" has been extended recently via new amendments to the CBL. In effect, in accordance with the revised Article 64 to come into force on January 1, 2017, borrowers are to be treated as connected if they are linked economically in such a way that deterioration in the financial condition of one entails deterioration in the financial condition of the other. As a result, from 2017 the specific criteria that enable the CBR to consider borrowers as "connected" will be oriented toward both legal and economic relationships among parties. In addition, the concept of RPs is no longer limited to parties connected to each other but also to parties connected to the credit institutions.</p>
EC6	Laws, regulations or the supervisor set prudent and appropriate <sup>119</sup> requirements to control and constrain large credit exposures to a single counterparty or a group of connected counterparties. "Exposures" for this purpose include all claims and transactions (including those giving rise to counterparty credit risk exposure), on-balance sheet as well as off-balance sheet. The supervisor determines that senior management monitors these limits and that they are not exceeded on a solo or consolidated basis.
Description and findings re EC6	<p>The general principle is that a bank's exposure to a counterparty or a group of connected counterparties cannot exceed 25 percent of own funds. This limit will be lowered to 20 percent from 2017 onward. For that purpose, "exposures" means any asset or off-balance sheet item referred to in CBL and instructions. Institutions are expected to have procedures for independent monitoring of any breaches of policies and procedures, including the monitoring and reporting of breaches of concentration limits. In the CBR inspection methodology (Letter N-26 T), there are several diligences to be followed to ascertain conformity with the principles mentioned above. The inspector should assess internal systems and rules for identifying, ongoing monitoring, assessing, and controlling credit risk and concentration risk and the degree of their effective implementation in practice. Attention will also be given to the management's ability to adequately manage the credit risk within the bank—in all stages of the lending activities. Inspectors will ascertain that risks arising from exposures to parties connected to each other are properly captured and monitored by the bank. Due consideration will be given to any breach of limits. The CBR team will also use media reports to</p>

<sup>119</sup> Such requirements should, at least for internationally active banks, reflect the applicable Basel standards. As of September 2012, a new Basel standard on large exposures is still under consideration.

	<p>expand their analysis of relationships between banks and their customers. The corporate structure of borrowers is also assessed from a risk concentration standpoint.</p> <p>The discussion with the CBR staff confirmed this approach. In the view of the assessors, the approach implemented by the CBR is consistent with the Basel Standard on the supervisory framework for measuring and controlling large exposures.</p>
EC7	The supervisor requires banks to include the impact of significant risk concentrations into their stress testing programs for RM purposes.
Description and findings re EC7	<p>Regulation 2005-U on a bank's financial position contains a few provisions on stress testing. In particular, CBR staff uses a questionnaire to assess the quality of RM, which is one criterion used by CBR to ascertain the soundness of a given bank. Question 7 of that questionnaire asks whether the <i>"bank has any formalized procedures for evaluating the potential impact exerted upon the bank's financial position by a number of planned changes in the risk factors, which correspond to extraordinary but probable events (the stress test)."</i> When evaluating this question, it is necessary to take into account whether the stress tests are of a complex character, i.e., whether they embrace the main risks inherent in the bank's activity (the credit, market, and interest risks, the risk of the loss of liquidity, the operational and other risks, essential for the bank's activity).</p> <p>More detailed provisions on stress tests can be found in Ordinance 3624-U. Chapter 7 requires banks to include the impact of significant risk concentrations into their stress testing programs for RM purposes. These exercises should contain scenario analysis in respect of concentration risk corresponding to their business model and scale. The stress testing results are regularly reported to the bank's BoD and executive departments which, when necessary, take appropriate action to decrease the level of concentration.</p>
<b>Assessment of Principle 19</b>	<b>Largely Compliant</b>
Comments	<p>The ICAAP Regulation 3624-U of April 15, 2015 contains new provisions on concentration risk. It is in many respects (as discussed in other parts of this report) a major step forward. Before the enactment of this norm, the CBR did not have the power to set requirements on RM and to impose on banks any obligations in that regard. Regulation 2005-U has also been revised several times, including in 2014 and 2015, with a few important additions to bank's economic position analysis, including new indices of concentration of major credit risks (PA5), of credit risks on shareholders (partners) (PA6), and of credit risks on insiders (PA7). A decision has also been taken to lower the maximum limit of a bank's exposure to a single counterparty or a group of connected counterparties from 25 percent of eligible capital to 20 percent.</p> <p>It is also noteworthy that the CBR has a wide range of powers to address situations where banks are taking excessive concentration risk, including the power to instruct the bank to mitigate the risk exposure when the concentration is deemed excessive.</p> <p>The current mission, however, is not in a position to assess the effective implementation of the new provisions described above. For RM purposes, for example, SIFIs have begun to include the impact of significant risks—including risk concentrations—into their stress testing programs since January 1, 2016 only, and for non-SIFIs, this approach is set to start on January 1, 2017.</p>

The same holds true for the new responsibilities assigned to banks' boards regarding RM. As discussed above, credit institutions should determine their risk appetite based on several indicators and their level of concentration risk arising from the different exposures they are willing to accept, with regard to institution's business model. Reports on material risks, including concentration risks, should also be reported to the bank's board on a quarterly basis. This new provision is in the process of being implemented and will not be enforceable before 2017.

The definition of economic linkages is not implemented yet. This undermines the CBR's ability to oversee the entire spectrum of concentration. The problem stems from the fact that the determination by the CBR—and banks alike—of relatedness between customers connected economically will start in 2017.

In the same vein, the new regime on exposures arising from transactions of person(s) connected to the credit institution itself will not be implemented before January 2017. As of today, exposures to RPs refer only to parties related to each other (see CP20 for details).

According to discussions with market participants, the issue of large exposures is a matter of concern. Statistics from the CBR on shareholder and insider credit risks confirm the general sentiment. In 2014, the large loan exposure of the banking sector grew by 34.9 percent to 19.5 trillion rubles. The share of large loans in the banking sector assets remained unchanged over the year and stood at 25.1 percent. During the reporting year, 122 credit institutions violated the required maximum exposure per borrower or group of related borrowers (N-6) ratio (69 credit institutions in 2013), and 14 credit institutions violated the required large credit exposure (N-7) ratio (6 credit institutions in 2013). As of January 1, 2015, the maximum value of loans, guarantees, and sureties provided by a credit institution (banking group) to its members (shareholders) (N-9.1) ratio was calculated by 306 credit institutions, or 36.7 percent of the total operating credit institutions (338 credit institutions, or 36.6 percent as of January 1, 2014). The ratio was breached by six credit institutions (three credit institutions in 2013). There were a total of 84 violations, compared with 144 violations a year earlier. Sixteen credit institutions (nine credit institutions in 2013) failed to meet the total insider risk (N10.1) ratio requirements.

All things considered, the assessors are not in position to reflect the latest legal and regulatory reforms in their rating. The grade assigned to this CP in 2008 remains the same. Concerns with respect to the capture of relatedness are reflected in the grading to CP20.

**Recommendations:**

- Conduct a horizontal review across the industry to verify the degree of conformity with LEL Requirements in light of the new statutory ratio N-25.
- Instruct the industry to increase efforts in establishing clear understanding of relatedness between customers connected economically.
- Include in the inspection program for 2017/2018 an analysis of the way concentration risks have been included into banks' RM framework in light of the new ICAAP regime.



<b>Principle 20</b>	<b>Transactions with RPs.</b> In order to prevent abuses arising in transactions with RPs <sup>120</sup> and to address the risk of conflict of interest, the supervisor requires banks to enter into any transactions with RPs <sup>121</sup> on an arm's length basis; to monitor these transactions; to take appropriate steps to control or mitigate the risks; and to write off exposures to RPs in accordance with standard policies and processes.
<b>Essential criteria</b>	
<b>EC1</b>	Laws or regulations provide, or the supervisor has the power to prescribe, a comprehensive definition of "RPs." This considers the parties identified in the footnote to the Principle. The supervisor may exercise discretion in applying this definition on a case by case basis.
Description and findings re EC1	<p>The regime governing transactions with RPs is defined in various texts. Until 2016, the definition of RPs was narrow and mainly based on legal relationships. In particular, the criterion of a possible relatedness of a person (persons) to a credit institution itself was not captured, only relations within a group of affiliated parties were considered. To streamline the legal regime, the CBL was subject to a series of revisions,<sup>122</sup> some of which are set to come into force in 2017 only (e.g., Article 64<sup>1</sup>).<sup>123</sup></p> <p>The concept of RPs can be found in Article 4 of Federal Law 948-1, entitled "On Competition and the Restriction of Monopolies in Commodity Markets."<sup>124</sup> This article stipulates that the affiliated persons of a credit institution are the natural persons and legal entities that exert influence<sup>125</sup> on the activity of the given organization, namely: (i) a member of the BoD (the supervisory council); (ii) a member of the collegiate management body; (iii) persons having more than 20 percent of voting rights; (iv) the legal entities in which the given credit institutions possesses 20 percent of stakes or voting rights. The definitions of parent, subsidiary, and dependent companies are also contained in Article 67.3 of the Civil Code of the Russian Federation. CBR Instruction 139-I defines RPs of a bank as individuals and legal entities capable of influencing decisions that carry credit risk.</p>

<sup>120</sup> Related parties can include, among other things, the bank's subsidiaries, affiliates, and any party (including their subsidiaries, affiliates and special purpose entities) that the bank exerts control over or that exerts control over the bank, the bank's major shareholders, board members, senior management and key staff, their direct and related interests, and their close family members as well as corresponding persons in affiliated companies.

<sup>121</sup> Related party transactions include on-balance sheet and off-balance sheet credit exposures and claims, as well as, dealings such as service contracts, asset purchases and sales, construction contracts, lease agreements, derivative transactions, borrowings, and write-offs. The term transaction should be interpreted broadly to incorporate not only transactions that are entered into with related parties, but also situations in which an unrelated party (with whom a bank has an existing exposure) subsequently becomes a related party.

<sup>122</sup> In accordance with Federal Law 146-FZ of July 2, 2013 (as amended on December 22, 2014).

<sup>123</sup> In accordance with CBR Ordinance 490-U of December 16, 2014, as of January 1, 2016, statutory ratios comprise also the "Maximum risk per entity associated with the bank (group of entities associated with the bank."

<sup>124</sup> See also CBR Regulation 307-P of July 20, 2007 on the procedure for keeping accountancy and presenting information about affiliated persons of credit organizations (with the Amendments and Additions of April 30, 2009, April 27, 2010, and July 19, 2012).

<sup>125</sup> In accordance with item 7.3 of Regulation 345-P, control and significant influence are defined in accordance with International Financial Reporting Standard (IFRS) 10—Consolidated Financial Statements, and IAS 28—Investments in Associates and Joint Ventures, which entered into force within the Russian Federation pursuant to Russian Federation MoF Order 217N of December 28, 2015, on the Entry into Force and Repeal of International Financial Reporting Standards Documents within the Russian Federation.

	<p>Other indications are contemplated in Article 64 of the CBL which defines related borrowers as dependent upon one another or having a parent—subsidiary relationship.</p> <p>As indicated above, more details about the concept of RPs have been introduced by the new Article 64<sup>1</sup> of the CBL that will enter into force only in 2017. Pursuant to this new article, <i>a legal entity related to a credit institution is a legal entity which controls a credit institution or exerts material influence on it, or a legal entity whose activity is controlled by a credit institution or which is under material influence of a credit institution.</i></p> <p>In the same vein, a private individual related to a credit institution is a private individual (including the individual's close relatives, e.g., his (her) spouse, parents, children, adoptive parents, grandparents, grandchildren) who (i) controls a credit institution or exerts material influence on it; (ii) is a member of a BoD (supervisory board), director and his deputy, chief accountant, etc.</p> <p>Another significant change since the previous FSAP is the role assigned to the Banking Supervision Committee of the CBR. In effect, Article 64<sup>1</sup> of the CBL stipulates that, for the purposes of establishing maximum risk per person related to a credit institution, the Banking Supervision Committee of the CBR is empowered to decide on the relatedness of the person(s) to the credit institution. Furthermore, a decision by the Banking Supervision Committee shall provide substantiation for establishing the relatedness of a particular person (or a group of persons) with a bank, including information on the criteria on which the Committee's decision was based, as well as the time limits for a credit institution to address excessive exposure to the RP. In this process, the burden of proof lies with the credit institution which has to prove the absence of relatedness.</p> <p>The definition of RP transaction is not explicitly established in the law. According to the discussions with the CBR, RPs transactions cover all types of operations, including on-balance sheet and off-balance sheet credit exposures and claims, as well as dealings such as service contracts, derivative transactions, etc.</p> <p>As indicated in the self-assessment, to get an understanding of possible related party relationships, the CBR evaluates information from bank's annual (published) financial statements, a number of which are compiled in accordance with IFRS standards. Also, the CBR uses two main reporting document (N-6 and N-25) that provide details on transactions with related and affiliated parties.</p>
<b>EC2</b>	Laws, regulations or the supervisor require that transactions with RPs are not undertaken on more favorable terms (e.g., in credit assessment, tenor, interest rates, fees, amortization schedules, requirement for collateral) than corresponding transactions with non-related counterparties. <sup>126</sup>
Description and findings re EC2	Pursuant to the CBR's recommendation contemplated in Letter f2-T entitled "On a Bank's Performance of Transactions with RPs and the Assessment of Risks Associated with Such Transactions," banks should have internal procedures in place to prohibit extension of credits to RPs (including contingent liabilities) on terms that are more favorable than those granted to non-related borrowers.

<sup>126</sup> An exception may be appropriate for beneficial terms that are part of overall remuneration packages (e.g., staff receiving credit at favorable rates).

	<p>Assessors were told that these “insider loans” are reviewed during onsite inspections and due diligence is performed to determine whether their overall terms are below current market rates. Inspectors will pay particular attention to the term of the contract, collateral, and <i>pari passu</i> clause. A comparison with similar transactions with non-insiders will be made to detect any preferential treatment. Also, according to Instruction 139-I Annex 1, Codes 8956/8957, loans to the bank’s RPs are deemed to be of higher risk and thus must be calculated with a risk weight co-efficient of 1.3 (rather than 1.0 or 100 percent risk weighting for most other loans).</p> <p>There are important limitations though. The CBR lacks the authority to discipline a bank in the event a transaction with RPs is undertaken on more favorable terms. While these operations exceeding certain amounts have to be approved by the board (see EC3), there is no legal prohibition. Additionally, the CBR lacks authority to impose penalties on directors who have personally benefited from these favorable conditions.</p>
<b>EC3</b>	The supervisor requires that transactions with RPs and the write-off of related-party exposures exceeding specified amounts or otherwise posing special risks are subject to prior approval by the bank’s board. The supervisor requires that board members with conflicts of interest are excluded from the approval process of granting and managing related party transactions.
Description and findings re EC3	Pursuant to the law on Joint Stock Companies and Regulation 254-P, the write-off of loans provided by a bank to a shareholders and/or their RPs that exceeds 1 percent of the institution’s capital are subject to the prior approval of the BoD. The interested parties should not be involved in the decision making process. In practice, the CBR examiners will review a set of documents to ascertain the compliance with this provision, including minutes of the board and the signature of members who attended the meeting. It was not clear, however, if the same requirements described above also apply to bank formed as limited liability companies.
<b>EC4</b>	The supervisor determines that banks have policies and processes to prevent persons benefiting from the transaction and/or persons related to such a person from being part of the process of granting and managing the transaction.
Description and findings re EC4	The observations made during the 2008 BCP report remain valid. In consonance with the recommendations laid out by the CBR in Letter 2-T, banks should have internal procedures in place to prohibit the approval of loans to insiders and other RPs with the participation or voting for approval of those persons who have an interest in the decision. However, since the letter mentioned above does not have a binding effect, there is no explicit regulatory prohibition in place to preclude directors or other person with a conflict of interest from being part of the decision-making process on their own loans.
<b>EC5</b>	Laws or regulations set, or the supervisor has the power to set on a general or case by case basis, limits for exposures to RPs, to deduct such exposures from capital when assessing capital adequacy, or to require collateralization of such exposures. When limits are set on aggregate exposures to RPs, those are at least as strict as those for single counterparties or groups of connected counterparties.
Description and findings re EC5	There are specific limits for exposures to RPs that can be found in different sources. Article 62 of the CBR defines the general principles; it empowers CBR to set ratios with the aim to ensure the stability of the credit institutions; this includes the definition of “maximum risk per borrower or a group of related borrowers (Section 3 of Article 62) and the maximum risk per party related to the credit institution or group of parties related to the credit institution (Section 11 of Article 62). It is noteworthy that this Section 11 was introduced not long ago by Federal Law 146-FZ of July 2, 2013 and has not yet been enforced.

	<p>Further, Article 64 of the CBL indicates that maximum risk per borrower or group of related borrowers dependent on one another or being parent and subsidiary shall be established as percentages of the capital of a credit institution and may not exceed 25 percent of the capital of the said institution. In establishing maximum risk, the entire amount of loans extended by a credit institution to a borrower or a group of related borrowers and the sums of guarantees and warranties granted to these parties shall be taken into account.</p> <p>Specific limits also apply to shareholders. In virtue of Article 71 of CBL, the maximum amount of loans, bank guarantees, and warranties granted by a credit institution to its members (shareholders) shall be determined as percentages of the capital and may not exceed 50 percent.</p>
<b>EC6</b>	<p>The supervisor determines that banks have policies and processes to identify individual exposures to and transactions with RPs as well as the total amount of exposures, and to monitor and report on them through an independent credit review or audit process. The supervisor determines that exceptions to policies, processes and limits are reported to the appropriate level of the bank's senior management and, if necessary, to the board, for timely action. The supervisor also determines that senior management monitors related party transactions on an ongoing basis, and that the board also provides oversight of these transactions.</p>
Description and findings re EC6	<p>In accordance with Letter 2-T and Letter 77-T, the CBR recommends bank internal policies and processes be established to monitor the performance of credit risks on related-party transactions. The CBR determines via onsite inspections that banks have policies and procedures to identify, monitor, and report to the board and senior management exposures to affiliated parties as recommended in the above mentioned letters. The CBR examiners will pay particular attention to the following: (i) internal documents dealing with credit policy; (ii) methodological guidelines used in the assessment of credit risk; (iii) compliance with established lending limits; (iv) the quality, scope, and timeliness of reporting to the BoD; and (v) the overall organization of the management of credit risk at a lending institution on an ongoing basis.</p> <p>Relevant provisions of CBR recommendation 119-T also suggest that the BoD appoint independent directors to better ensure a more objective decision-making process regarding the review of business plans, including credit and/or investment policy and oversight of (large) of transactions in which insiders or shareholders persons are considered.</p>
<b>EC7</b>	<p>The supervisor obtains and reviews information on aggregate exposures to RPs.</p>
Description and findings re EC7	<p>CBR Instruction 139-I contains the aggregated limits that banks are required to report on a monthly basis:</p> <ul style="list-style-type: none"> <li>• N6: aggregate size of loans to any one borrower and/or connected group is limited to 25 percent of bank's capital;</li> <li>• N9.1: aggregate credits to shareholders holding more than 5 percent of the bank's stock limited to 50 percent of bank's capital; and</li> <li>• N10.1: aggregate size of loans to bank insiders (directors, executive officers) is limited to 3 percent of bank's capital. Regarding the latter aspect, the aggregated limit only applies to the individual and is not aggregated with other connected parties of the insider.</li> </ul> <p>At present, the CBR is working on establishing a statutory ratio N25 of the maximum value of risk to the bank's related party (a group of the bank's RPs). The ratio is designed to limit the credit risk of the bank to its related party (group of the bank's RPs) and determine the maximum ratio of the total</p>

	<p>obligations of a related party (group of the bank's RPs) to the bank and obligations to third parties. The maximum level of N25 is to be established at 20 percent. The proposed date of this ratio's establishment is January 2017.</p> <p>Also, when supervision discovers that the risk of each shareholder of the bank (a group of the bank's related shareholders) exceeds 20 percent of the bank's equity, the CBR begins to conduct additional supervisory activities with such banks and their shareholders as part of preventive supervisory measures. During this activity, the CBR proposes that such banks and their shareholders should determine prospects for reducing risk concentration of shareholders and diversification of their banking business with the development of appropriate schedules oriented toward results to be achieved within a reasonable time (CBR Letter as of April 4, 2010 04-15-6/1550 "On Assessment of Bank Risks of Owners").</p>
<b>Assessment of Principle 20</b>	<b>Materially Non Compliant</b>
Comments	<p>Important amendments have been introduced since 2015 to the CBL that streamline the legal regime applicable to RPs. In particular, the law now captures a group of people connected to the bank. Important progress is also found in the role allocated to the Banking Supervisory Committee of the CBR in deciding about the relatedness of the persons or a group of persons to the credit institution. The underlying motivation for such BSC involvement is to ensure that a collegiate body will exercise unbiased judgment in challenging any error of banks in their approach to relatedness. Moreover, the banking industry has been duly updated by the CBR about the forthcoming changes. These new reforms are much welcome as they constitute an important step forward in monitoring and mitigating risks arising from RP Transactions.</p> <p>There are however a series of issues that have not been addressed or are not yet implemented and enforced.</p> <ul style="list-style-type: none"> <li>• The definition of RPs arises from a "patchwork" of different legal sources, as opposed to being founded on a single non-ambiguous one.</li> <li>• The new regime about exposures arising from transactions of person(s) connected to the credit institutions will not be implemented before January 2017. The CBR is currently working on a new statutory ratio N25 that will set at 20 percent the maximum limit of risk to the bank's related party (or group of the bank's RPs). For some banks, this new ratio is posing some difficulties and thus a decision was made to give them some time to decrease their claims to RPs by 2017 to meet the new statutory ratio.</li> <li>• The regulatory framework for related party transactions does not require that lending to RPs be on same terms and conditions as those generally offered to the public. The CBR made recommendations in that regard, but they are not binding and thus not enforceable. Additionally, the CBR lacks authority to impose penalties on directors who personally benefited from these favorable conditions.</li> <li>• According to the law on Joint Stock Companies, write-off of loans provided by a bank to a shareholder and/or his RPs that exceeds 1 percent of the institution's capital are subject to the prior approval of the BoD. It is not clear, however, if the same requirement applies to banks that opted for the status of LLC.</li> <li>• Banks should report different exposures to RPs (see EC 7) on a monthly basis. However, there is no obligation for banks to report immediately to the CBR any serious breach with the statutory</li> </ul>

ratios N6, N9, N10, and N25. The CBR told the mission that the supervisor could ask the bank to report on a daily basis should any particular concern arise.

- In the definition of connectedness, the concept of economic linkages has been introduced under the new Article 64 of the CBL but it will not be implemented before 2017.

These issues are considered significant by the BCP assessors and as a result they cannot support an upgrade of the rating assigned to this CP in 2011. Related party lending has been an important source of bank failures in Russia, and the nature of banking business in the country is conducive to related party exposure. In a recent case involving the 41 top banks, there was a RUB 2 billion (\$60 million) hole in bank's balance sheet generated by loans made to companies affiliated with the bank's owners. Other similar cases led to several license revocations.

As indicated in the 2014 CBR BSR, there have been a number of breaches of existing ratios. As of January 1, 2015, the N9.1 ratio (maximum value of loans, guarantees, and sureties provided by a credit institution to its shareholders) was breached by six credit institutions (three credit institutions in 2013). There were a total of 84 and 144 violations respectively in 2014 and 2013. In 2014, 16 credit institutions (nine credit institutions in 2013) failed to meet the total insider risk (N10.1) ratio requirements.<sup>127</sup>

The Russian authorities may wish to consider the following recommendations.

**Recommendations:**

- Strengthen the definition of RPs, which appears neither organic (as it results from the combination of different legal texts) nor exhaustive (as it does not seem to cover all the cases envisaged under this Principle 20).
- Establish a legal prohibition for related party transactions performed on more favorable terms than corresponding transactions with non-related counterparties.
- Include in the regulation a prohibition to preclude directors or other persons with a conflict of interest from being part of the decision-making process on their own loans.
- Subject borrowers to the obligation to declare any relatedness with the bank.
- Include in the law a provision requiring major shareholders to disclose their "business interests."
- Require banks to report immediately to the CBR any serious breach of the statutory ratios applicable to RP.
- Subject banks with LLC status to the obligation whereby transactions with RPs and the write-off of related-party exposures exceeding a specified amount are subject to prior approval by the bank's board.
- Define in a regulation the types of transactions that give rise to RP exposures
- Exercise control over the observance by credit institutions of calculated maximum risk per person related to a credit institution.

<sup>127</sup> CBR 2014 BSR.

<b>Principle 21</b>	<b>Country and transfer risks.</b> The supervisor determines that banks have adequate policies and processes to identify, measure, evaluate, monitor, report and control or mitigate country risk <sup>128</sup> and transfer risk <sup>129</sup> in their international lending and investment activities on a timely basis.
<b>Essential criteria</b>	
<b>EC1</b>	The supervisor determines that a bank's policies and processes give due regard to the identification, measurement, evaluation, monitoring, reporting, and control or mitigation of country risk and transfer risk. The supervisor also determines that the processes are consistent with the risk profile, systemic importance and risk appetite of the bank, take into account market and macroeconomic conditions and provide a comprehensive bank-wide view of country and transfer risk exposure. Exposures (including, where relevant, intra-group exposures) are identified, monitored and managed on a regional and an individual country basis (in addition to the end-borrower/end-counterparty basis). Banks are required to monitor and evaluate developments in country risk and in transfer risk and apply appropriate countermeasures.
Description and findings re EC1	<p>Country and transfer risks are not specifically address as such in the current regulation, with the exception of Ordinance 3624-U on Capital and RM and CBR Ordinance 1584-U of 22 June 2005 on loss provisioning for credit institutions' operations with offshore residents.</p> <p>Article 1.2.1 of Regulation 242-P of December 16, 2003 on the organization of internal control in banks and banking groups stipulates that the internal control system of a bank shall also address the management of bank risks, in general. This regulation also requires banks and banking groups to specifically adopt a number of internal RM guidelines covering, inter alia, credit and deposit policy, lending to RPs, interest rate policy, FX operations, securities, AML/CFT, and security. Country and transfer risk are not specifically singled out as a risk area.</p> <p>Regulation 2005-U, which lays out the methodology for estimating banks' economic position, contains a series of seven indicators. These indicators are used to classify banks into five "quality" groups (from good to bad) depending on the importance of shortcomings detected in key areas, including internal control and strategic RM. This regulation refers in particular to the existence of internal documents on controlling the principal risks inherent in the bank's activity, including credit, market, interest, integrity, liquidity, OR, as well as risks stemming from operations with RPs. Country and transfer risks are not specifically mentioned.</p> <p>The only regulation that refers explicitly to country and transfer risks is Ordinance 3624-U that governs the Internal Capital Adequacy Assessment Processes (ICAAP) that credit institutions must establish. The appendix of this ordinance recognizes FX risks among market risk and concentration risk and also refers to country risk within concentration risk. The ordinance reads: "<i>The credit institution [...] shall establish a methodology for determining the risks material for the credit institution [...], which shall be based on a system of indicators characterizing: [...] the volumes of operations carried out within individual lines of business (for example, a significant amount of international</i></p>

<sup>128</sup> Country risk is the risk of exposure to loss caused by events in a foreign country. The concept is broader than sovereign risk, as all forms of lending or investment activity, whether to/with individuals, corporates, banks, or governments are covered.

<sup>129</sup> Transfer risk is the risk that a borrower will not be able to convert local currency into FX and so will be unable to make debt service payments in foreign currency. The risk normally arises from exchange restrictions imposed by the government in the borrower's country. (Reference document: *IMF paper on External Debt Statistics—Guide for Compilers and Users*, 2003.)



	<p><i>operations of the credit institution [...] may serve as a basis for recognizing the country risk as material).</i>" The same text stipulates that in order to identify and assess the concentration risk, the credit institution may use the following indices: <i>"the ratio of the total claims of the credit institution [...] to its counterparties in one sector of the economy (one country, geographic region) to the total amount of similar claims of the credit institution [...]"</i> The credit institution [...] shall assess this kind of risks inherent to its activity [...] and their materiality on a regular basis (at least once annually)".</p> <p>CBR Ordinance 1584-U of June 22, 2005 governs the regime for monitoring risk exposures to offshore residents and provisioning loss arising from Credit Institutions' operations with these customers.</p> <p>For the purpose of analyzing all aspects of country risk, the CBR has prepared informational Letter 15-1-5/4957 of October 7, 2008, "On International Approaches (Standards) of Country RM and Control." This letter is based on the documents of the Basel Committee on Banking Supervision (BCBS) that provides guidance on "Management of Banks' International Lending: Country Risk Analysis and Country Exposure Measurement and Control." The CBR letter recommends that the CBR regional branches should pay attention to country RM when evaluating RM systems in credit institutions.</p> <p>Lastly, the country risk assessment is taken into account in the calculation of prudential standards (including the capital adequacy ratio). Procedures for calculation are defined in CBR Instruction 139-I.</p> <p>According to the discussion with CBR staff, country risk is covered in the context of RM and internal control oversight.</p>
<b>EC2</b>	<p>The supervisor determines that bank' strategies, policies and processes for the management of country and transfer risks have been approved by the banks' boards and that the boards oversee management in a way that ensures that these policies and processes are implemented effectively and fully integrated into the banks' overall RM process.</p>
Description and findings re EC2	<p>According to the banking law and Chapter 2 of the Ordinance 3624-U on ICAAP, approval of RM strategy and RM methods falls within the competence of the BoD. The latter shall define and approve the strategies and the RM policies and periodically review them with respect to changes in activities and in the external environment; define the system of internal controls and assess its consistency with the established risks appetite and strategies and with the evolution of the firm's risk profile; consider not less than once a year any change to be made to the RM strategy; be informed through periodic reporting about any violation of limits and measures to be taken to correct the situation.</p> <p>In addition, the management body is required to set operational limits on risk exposures—taking into account the results of stress tests and the economic context—and clearly define the responsibilities and the tasks of the functions involved in the RM process. The RM function is involved in the definition of the bank's risk appetite and in the formulation of the RM policies and process, as well as in the identification of operational limits to the different risk exposures, consistently with the nature, size, and complexity of the bank's activities.</p>

	<p>While Ordinance 3624-U refers to a wide variety of risks in multiple instances, country and transfer risks are mentioned only once. It is presumed that RM cover all types of risks, including those stemming from exposures to countries or to borrowers unable to make debt service payments in foreign currency.</p> <p>The adequacy of banks' RM policies and their application to effectively address and mitigate country and transfer risk is assessed through onsite examinations. Country and transfer risk seems to be evaluated mainly as a subset of credit risk.</p>
<b>EC3</b>	The supervisor determines that banks have information systems, RM systems and internal control systems that accurately aggregate, monitor and report country exposures on a timely basis; and ensure adherence to established country exposure limits.
Description and findings re EC3	<p>As indicated above, there are no specific requirements for management of country risk and transfer risk. The general RM and internal control regulations apply (see CP 15), including in respect to information systems for RM.</p> <p>Pursuant to Ordinance 3624-U, banks must have in place risk policies and a RM process to identify, measure, evaluate, monitor, mitigate, and communicate risks to the BoD and to the supervisory authorities. Also, in accordance with Regulation 242-P, credit institutions are required to establish adequate management and control mechanisms in order to control all the risks to which they are exposed. Further, the above-mentioned arrangements cover all forms of risk in a manner consistent with the characteristics, size, and complexity of the business conducted by the bank.</p> <p>Also, in accordance with Regulation 242-P, the tasks of the internal control system include, among other things, assurance of accuracy, fullness, fairness, and timeliness of information on risk exposures and their timely reporting to senior management.</p> <p>One can infer from the above that country and transfer risks are subsumed in the overall RM process. The mission was informed that in practice, accuracy of prudential standards calculations and provisioning for operations with residents of offshore zones is assessed both in the course of offsite supervision and inspections, on a regular basis.</p>
<b>EC4</b>	<p>There is supervisory oversight of the setting of appropriate provisions against country risk and transfer risk. There are different international practices that are all acceptable as long as they lead to risk-based results. These include:</p> <ul style="list-style-type: none"> <li>(a) The supervisor (or some other official authority) decides on appropriate minimum provisioning by regularly setting fixed percentages for exposures to each country taking into account prevailing conditions. The supervisor reviews minimum provisioning levels where appropriate.</li> <li>(b) The supervisor (or some other official authority) regularly sets percentage ranges for each country, taking into account prevailing conditions and the banks may decide, within these ranges, which provisioning to apply for the individual exposures. The supervisor reviews percentage ranges for provisioning purposes where appropriate.</li> <li>(c) The bank itself (or some other body such as the national bankers' association) sets percentages or guidelines or even decides for each individual loan on the appropriate provisioning. The adequacy of the provisioning will then be judged by the external auditor and/or by the supervisor.</li> </ul>

Description and findings re EC4	<p>There are no limits and provisions against country and transfer risks, with the exception of operations with customers residing in offshore zones. Banks are expected to consider these risks as part of their overall provisioning framework.</p> <p>Regulation 1584-U asks banks to monitor exposures and make provisions for loans and financial instruments given to offshore residents as soon as the loans or financial instruments are recorded in the balance sheet.</p> <p>The levels of provisioning depend on the group of the offshore zone in accordance with CBR Ordinance 1317-U. Operations with offshore residents in Group I do not require provision; operations with offshore residents in Groups II and III require, respectively, a provision of 25 percent or 50 percent of the relevant account balance or of the average daily estimated debit account turnover for the last 30 calendar days.</p> <p>CBR Regulation 254-P on asset classification and provisioning requires banks to classify their assets according to fixed categories: standard, "non-standard", doubtful, non-performing, and bad. The regulation also defines the financial conditions that need to be met and the level of reserves. It is not clear, however, whether this regulation includes country and transfer risk into credit risk. There is a provision, however, stipulating that the "<i>deterioration of the economic situation in the country of the borrower's residence and/or where the credit institution's borrower performs its activities</i>" may be a material factor that can lead the bank to reclassify the loan in a lower category.</p>
<b>EC5</b>	The supervisor requires banks to include appropriate scenarios into their stress testing programs to reflect country and transfer risk analysis for RM purposes.
Description and findings re EC5	<p>As discussed in detail in CP 15, Regulation 2005-U and Ordinance 3883-U contain multiple provisions in relation to stress testing that provide guidance to CBR examiners for assessing the extent to which stress testing is correctly and efficiently embedded into the RM system of a bank.</p> <p>The use of stress testing programs has also been included into the ICAAP process. Ordinance 3624-U (clause 5.4) establishes stress testing requirements for the assessment of capital adequacy. Among other conditions, the stress testing processes shall be used in the bank's assessment of its capital adequacy and shall be performed on a regular basis. Stress testing procedures should contain several key features (see CP 15 for details). Moreover, when selecting the stress testing scenario, the bank shall ensure that all the risks and areas of activity material for the credit institution are covered. Banks are also required to regularly (at least once a year) assess the scenarios under consideration, the quality of data, and the assumptions used for the stress testing exercises and the compliance of the stress testing results with bank's established goals.</p> <p>It is assumed that country and transfer risks are to be covered in the stress testing programs as would be any other type of material risk.</p>
<b>EC6</b>	The supervisor regularly obtains and reviews sufficient information on a timely basis on the country risk and transfer risk of banks. The supervisor also has the power to obtain additional information, as needed (e.g., in crisis situations).
Description and findings re EC6	<p>Country and transfer risks exposures are captured for operations with borrowers residing in offshore centers only. Information on the value of operations between credit institutions, which are Russian residents and non-resident counterparties, shall be submitted in the following reporting forms:</p> <ul style="list-style-type: none"> <li>• Data on Major Loans (0409118);</li> </ul>

	<ul style="list-style-type: none"> <li>• Report of an Authorized Bank on Foreign Operations (0409401);</li> <li>• Data on Settlements under Operations between Residents and Non-Residents with Securities, Shares, Equity Interest, and Investments in Assets (0409405);</li> <li>• Data on Interbank Loans and Deposits (0409501); and</li> <li>• Data on Open Correspondent Accounts and Their Balances (0409603).</li> </ul>
<b>Assessment of Principle 21</b>	<b>Materially Non-Compliant</b>
<b>comments</b>	<p>There are no specific requirements for the management of country risk and transfer risk. The general RM and internal control regulations apply. Country risk is assessed on an ad hoc basis as there are no specific guidelines or regulations for country or transfer risk outside of the general BCBS principles. As a result, minimum requirements for risk policies, processes, and limits are uncertain. In that area, since no major progress has been made since the last 2008 FSAP mission, the rating previously assigned to this CP remains the same.</p> <p>The authorities may wish to consider the following suggestions to bring this standard to a higher degree of conformity, especially in the current context of ruble depreciation.</p> <p><b>Recommendations:</b></p> <ul style="list-style-type: none"> <li>• Establish specific guidelines or regulations for country or transfer risk outside of the general RM requirements and risk exposure to offshore residents.</li> <li>• Establish specific policies to address provisioning for country and transfer risks.</li> <li>• Require detailed prudential return on country risk and transfer risks.</li> <li>• Ensure greater focus of oversight—both at onsite and offsite levels on risks stemming from country (including sovereign) risks and transfers risks.</li> </ul>
<b>Principle 22</b>	<b>Market risk.</b> The supervisor determines that banks have an adequate market RM process that takes into account their risk appetite, risk profile, and market and macroeconomic conditions and the risk of a significant deterioration in market liquidity. This includes prudent policies and processes to identify, measure, evaluate, monitor, report and control or mitigate market risks on a timely basis.
<b>Essential criteria</b>	
<b>EC1</b>	Laws, regulations or the supervisor require banks to have appropriate market RM processes that provide a comprehensive bank-wide view of market risk exposure. The supervisor determines that these processes are consistent with the risk appetite, risk profile, systemic importance and capital strength of the bank; take into account market and macroeconomic conditions and the risk of a significant deterioration in market liquidity; and clearly articulate the roles and responsibilities for identification, measuring, monitoring and control of market risk.
Description and findings re EC1	<p>As with credit risk, Ordinance 3624-U sets the qualitative requirements for internal market RM procedures. Under the ordinance, risk appetite shall be determined as a combination of quantitative and qualitative indicators. Chapters 1 and 3 of the Annex to the ordinance set out the requirements for identifying, assessing, and limiting the market risk of the institutions a whole. Chapter 6 of the annex to the ordinance, Section 6.2 sets RM requirements to address market liquidity risk and the risk of losses in relation to deterioration in market liquidity.</p> <p>Banks are also subject to Ordinance 2005-U, which requires the supervisors to establish that internal control documents and procedures are in place and are commensurate with the activities of the bank. The inspection process can be used to identify if the policies, processes and oversight</p>

	practices are followed by the bank. However, as market risk is not a predominant risk for banks in the Russian banking sector, it is less common for this risk area to be in scope. The CBR determines whether the risk processes are appropriate or deficient through its onsite inspection processes.
<b>EC2</b>	The supervisor determines that bank's strategies, policies and processes for the management of market risk have been approved by the banks' boards and that the boards oversee management in a way that ensures that these policies and processes are implemented effectively and fully integrated into the banks' overall RM process.
Description and findings re EC2	<p>Ordinance 3624-U sets the qualitative requirements for internal market RM procedures, including requirement to approve the respective policies and processes by the bank's board. Section 2.3 of the ordinance requires the board (supervisory board) of the credit institution (i.e., as appropriate, the parent credit institution of the banking group, subsidiary credit institution) to approve: the risk and capital management strategy of the credit institution; the procedure for managing the most material risks and capital of the credit institution and control over its implementation.</p> <p>As noted above, Ordinance 2005-U still applies to all banks, and thus the supervisor is required to consider the nature of risk oversight within the supervised institutions.</p>
<b>EC3</b>	<p>The supervisor determines that the bank's policies and processes establish an appropriate and properly controlled market risk environment including:</p> <ul style="list-style-type: none"> <li>(a) effective information systems for accurate and timely identification, aggregation, monitoring and reporting of market risk exposure to the bank's board and senior management;</li> <li>(b) appropriate market risk limits consistent with the bank's risk appetite, risk profile and capital strength, and with the management's ability to manage market risk and which are understood by, and regularly communicated to, relevant staff;</li> <li>(c) exception tracking and reporting processes that ensure prompt action at the appropriate level of the bank's senior management or board, where necessary;</li> <li>(d) effective controls around the use of models to identify and measure market risk, and set limits; and</li> <li>(e) sound policies and processes for allocation of exposures to the trading book.</li> </ul>
Description and findings re EC3	<p>As discussed above in CPs 15 and 17, Ordinance 3624-U sets the qualitative requirements for RM procedures in the context of the ICAAP. The expectations around market risk in particular are set out in Chapter 3 of the main ordinance, Chapter 3 (Market risk) of the Annex; documentation requirements are set out in Chapter 7 of the main ordinance. The main references for this criterion are as follows:</p> <ul style="list-style-type: none"> <li>(a) Information and reporting: Ordinance 3624-U, Chapter 3, Section 3.1, Chapter 6, Section 6.2.</li> <li>(b) Appropriate limits: Ordinance 3624-U, Chapter 2, Sections 2.1 and 2.2; Chapter 4, Section 4.1 (requirement to set risk appetite).</li> <li>(c) Exception reporting: Ordinance 3624-U, Chapter 4, Section 4.14.</li> <li>(d) Effective controls around limits: Ordinance 3624-U, Chapter 4, Sections 4.12 and 4.14 and also Chapter 6, Section 6.2 and Chapter 3 of the annex, Sections 3.2 and 3.4.</li> <li>(e) Trading book boundary: Regulation 511-P Section 1.1.</li> </ul> <p>Banks reporting obligations to the CBR: credit institutions are obliged to provide the CBR certain reporting forms on daily basis (e.g., 0409701) and report OTC derivatives trades to trade repository which requires effective information systems to be established.</p>

	<p>Ordinance 2005-U requires supervisors to examine whether banks have appropriate risk measurement procedures and impose suitable limits. Timely reporting, i.e., that reports must be made on time and within a specific deadline, is not explicitly identified as a standard banks should meet in either Ordinance 3624-U or Ordinance 2005-U. Exception reporting is addressed in Ordinance 3624-U, Section 4.1.4.</p> <p>The assessors were able to review inspection reports focusing on the market risk environment and correct calculation of market risk positions and capital adequacy. The features noted in this criterion were addressed.</p>
<b>EC4</b>	<p>The supervisor determines that there are systems and controls to ensure that banks' marked-to-market positions are revalued frequently. The supervisor also determines that all transactions are captured on a timely basis and that the valuation process uses consistent and prudent practices, and reliable market data verified by a function independent of the relevant risk-taking business units (or, in the absence of market prices, internal or industry-accepted models). To the extent that the bank relies on modeling for the purposes of valuation, the bank is required to ensure that the model is validated by a function independent of the relevant risk-taking businesses units. The supervisor requires banks to establish and maintain policies and processes for considering valuation adjustments for positions that otherwise cannot be prudently valued, including concentrated, less liquid, and stale positions.</p>
Description and findings re EC4	<p>While noting that there is an assessment of internal controls and strategic RM in Ordinance 2005-U, it is Ordinance 3624-U that more clearly sets the qualitative requirements for internal market RM procedures.</p> <p>Frequency of valuation of positions: Chapter 3 of the annex, Section 3.4 requires the credit institution to establish the procedure and frequency of assessing the methodology for determining the value of the trading portfolio instruments as well as the policy for the frequency of assessment of valuation.</p> <p>With respect to independence of the valuation process, Chapter 3 of the annex, Section 3.4 the methodology for determining the value of the trading portfolio instruments, including sources of market information used for determining the value of the trading portfolio instruments, must be developed independently of the divisions responsible for assuming the market risk positions.</p> <p>With respect to valuation adjustments for hard to value positions, Chapter 3 of the annex, Section 3.4, the institution must develop a methodology to assess the degree of uncertainty of the estimates obtained using such models and, if necessary, to adjust the value of the instruments assessed using quantitative assessment models. Chapter 7 of the annex sets out requirements for the monitoring and management of concentrations. CBR Letter 37-T contains guidelines for assessment of accuracy of credit institutions' fair value accounting practices.</p> <p>In terms of use of models for valuation purposes (not a widespread practice from what the assessors could determine) Chapter 3, Paragraph 3.2 requires the bank to comply with the requirements to such types of methods in international practice.</p>
<b>EC5</b>	<p>The supervisor determines that banks hold appropriate levels of capital against unexpected losses and make appropriate valuation adjustments for uncertainties in determining the fair value of assets and liabilities.</p>

Description and findings re EC5	<p>Banks were obliged to maintain an adequate amount of capital against market risk in accordance with Regulation 387-P until January 1, 2016, when Regulation 511-P “On the Procedure for Credit Institutions to Calculate Market Risk” came into force. This regulation also sets the requirement for valuation adjustments for less liquid positions.</p> <p>Chapter 3 of Ordinance 3624-U also requires that the procedures for managing market risk shall include determination of capital requirements. Banks must thus determine a target capital level, target capital structure, capital sources, target level of capital adequacy, as well as target risk levels and the target risk structure of the credit institution (banking group), based on the risk appetite indicators. Chapter 4, Section 4.4.2, requires banks to have indicators of market risk showing the capital value required to cover losses arising due to changes in the financial instruments’ value. Also, as noted above in EC4, Chapter 3, Section 3.4 of the Annex requires banks to have methodologies to help them assess hard to value positions and make adjustments accordingly. Chapter 4, Section 4.9.1 requires banks to have procedures for capital allocation in respect of, e.g., for market risk.</p> <p>CBR Letter 37-T “Concerning Means of Monitoring of the Accuracy of Fair Value Accounting Practices Used by Credit Institutions” contains guidelines for the assessment of the accuracy of credit institutions’ fair value accounting practices.</p> <p>The newly established—though not yet fully staffed—division in the CBR on valuation expects to support the work of the on and offsite functions, as well as to support banks in respect of fair valuation issues.</p>
<b>EC6</b>	The supervisor requires banks to include market risk exposure into their stress testing programs for RM purposes.
Description and findings re EC6	Ordinance 3624-U, Chapter 5, introduces requirements for banks to use a stress testing methodology based on historical and hypothetical events (scenario analysis) and analysis of the credit institution’s sensitivity to changes in their key risk factors. Prior to this ordinance coming into force, Ordinance 2005-U has required (and continues to require) the supervisor to consider whether the bank’s stress testing practices are commensurate with its activities.
<b>Assessment of Principle 22</b>	<b>Largely Compliant</b>
Comments	<p>Market risk is a less developed area of banks’ activities than in some other jurisdictions. Banks are not authorized to use models for Pillar 1 regulatory capital calculations, and historically the volumes of tradable securities has been low and complex structured products do not feature. Banks may, however, use economic capital models in the context of the ICAAP, as set out in Ordinance 3624-U.</p> <p>Until 2014, the CBR did not have the legal powers to enforce RM and control standards and so, in common with the other risk areas, the enhanced framework under Ordinance 3624 is valuable, but as yet at a very early stage of implementation and a track record is not yet available.</p> <p>The Russian banking sector has had to weather some extreme movements in FX rates over the past year. The CBR operates a net open position limit system of 10 percent of the regulatory capital for each major currency and 20 percent of the regulatory capital in aggregate. The NOP rule has been in place for over twenty years, during most of which time, the currency has been very stable. In view</p>



	<p>of more recent volatility and notwithstanding provisions and restrictions set out in Instruction 124-I,<sup>130</sup> the banks' relative inexperience in managing such risk, which was commented on by a number of external market participants, the CBR may wish to re-examine their regulations. The assessors recognize that in the 2008-9 financial crisis, the CBR issued additional recommendations (letters) to credit institutions with respect to keeping the FX positions at a certain level and that the CBR took into account the extent to which banks followed those recommendations when it set limits for the banks' participation in the CBR's auctions on unsecured loans. Nevertheless, it is recommended that the underlying regulations be reviewed.</p> <p>The assessors understood that, while it is not standard practice, there are instances when one entity within a wider group will carry out market risk activities on behalf of its affiliated group members, including the bank entities within the group. The assessors cannot comment on whether such entities warrant near term inspections to ensure that market risk activities are properly controlled and understood by group management, but CBR's program of coordinated inspections for bank and non-bank entities of a group will be an important tool to address risks in such groups as the complexity of the market continues to evolve.</p>
<b>Principle 23</b>	<b>Interest rate risk in the banking book.</b> The supervisor determines that banks have adequate systems to identify, measure, evaluate, monitor, report and control or mitigate interest rate risk <sup>131</sup> in the banking book on a timely basis. These systems take into account the bank's risk appetite, risk profile and market and macroeconomic conditions.
<b>Essential criteria</b>	
<b>EC1</b>	Laws, regulations, or the supervisor require banks to have an appropriate interest rate risk strategy and interest rate RM framework that provides a comprehensive bank-wide view of interest rate risk. This includes policies and processes to identify, measure, evaluate, monitor, report, and control or mitigate material sources of interest rate risk. The supervisor determines that the bank's strategy, policies and processes are consistent with the risk appetite, risk profile and systemic importance of the bank, take into account market and macroeconomic conditions, and are regularly reviewed and appropriately adjusted, where necessary, with the bank's changing risk profile and market developments.
Description and findings re EC1	As with other material risks, including interest rate risk, the RM requirements are set out in Ordinance 3624-U. Chapter 1 requires "detection, evaluation, and aggregation" of the material risks—individual institution and group wide—while Chapter 2 requires a system of control (Section 2.1) for the material risks, including methods and procedures for RM.
<b>EC2</b>	The supervisor determines that a bank's strategy, policies and processes for the management of interest rate risk have been approved, and are regularly reviewed, by the bank's board. The supervisor also determines that senior management ensures that the strategy, policies and processes are developed and implemented effectively.

<sup>130</sup> Instruction 124-I does not permit the recognition of all hedging instruments (Paragraph 1.7.2). Furthermore, the instruction introduces a requirement that banks have certainty in relation to their transactions—i.e., "open FX positions can be managed through the purchase and sale of foreign currency and/or any other transactions with financial instruments denominated in a foreign currency if there is every reason to believe that the corresponding transaction will be exercised or there are no reasons that may prevent it from being exercised and which only permits the management of an open position "if there is every reason to believe that the corresponding transaction will be exercised or there are no reasons that may prevent it from being exercised" (Paragraph 2.2).

<sup>131</sup> Wherever "interest rate risk" is used in this Principle, the term refers to interest rate risk in the banking book. Interest rate risk in the trading book is covered under Principle 22.

Description and findings re EC2	<p>Section 2.3 of Ordinance 3624-U (inter alia) requires the board (supervisory board) of the credit institution (i.e., as appropriate, the parent credit institution of the banking group, subsidiary credit institution) to approve: the RM strategy of the credit institution; the procedure for managing the most material risks of the credit institution and control over its implementation.</p> <p>The board and executive management have responsibilities for setting the risk strategy and designing and implementing the policies and procedures of RM. The ordinance requires, at a minimum, an annual review of strategy, policies, and procedures.</p>
<b>EC3</b>	<p>The supervisor determines that banks' policies and processes establish an appropriate and properly controlled interest rate risk environment including:</p> <ul style="list-style-type: none"> <li>(a) comprehensive and appropriate interest rate risk measurement systems;</li> <li>(b) regular review, and independent (internal or external) validation, of any models used by the functions tasked with managing interest rate risk (including review of key model assumptions);</li> <li>(c) appropriate limits, approved by the banks' boards and senior management, that reflect the banks' risk appetite, risk profile and capital strength, and are understood by, and regularly communicated to, relevant staff;</li> <li>(d) effective exception tracking and reporting processes which ensure prompt action at the appropriate level of the banks' senior management or boards where necessary; and</li> <li>(e) effective information systems for accurate and timely identification, aggregation, monitoring and reporting of interest rate risk exposure to the banks' boards and senior management.</li> </ul>
Description and findings re EC3	<p>The requirements for interest rate RM procedures are chiefly established in Chapter 5 of the Annex to Ordinance 3624-U.</p> <p>In accordance with Clause 5.2 of Chapter 5 of the Annex to Ordinance 3624-U, the methods of interest rate assessment used by the credit institution shall cover all material sources of interest rate risk inherent to the operations (transactions) carried out by the credit institution sensitive to interest rate changes.</p> <p>The assumptions (for example, those used when determining the maturity term and cost of assets or liabilities) adopted within the framework of the interest rate risk assessment methodology shall be recorded in the documents of the credit institution developed within the framework of ICAAPs. The credit institution shall analyze the sensitivity of the interest rate risk assessment results to changes in the adopted assumptions. The correlation between the results of the interest rate risk assessment and the adopted assumptions shall be intelligible to the heads of divisions performing functions associated with risk assumption and management, as well as to the executive bodies of the credit institution.</p> <p>In accordance with Clause 5.3 of Chapter 5 of the Annex to Ordinance 3624-U, for the purposes of limiting interest rate risk, the credit institution shall establish:</p> <ul style="list-style-type: none"> <li>• a system of interest rate risk limits;</li> <li>• continuous control of compliance with the established limits at the credit institution (subsidiary credit institution);</li> <li>• procedures for immediate notification of the BoD (supervisory board) and executive bodies of the credit institution of violations of the established limits by the credit institution, and in</li> </ul>

	<p>the event the volume of the assumed interest rate risk exceeds the threshold established in the internal documents of the credit institution; and</p> <ul style="list-style-type: none"> <li>• measures for reducing the interest rate risk to be taken upon reaching the threshold level established in the documents of the credit institution developed within the framework of ICAAPs.</li> </ul> <p>General requirements for ICAAP reporting are stipulated in Chapter 6 of Ordinance 3624-U. In addition, in accordance with Clause 5.4 of Chapter 5 of the Annex to Ordinance 3624-U, the reports on interest rate risk to the BoD (supervisory board) and executive bodies of the credit institution shall include the following:</p> <ul style="list-style-type: none"> <li>• information on the current interest rates on the banking market and their changes;</li> <li>• information on the volume of interest rate risk for aggregate positions of the financial instruments sensitive to changes in interest rates;</li> <li>• information on the compliance of positions of the financial instruments sensitive to changes in interest rates with the established limits;</li> <li>• stress testing results;</li> <li>• opinions (expert assessments) of analysts on interest rate changes in the long term;</li> <li>• information on forecast values of indicators for financial instruments sensitive to interest rate changes (for example, forecast of an outflow/inflow of on-demand deposits, or early/full loan repayment); and</li> <li>• information on the results of interest rate risk measurement by the method(s) used by the credit institution (the parent credit institution of the banking group).</li> </ul> <p>Please refer to CP 15 in respect of information systems.</p>
<b>EC4</b>	The supervisor requires banks to include appropriate scenarios into their stress testing programs to measure their vulnerability to loss under adverse interest rate movements.
Description and findings re EC4	<p>Chapter 5 of Ordinance 3624-U sets out the general expectations for designing stress tests, and Chapter 5, Section 5.2 requires stress testing of interest rate movements.</p> <p>See also EC13 of Principle 15, which is also applicable to IRRBB management.</p>
<b>Assessment of Principle 23</b>	<b>Largely Compliant</b>
Comments	<p>As in other risk focused areas, the regulatory framework has been enhanced. However, many of the new provisions that require banks to improve their risk management practices, including a greater emphasis on stress testing, are not yet fully in force.</p> <p>The Russian banking system has experienced sudden interest rate hikes in recent years, which put a premium on the effective management of interest rate risk in banks' balance sheets. Multiple industry commentators with whom the assessors met noted that there are, at present, limited options available to banks in terms of instruments to hedge interest rate risk. In this context, it becomes even more important for banks to develop meaningful stress scenarios and build management strategies to allow the banks to withstand any future shocks that might manifest. While the CBR is already aware that banks' stress testing programs are improving in quality, through the information gained via inspections and ARs, it is recommended that the CBR focus attention on the management of this risk to ensure that banks are forward looking and strategic in their planning.</p>

<b>Principle 24</b>	<b>Liquidity risk.</b> The supervisor sets prudent and appropriate liquidity requirements (which can include either quantitative or qualitative requirements or both) for banks that reflect the liquidity needs of the bank. The supervisor determines that banks have a strategy that enables prudent management of liquidity risk and compliance with liquidity requirements. The strategy takes into account the bank's risk profile as well as market and macroeconomic conditions and includes prudent policies and processes, consistent with the bank's risk appetite, to identify, measure, evaluate, monitor, report and control or mitigate liquidity risk over an appropriate set of time horizons. At least for internationally active banks, liquidity requirements are not lower than the applicable Basel standards.
<b>Essential criteria</b>	
<b>EC1</b>	Laws, regulations or the supervisor require banks to consistently observe prescribed liquidity requirements including thresholds by reference to which a bank is subject to supervisory action. At least for internationally active banks, the prescribed requirements are not lower than, and the supervisor uses a range of liquidity monitoring tools no less extensive than, those prescribed in the applicable Basel standards.
Description and findings re EC1	<p>The CBR has authority under the CBL to set prudential regulations on liquidity (Article 62). The CBL (Article 66) provides high level definitions of the numerator and denominator of the liquidity ratio and the CBL (Article 57) also provides the CBR with the authority to impose the liquidity coverage ratio (the LCR) for systemically important credit institutions.</p> <p>The CBR is in the process of implementing the Basel III liquidity framework for systemic institutions, a category that is defined based on the criteria of international activity, among others. As part of its adoption of the LCR, in the light of the scarcity of high quality liquid assets (HQLA) in the market, the CBR is making use of the Alternative Liquidity Approaches (ALA) and provides a committed liquidity facility (CLF) (Option 1 under Basel) and allows foreign currency HQLA to cover domestic currency liquidity needs (Option 2). In terms of future developments, and with respect to the Net Stable Funding Ratio (NSFR), the CBR plans to develop the methodology for the NSFR calculation by Russian banks for reporting (i.e., monitoring) purposes in 2016, with an implementation date in Russia planned for January 1, 2018, in accordance with the Basel timetable. The CBR has been participating in and contributing to the semi-annual BCBS Basel III monitoring exercises (Quantitative Impact Study (QIS)) on the NSFR since 2011. Banks have been kept informed of the CBR's implementation plans through press releases and industry dialogue.</p> <p>In 2014, the CBR adopted Regulation 421-P that sets the methodology for the LCR calculation on a standalone basis. The largest Russian banks with total assets of RUB 50 billion or more and (or) retail deposits of RUB 10 billion or more have had to report the LCR since July 2014, with the first report submitted on August 1, 2014.</p> <p>In 2015, the CBR adopted Regulation 510-P, which implements the Basel liquidity framework, including both the Basel LCR standard of January 2013 and also the September 2008 "Principles for Sound Liquidity Risk Management and Supervision." Regulation 510-P is based on Regulation 421-P and introduces the LCR on a consolidated basis for banking groups of systemically important banks and on a standalone basis for those systemically important banks which do not have a banking group to be met on an ongoing basis. Regulation 510-P adopts a phase-in schedule for the LCR, which is consistent with the Basel standard: 70 percent—from</p>

January 1, 2016; 80 percent—from January 1, 2017; 90 percent—from January 1, 2018; 100 percent—starting from January 1, 2019.

Non-systemic banks are subject to Regulation 139-I which establishes quantitative standards banks must maintain and includes three liquidity ratios: instant (N2), current (N3), and long term (N4), which address current, one month, and over one-year maturity liquidity horizons, respectively. Banks must comply with the statutory ratios established by Instruction 139-I on a daily basis (Section 9.1). Conformity with the ratios is assessed based on monthly or more frequent reports (Chapter 10 of Instruction 139-I), and information on the level of liquidity ratios is used on a quarterly basis for the assessment banks' economic position as set out in Ordinance 2005-U (see also CP8).

The Instant ratio (N2) is calculated on the basis of original contractual maturity and liquid assets and must be greater than or equal to 15 percent of on-demand liabilities. Liquid assets are cash or financial assets with one-day maturity, are on demand, or can be sold with immediate effect. Placements with the CBR, domestic banks, Vnesheconombank, banks of countries with country risk assessments of 0 or 1, or high-income countries which are OECD and/or Eurozone members, the International Bank for Reconstruction and Development, the International Financial Corporation, and the European Bank for Reconstruction and Development are eligible as liquid assets.

The current (N3) ratio requires banks to hold at least 50 percent of one-month liabilities in the form of liquid assets with residual maturity of one month.

The long term (N4) ratio requires banks to hold at least 120 percent of liabilities with a residual maturity of over one year in the form of liquid assets with residual maturity of more than one year. The denominator for N4 includes total capital.

Bank liabilities include loans and deposits received by the bank, but not the bank's traded debt, not including the sum of a subordinated loan or deposit received by the bank in the amount of its residual cost included in the calculation of bank equity (capital), as well as debt instruments of the bank traded on the market and maturing in more than 365/366 calendar days.

The CBR has issued recommendations on liquidity management in Letter 139-T (which was issued in 2007, predating the BCBS Sound Principles on Liquidity Risk Management) and in Letter 15-1-4/536 (in 2008), which is based on the BCBS document. The CBR recommendations call for (i) clear identification of units in the bank responsible for developing and implementing policy and decision making with regard to liquidity policy; (ii) a mandatory information system for the collection and analysis of information on liquidity; (iii) descriptions of liquidity forecasting systems; (iv) asset/liability analysis and decision-making procedures; (v) liquidity stress testing, including a worst case scenario; (vi) liquidity contingency plans; and (vii) analysis of the linkages between a bank's FX operations and its liquidity, and its liquidity in FX, also by currency.

CBR Letter 26-T covers liquidity risk in its instructions for onsite inspections. It requires that inspectors review the presence of management approved written policies and procedures for liquidity risk, as well as liquidity monitoring practices.

	Ordinance 3624-U sets the qualitative requirements for internal risk-management procedures, including liquidity risk, that include appropriate board and senior management oversight, appropriate risk measurement, monitoring, and control functions, and comprehensive internal controls.
<b>EC2</b>	The prescribed liquidity requirements reflect the liquidity risk profile of banks (including on- and off-balance sheet risks) in the context of the markets and macroeconomic conditions in which they operate.
Description and findings re EC2	<p>The LCR calculations (Regulations 421-P and 510-P) require consideration of on and off-balance sheet assets and liabilities (e.g., Regulation 421, Chapter 1, Paragraph 1.4).</p> <p>Regulation 510-P, Annex 1, Paragraph 5 requires the institution to have due regard for characteristics based on predictions of customer behavior, including the state of the financial markets in normal and stressed times.</p> <p>The calculations of liquidity ratios required to be met under Instruction 139-I include on- and off-balance sheet items (repo style transactions, guarantees, etc.).</p>
<b>EC3</b>	The supervisor determines that banks have a robust liquidity management framework that requires the banks to maintain sufficient liquidity to withstand a range of stress events, and includes appropriate policies and processes for managing liquidity risk that have been approved by the banks' boards. The supervisor also determines that these policies and processes provide a comprehensive bank-wide view of liquidity risk and are consistent with the banks' risk profile and systemic importance.
Description and findings re EC3	<p>As with other material risks, Ordinance 3624 sets standards for liquidity RM, in particular Chapter 6 of the Annex. Identification, control, strategy, policies, and procedures must be approved by the board (Chapters 1 and 2), stress testing requirements apply (Chapter 5), and Chapter 6 of the Annex, Section 6.2 specifically requires the institution to establish procedures to respond to unforeseen liquidity pressures.</p> <p>Through Letter 119-T, the CBR has issued general guidance on CG in banks, including recommendations to provide for approval of the risk appetite and RM policies and processes, review of risk limits, and monitoring by executive bodies of the bank's risks. Letter 139-T also makes recommendations on the monitoring of the quality and objectives of bank's RM strategies. Letter 26-T on onsite inspections stipulates that inspectors should review whether a management-approved, written, internal strategy exists that defines liquidity RM policies and the policy for monitoring the status of the bank's liquidity. This strategy should be updated in a timely way, as needed. The CBR may ask for more frequent reporting of liquidity positions and conduct special visits to discuss funding and liquidity.</p> <p>Should an assessment reveal non-conformity with the requirements set by the CBR and (or) the nature and scope of operations performed by a credit institution (in a banking group), the level and combination of risks assumed, the CBR is obliged to send the credit institution a direction to remedy and rectify the matter.</p> <p>Principles 1 and 3 of Annex 1 of Regulation 510-P set the requirement that the parent credit institution of the banking group shall ensure the design of an efficient liquidity RM system to maintain an adequate level of liquidity and shall develop the liquidity RM strategy and policy,</p>

	<p>including the implementation procedure for the purpose of liquidity RM in accordance with the established risk appetite, as well as the maintenance of a sufficient level of liquidity. Each bank should update the strategy and policies on a regular basis.</p> <p>In addition to the ordinances setting out the LCR framework and standards, all banks are also subject to quarterly assessment under Ordinance 2005-U with respect to the monitoring and management of liquidity. The evaluation of the economic position of banks' liquidity is carried out in the context of Chapter 3 of the ordinance (i.e., the quantitative indicators noted in EC1), and the internal controls and RM are assessed through Annexes 6 and 8.</p>
<b>EC4</b>	<p>The supervisor determines that banks' liquidity strategy, policies and processes establish an appropriate and properly controlled liquidity risk environment including:</p> <ul style="list-style-type: none"> <li>(a) clear articulation of an overall liquidity risk appetite that is appropriate for the banks' business and their role in the financial system and that is approved by the banks' boards;</li> <li>(b) sound day-to-day, and where appropriate intraday, liquidity RM practices;</li> <li>(c) effective information systems to enable active identification, aggregation, monitoring and control of liquidity risk exposures and funding needs (including active management of collateral positions) bank-wide;</li> <li>(d) adequate oversight by the banks' boards in ensuring that management effectively implements policies and processes for the management of liquidity risk in a manner consistent with the banks' liquidity risk appetite; and</li> <li>(e) regular review by the banks' boards (at least annually) and appropriate adjustment of the banks' strategy, policies and processes for the management of liquidity risk in the light of the banks' changing risk profile and external developments in the markets and macroeconomic conditions in which they operate.</li> </ul>
Description and findings re EC4	<p>The CBR adopts on and offsite techniques to evaluate banks' liquidity strategy, policies, and processes.</p> <p>Internal liquidity RM procedures are assessed as a part of the overall bank's management assessment under Ordinance 2005-U (Chapter 3 and Annexes 6 and 8), and in future this will be complemented by assessment under Ordinance 3883-U.</p> <p>As noted above, Ordinance 3624 sets standards to ensure identification, evaluation, and aggregation of liquidity risk (Chapter 1), and a risk control and management environment (Chapter 2). Liquidity risk standards are further reinforced for systemic institutions through Regulation 510-P, which requires that the parent credit institution of the banking group develop a liquidity RM strategy and policy. A requirement to monitor intra-day liquidity is imposed on systemic banks via Regulation 510-P (Annex 1, paragraph 8).</p> <p>The existence and effectiveness of a bank's approach is reviewed through inspections as well as offsite scrutiny of relevant documentation. Based on Letter 26-T, inspectors review whether the bank has a special unit or dedicated staff responsible for the development of a liquidity RM strategy. Existence of a management information system for liquidity risk is also checked, as well as management's and the board's regular review of liquidity policies and practices. Particular attention is given to measures taken by the board to enforce the internal policies and processes. Ordinance 1379-U on access to the deposit insurance system also requires (Appendix IV)</p>



	information on the implementation of liquidity management policies and procedures, including whether they are monitored on a consistent and continuous basis.
<b>EC5</b>	<p>The supervisor requires banks to establish, and regularly review, funding strategies and policies and processes for the ongoing measurement and monitoring of funding requirements and the effective management of funding risk. The policies and processes include consideration of how other risks (e.g., credit, market, operational and reputation risk) may impact the bank's overall liquidity strategy, and include:</p> <ul style="list-style-type: none"> <li>(a) an analysis of funding requirements under alternative scenarios;</li> <li>(b) the maintenance of a cushion of high quality, unencumbered, liquid assets that can be used, without impediment, to obtain funding in times of stress;</li> <li>(c) diversification in the sources (including counterparties, instruments, currencies and markets) and tenor of funding, and regular review of concentration limits;</li> <li>(d) regular efforts to establish and maintain relationships with liability holders; and</li> <li>(e) regular assessment of the capacity to sell assets.</li> </ul>
Description and findings re EC5	<p>The consideration of funding is largely found in the annex to Regulation 510-P.</p> <ul style="list-style-type: none"> <li>(a) Analysis of funding requirements under alternative scenarios: the parent of a banking group must conduct various short and long term stress scenarios and shall take account of these results in fine tuning its strategy and policies (Annex 1, Paragraph 10).</li> <li>(b) High quality, unencumbered, liquid assets: the requirements to hold a cushion of high quality, unencumbered, liquid assets that can be used, without impediment, to obtain funding in times of stress are set by Chapter 2 (2.12) of Regulation 421-P and Regulation 510-P (Annex 1, Paragraphs 1 and 9 and, in particular, Paragraph 12).</li> <li>(c) Diversification (including counterparties, instruments, currencies and markets) and tenor of funding, and regular review of concentration limits: the parent of the banking group is obliged to maintain and refresh (at least annually) a funding strategy that ensures diversification of funding sources by classes and time periods (Annex 1, paragraph 7).</li> <li>(d) Establish and maintain relationships with liability holders; and (e) regular assessment of the capacity to sell assets: the parent of a banking group is required to maintain a continual presence in financial markets selected by it for funding purposes as well as stable relationships with creditors and other parties providing funds. The parent credit institution (credit institution) should regularly assess its own ability and that of its banking group members (if any) to promptly raise funds from each funding source. The parent credit institution (credit institution) should identify and carefully control the key fund raising factors in order to secure its own ability to raise funds (Annex 1, Paragraph 7). Further, under Paragraph 2.11 of Regulation 510-P, the parent credit institution (credit institution) should regularly assess the availability of an active market for high quality liquid assets and the possibility to use these high quality liquid assets to raise funds (access to the market) in accordance with Clauses 2.1 and 2.2 of Regulation 421-P.</li> </ul> <p>The CBR has regard to access to funding and a parent credit institution (credit institution) must submit to the CBR an analysis of the possible immediate sale and/or transfer as a security under asset fund-raising transactions included in the HQLA, including the availability of an active market and the access of the parent credit institution (credit institution) to this market (including confirmation of transactions made with a representative share of these assets during the period preceding the calculation date of the liquidity coverage ratio without a material loss in their value)</p>

	and information on the absence of any statutory, regulatory, contractual, or any other restrictions on such transactions.
<b>EC6</b>	The supervisor determines that banks have robust liquidity contingency funding plans to handle liquidity problems. The supervisor determines that the bank's contingency funding plan is formally articulated, adequately documented and sets out the bank's strategy for addressing liquidity shortfalls in a range of stress environments without placing reliance on lender of last resort support. The supervisor also determines that the bank's contingency funding plan establishes clear lines of responsibility, includes clear communication plans (including communication with the supervisor) and is regularly tested and updated to ensure it is operationally robust. The supervisor assesses whether, in the light of the bank's risk profile and systemic importance, the bank's contingency funding plan is feasible and requires the bank to address any deficiencies.
Description and findings re EC6	<p>Currently, domestic systemically important banks are obliged to compile recovery plans which include measures for dealing with liquidity problems.</p> <p>According to Regulation 510-P (Paragraph 11 of Annex 1), the parent credit institution (credit institution) must approve the formal action plan aimed at ensuring business continuity and/or the business recovery of the parent credit institution (credit institution) and/or banking group members if any non-standard or emergency situations arise.</p> <p>This plan should include the management policy for various crisis situations, the allocation of authority and responsibilities among employees, business units, and executive bodies of the parent credit institution (credit institution) and banking group members, and detailed implementation procedures. To ensure the sustainability of operations, the plan requires regular audits (testing) and review (at least annually).</p> <p>All banks are required to develop plans aimed at ensuring business continuity and/or business recovery under Regulation 242-P and to include one section specifically directed at emergency liquidity (Appendix 5, Section 9.2.4).</p>
<b>EC7</b>	The supervisor requires banks to include a variety of short-term and protracted bank-specific and market-wide liquidity stress scenarios (individually and in combination), using conservative and regularly reviewed assumptions, into their stress testing programs for RM purposes. The supervisor determines that the results of the stress tests are used by the bank to adjust its liquidity RM strategies, policies and positions and to develop effective contingency funding plans.
Description and findings re EC7	<p>Banks must have regard to general requirements for stress tests provided by Chapter 5 of Ordinance 3624-U. For systemic risk assessment purposes, the CBR conducts a semi-annual survey among the top 30 banks on their FX liquid assets and liabilities. Banks are asked to provide information both on the contractual and expected redemption schedule. This information is used for CBR planning of foreign currency liquidity provision to banks.</p> <p>According to Regulation 510-P (to Paragraph 10 of Appendix 1), for the purposes of identifying any potential liquidity problems and confirming that current liquidity is consistent with the liquidity risk level established by the parent credit institution (credit institution), the parent credit institution (credit institution) regularly (at least annually or more frequently during the periods of stress) should carry out stress tests under different short and long-term scenarios, including crisis event scenarios that are related either to the activity of the parent credit institution and the</p>

	<p>banking group members (credit institution) or to the entire market (individually or as a combination of scenarios), in accordance with Ordinance 3624-U.</p> <p>The parent credit institution (credit institution) should consider the results of the stress tests and update its strategy, liquidity management policy, asset and liability management policy, and also develop action plans aimed at ensuring going concern assumptions and/or the business recovery of the parent credit institution (credit institution) and/or banking group members in cases where any non-standard or emergency situations arise.</p> <p>The parent credit institution (credit institution) must disclose stress testing results to the CBR.</p> <p>Under Ordinance 2005-U, the supervisor must assess the adequacy of the bank's stress testing approach, bearing in mind whether the testing is commensurate with the scale and nature of the bank's activities.</p>
<b>EC8</b>	<p>The supervisor identifies those banks carrying out significant foreign currency liquidity transformation. Where a bank's foreign currency business is significant, or the bank has significant exposure in a given currency, the supervisor requires the bank to undertake separate analysis of its strategy and monitor its liquidity needs separately for each such significant currency. This includes the use of stress testing to determine the appropriateness of mismatches in that currency and, where appropriate, the setting and regular review of limits on the size of its cash flow mismatches for foreign currencies in aggregate and for each significant currency individually. In such cases, the supervisor also monitors the bank's liquidity needs in each significant currency, and evaluates the bank's ability to transfer liquidity from one currency to another across jurisdictions and legal entities.</p>
Description and findings re EC8	<p>The CBR does not impose particular requirements on banks with regard to foreign currency liquidity. Ordinance 2332-U, however, requires the most active banks to file data on foreign currency dealings on a daily basis, and all banks are subject to the daily open position limits according to Instruction 124-I. Most significant Russian banks have currency dealings in only a limited number of currencies, and have strategies to manage their liquidity in these currencies. Through the extensive prudential reporting and open position reporting and the daily information from the major banks, the CBR can follow developments. The CBR has been in contact with the major banks on their responses to the recent liquidity difficulties.</p> <p>Consistent with the Basel standard of Regulation 510-P (Paragraph 1.9) and Regulation 421-P (Paragraph 5.2), the LCR is calculated and reported separately for operations in rubles and in each significant foreign currency. A currency is recognized as significant if the sum of on and off-balance sheet liabilities denominated in that currency equals or is greater than 5 percent of the total on and off-balance sheet liabilities. As under Basel III, banks are expected to maintain HQLA consistent with the distribution of their liquidity needs by currency. Regulation 510-P on the LCR requires that high-quality liquid assets denominated in foreign currencies be included in the numerator of the LCR in an amount not exceeding the net cash outflow in this foreign currency.</p> <p>More generally, Regulation 510-P sets consistent requirements for the parent bank to monitor FX liquidity in aggregate and by significant currency (see Chapters 1, 2, and 5 as well as Annex 1, Principles 6, 9, and 12).</p>

	<p>Since 2014, the CBR has carried out a regular stress testing exercise on FX liquidity for the 30 largest banks. The CBR collects daily reports from the interbank market to assess bank by bank availability of liquidity, rates, and volumes of flows. The CBR has expanded its toolkit to be able to provide liquidity more rapidly, e.g., through a wider range of acceptable collateral. In 2013, the CBR introduced a weekly reporting form covering banks' liquidity situation and buffers.</p>
<b>Assessment of Principle 24</b>	<b>Largely Compliant</b>
Comments	<p>For systemic banks, which are defined based on the criterion of international activity (among others), the CBR liquidity metrics and RM standards are well developed and reflect the components of this core principle. The CBR's understanding and responsiveness with respect to liquidity risk issues commands industry respect. The new standards are in force as of January 1, 2016. They are, however, not fully implemented yet in the sense that while banks must adhere to the new standards, the CBR is at the outset of its scrutiny of whether the banks are meeting the new standards as intended. At the time of the assessment, there had been three monthly reporting dates under the new standard.</p> <p>At the time of the assessment, quantitative and qualitative standards and the CBR's scrutiny of banks with respect to liquidity was transitioning from a reliance on the methodology set out in Ordinance 2005-U to the new standards. As noted throughout the assessment and in particular in CP8, Ordinance 2005-U provides a structured methodology for examining quantitative and qualitative risks, but it is the introduction of Ordinance 3624-U (and its assessment under Ordinance 3883-U) that will provide a more robust and complete approach to the examination of the effectiveness of banks' liquidity RM capacities for all banks on a solo and consolidated basis.</p> <p>To illustrate the transitional nature of practice at the time of the assessment, in terms of liquidity RM, the assessors were informed, for example, that the process of overviewing of all internal documents of SIBs in the field of liquidity risk and RM was initiated in January. This does not mean that the CBR has been inactive, as it was already the CBR's practice to analyze liquidity stress scenarios and contingency plans of the banks and send additional recommendations if needed. However, on balance, at this early stage it is hard to determine the extent to which the new framework is fully in force and actively monitored. Indeed, it should be noted that a positive finding of the assessment, based on discussions with the CBR and institutions, is that it appears that the quality of banks' RM, on average, has been enhanced in recent years, and that banks are more aware of the nature of liquidity risks.</p> <p>For the nonsystemic banks, to whom the full LCR metrics and management standards will not apply, it is harder to determine that the criteria of this principle are fully met, even taking into account the principle of proportionality, the use of Ordinance 2005-U, and the fact that Ordinance 3624-U will apply to all banks in due course. While Ordinance 3624 provides a good foundation for RM purposes, it lacks specificity in a number of respects—for example the various dimensions of funding risk—and it is not obvious that the 2008 sound principles for liquidity RM would act as sufficient grounds for the CBR to take binding corrective actions. It is, of course, noted that all Russian banks are subject to the three mandatory liquidity ratios set out in Instruction 139-I, but the key concern of the assessors relates to the liquidity RM dimension as opposed to the liquidity metrics, and the specific concerns held by the assessors are noted in the paragraph below.</p>

	<p>In practice, the de facto separation of the banking sector into systemic and non-systemic institutions for liquidity risk purposes has meant that some very clear and practical requirements are not applied on a mandatory basis to the non-systemic institutions. It is recommended that the CBR consider extending its regulations to the non-systemic sector, in a proportionate nature, in respect of the funding and requirements that are currently found in Regulation 510-P.</p> <p>Additionally, and while recognizing that the requirements around business continuity as set out in Regulation 242-P include reference to liquidity contingency, these requirements could be usefully enhanced in the manner found in Regulation 510-P.</p> <p>Subsequent to the assessment mission, the Basel Committee published the report of the Regulatory Consistency Assessment Programme (RCAP) on the Assessment of Basel III LCR regulations for Russia and found the Russian implementation to be compliant.</p>
<b>Principle 25</b>	OR. The supervisor determines that banks have an adequate OR management framework that takes into account their risk appetite, risk profile and market and macroeconomic conditions. This includes prudent policies and processes to identify, assess, evaluate, monitor, report and control or mitigate OR <sup>132</sup> on a timely basis.
<b>Essential criteria</b>	
<b>EC1</b>	Law, regulations or the supervisor require banks to have appropriate OR management strategies, policies and processes to identify, assess, evaluate, monitor, report and control or mitigate OR. The supervisor determines that the bank's strategy, policies and processes are consistent with the bank's risk profile, systemic importance, risk appetite and capital strength, take into account market and macroeconomic conditions, and address all major aspects of OR prevalent in the businesses of the bank on a bank-wide basis (including periods when OR could increase).
Description and findings re EC1	<p>In the 2008 BCP assessment, it was observed that the CBR did not have specific binding regulations on OR management in place at that time, but had issued recommendations through Letter 76-T on "The Organization of Operational Risk at Lending Institutions," and Directive 92-T on "The Organization of Legal Risk and Reputational Risk." These regulations are still in force. Other relevant regulations include CBR Letter 26-T of March 23, 2007 defining inspection procedures for RM, including OR.</p> <p>Additional norms and guidance have been issued such as:</p> <ul style="list-style-type: none"> <li>• Ordinance 3624-U of April 15, 2015 "On Requirements to Risk Management and Capital Management of Lending Institution and Banking Group (ICAAP)";</li> <li>• CBR Letter 69-T of May 16, 2012 that suggest banks to adopt the BCBS recommendations "Principles for the Sound Management of Operational Risk";</li> <li>• CBR Regulation 346-P of November 3, 2009 prescribing the calculation of OR according to the Basic Indicators Approach of Basel II accord.</li> </ul> <p>Pursuant to the abovementioned norms, banks are required to implement policies and processes in order to evaluate and manage the exposure to OR. For that purpose, banks shall determine risk factors and events related to OR. Procedures should be established to ensure that OR management is assessed by the internal audit department. Special attention should be paid to any events that</p>

<sup>132</sup> The committee has defined OR as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. The definition includes legal risk but excludes strategic and reputational risk.

	<p>may cause OR losses and measures to mitigate their cause. In that respect, banks must have and constantly update their OR losses data base.</p> <p>In addition, banks need to have in place contingency and business continuity plans in order to ensure their ability to operate on an ongoing basis and limit losses in the event of severe business disruption.</p> <p>Ordinance 3624-U and Letter 26-T detail the supervisory expectations on OR. For the purpose of assessing the bank's management of OR, CBR examiners are required to check if the bank has internal documents approved by the managerial body that define the following:</p> <ul style="list-style-type: none"> <li>• the basic principles of OR;</li> <li>• the procedure for and the methods of detecting, evaluating, monitoring and controlling and/or minimizing OR;</li> <li>• procedures for regulating banking risks stemming from outsourcing.</li> </ul> <p>In order to determine that the bank's strategy, policies, and processes are consistent with the bank's risk profile, systemic importance, and other requirements, the CBR has developed a series of guidance (inspection methodology in Letter 26-T) for controlling OR in the context of the overall RM system of a bank. For the purpose of substantiating the conclusions drawn up by the inspection team in relation to RM, CBR examiners will use a series of indicators for each type of material risk, including for OR. The indicators will be determined on the basis of a series of questions to be addressed by the inspection team. These indicators will then be used to assign a 4 level rating (ranging from good to unsatisfactory) for establishing the quality and adequacy of RM. To that end, for evaluating OR management, CBR examiners will consider a set of questions such as: does the bank have and utilize in-house documents dedicated to OR management? Have these documents been approved by senior management? Does the internal audit assess OR procedures? Do the procedures in place ensure the preservation and the possibility of restoration of bank's information system?</p>
<b>EC2</b>	<p>The supervisor requires banks' strategies, policies and processes for the management of OR (including the banks' risk appetite for OR) to be approved and regularly reviewed by the banks' boards. The supervisor also requires that the board oversees management in ensuring that these policies and processes are implemented effectively.</p>
Description and findings re EC2	<p>The new Article 11.1.1 of the banking law (introduced in 2013) defines the different roles and duties assigned to the BoD that includes, inter alia, approving the strategy for managing a credit institution's risks and capital, including measures aimed at ensuring capital adequacy and liquidity to cover risks related both to the credit institution in general, and to particular areas of its activity, as well as approving the procedure for managing major risks of the credit institution and exercising control over the implementation of the said procedure. These provisions are broadly enough to encompass OR.</p> <p>Further, Regulation 76-T defines OR and recommends that a lending institution place the following issues under the authority of the supervisory board: (i) approval of the basic principles of the OR management strategy; (ii) adapting the organizational structure where needed to lower OR; (iii) assuring that the internal control system is adapted to the detection and management of OR, e.g., by creating a special unit for OR; (iv) putting in place business continuity plans; and (v) assessment of the effectiveness of OR management.</p>

	<p>Moreover, as stipulated in Ordinance 3624-U, Chapter 4, the competent management body of each bank should adopt and periodically review the bank's business and RM strategies and policies, part of which is the OR policy. In the same vein, the BoD approves and periodically reviews the strategies and policies for taking up, managing, monitoring, and mitigating the risks to which the bank is or might be exposed (see EC 15 for more details).</p>
<b>EC3</b>	<p>The supervisor determines that the approved strategy and significant policies and processes for the management of OR are implemented effectively by management and fully integrated into the bank's overall RM process.</p>
Description and findings re EC3	<p>Letter 26-T provides guidance to CBR examiners to verify whether strategy and policies for OR are implemented by management and fully integrated in the bank's overall RM process. The CBR staff will determine whether the BoD exercises continuous oversight of the bank's credit activities and related risks, including OR. Attention will also be paid to the quality and frequency of reporting sent to the BoD about risks and any deviation from limits. In the same spirit, in accordance with CBR Ordinance 3883-U that entered into force in 2016, the CBR assesses the quality of the RM system, including OR in the context of the ICAAP.</p> <p>During onsite visits, the CBR interviews the management of commercial banks, and onsite inspections at selected banks are conducted to see whether significant policies and processes for OR are implemented effectively by the management. Both middle and senior management are interviewed.</p>
<b>EC4</b>	<p>The supervisor reviews the quality and comprehensiveness of the bank's disaster recovery and business continuity plans to assess their feasibility in scenarios of severe business disruption which might plausibly affect the bank. In so doing, the supervisor determines that the bank is able to operate as a going concern and minimize losses, including those that may arise from disturbances to payment and settlement systems, in the event of severe business disruption.</p>
Description and findings re EC4	<p>In accordance with Regulation 242-P on internal controls, banks are required to have business continuity plans in place to address any potential disruptions and business continuity problems, which are to be listed, and especially address breakdowns in automated systems and their back-up. Recommendations regarding the preparation of business continuity plans are provided in Regulation 76-T as well as in Appendix to Regulation 242-P 5.<sup>133</sup></p> <p>According to Appendix 5, the disaster recovery and business continuity plans—called Continuity and Recovery of Activities Plan (hereafter C&amp;RA Plan)—is a set of internal documents defining the aims, objectives, procedure, and methods of measures to preserve or restore bank's essential functions—including payment activities—in cases of severe disruption. In particular, banks shall determine the procedure for designing, approving, reviewing, monitoring, and testing (at least once a year) C&amp;RA Plans and specifying the respective powers of the management bodies and units. Also, for each internal banking process that is critically important for the bank's business, the plan should contain a detailed list of resources, including human, financial, material, technical (e.g., computer hardware, other technical equipment, software), and means of communication required for maintaining banks' activities in emergency mode.</p>

<sup>133</sup> Recommendations on the structure and content of a plan of action aimed at providing for the continuity of activities and/or the recovery of the activities of the credit institution in case of non-standard events and emergencies, as well as for organizing an audit of its feasibility.



	<p>Regulation 242-P also stipulates that C&amp;RA Plans shall be developed with due consideration to a series of key factors, including, for example: (i) types and nature of possible unusual events and the severities of impacts on bank's activities; and (ii) list of critically important banking functions as well as automated information systems that enable their implementation. For SIFIs in particular, Article 57 of the CBL sets the obligation develop and present recovery plans to the CBR.</p> <p>In accordance with Regulation 26-T, inspectors review whether a bank has contingency plans in place to assure its continued operation in the event of severe business disruption.</p>
<b>EC5</b>	<p>The supervisor determines that banks have established appropriate information technology policies and processes to identify, assess, monitor and manage technology risks. The supervisor also determines that banks have appropriate and sound information technology infrastructure to meet their current and projected business requirements (under normal circumstances and in periods of stress), which ensures data and system integrity, security and availability and supports integrated and comprehensive RM.</p>
Description and findings re EC5	<p>There are no explicit binding requirements for banks to have information technology processes to identify, assess, monitor, and manage technology risks. There are, however, several norms in which technology risks are mentioned. Regulation 242-P requires that banks shall have effective internal controls to ensure, inter alia, information security and protection of bank's interests in the informational area. Regulation 1176-U on banks' business plans requires in Article 3.3.11 information about safeguarding the activity of the bank, including the material and technical base of the organization, as well as information on IT for the protection of information. The Law on Information, Information Technology, and Information Protection 149-FZ lays down requirements with regard to information security. Also, the CBR issued in 2006 the Standard STO BR IBBS 1.0 on "Ensuring Information Security at Russian Banking Institutions," and Executive order 346-R that provides a "Methodology for the Evaluation of Compliance with Information Security Measures."</p> <p>CBR Letter 47-T of 24 March, 2005 "On Methodological Recommendations for Conducting Examinations of and Assessing the Organization of Internal Audit in Credit Organizations" and CBR Letter 25-T of February 18, 2010 "On Methodical Recommendations about Carrying out Check and the Assessment of the Organization of Internal Control behind Application of Information Technologies in Credit Institutions (Their Branches)" recommend that onsite inspectors of the CBR pay attention to the existence and observance of the bank's rules for protecting information against unauthorized access, distribution of information, and existence of the bank's rules of internal control for the management of information flows and maintaining of information security.</p> <p>Letter 69-T of May 16, 2012 also recommends that banks apply the BCBS principles for the sound management of OR, in particular to use a comprehensive approach for exposing, appraising, monitoring, and managing technology risk. In the same vein, banks' management must organize robust technology infrastructure to meet their current and projected business requirements (under normal circumstances and in periods of stress).</p> <p>Lastly, there is Law 149-FZ of 27 July, 2006 "On Information, Information Technologies, and Information Protection," which lays down requirements with regard to information security.</p> <p>In practice, the verification of adherence to these principles is done both onsite and offsite.</p>

	<p>To that end, there is special Direction of Information dedicated to IT aspects that provides support to the Department of Bank Supervision. This Direction is specialized on information and technological issues and has necessary information and technological expertise. The composition of the inspection teams which perform onsite visits include specialists with the necessary competences to assess information and technological related issues. There is also separate division in CBR, which performs special activities for protection in the field of information technologies—Head Department of Safety and Information Security (GUBZI).</p>
<b>EC6</b>	<p>The supervisor determines that banks have appropriate and effective information systems to:</p> <ul style="list-style-type: none"> <li>(a) monitor OR;</li> <li>(b) compile and analyze OR data; and</li> <li>(c) facilitate appropriate reporting mechanisms at the banks' boards, senior management and business line levels that support proactive management of OR.</li> </ul>
Description and findings re EC6	<p>In the regulation on OR described in EC 1, banks are required to monitor OR, compile and analyze OR data, and facilitate an appropriate reporting mechanism. There are also several provisions requiring the establishment of appropriate reporting mechanisms at the bank's board and senior management levels.</p> <p>The mission was told that:</p> <ul style="list-style-type: none"> <li>(a) During onsite inspections, CBR examiners assess the banks' ability, including shortcomings in information systems, to gather information on operational OR.</li> <li>(b) The banks' ability to compile and analyze the gathered data is taken into consideration when the CBR assesses the effectiveness of the information systems through onsite inspections.</li> <li>(c) The quality of reporting mechanisms is also a part of the RM assessment.</li> </ul> <p>Regulation 242-P on internal control also requires internal control of automated information systems to include general control and software auditing. General control of automated information systems shall also involve auditing of computer systems. These aspects are also captured in the course of onsite visits according to the CBR.</p>
<b>EC7</b>	<p>The supervisor requires that banks have appropriate reporting mechanisms to keep the supervisor apprised of developments affecting OR at banks in their jurisdictions.</p>
Description and findings re EC7	<p>There are several reporting mechanisms on OR. CBR Regulation 346-P of November 3, 2009 defines the methodology for calculating the amount of OR for bank's capital adequacy ratio and reporting to the CBR. Regulation 242-P (discussed above) requires informing CBR within three business days of any material changes in a bank's internal control system, including control for the operation of the banking RM system and the banking risk assessment system. In addition, the ARs of the CBR residing in systemically important credit institutions are personally present at meetings of board (supervisory board) and executive authorities of credit institution. Therefore, they have the opportunity to analyze reports on OR management and alert the CBR of material events (fraud, disruption of business).</p>
<b>EC8</b>	<p>The supervisor determines that banks have established appropriate policies and processes to assess, manage and monitor outsourced activities. The outsourcing RM program covers:</p> <ul style="list-style-type: none"> <li>(a) conducting appropriate due diligence for selecting potential service providers;</li> <li>(b) structuring the outsourcing arrangement;</li> <li>(c) managing and monitoring the risks associated with the outsourcing arrangement;</li> <li>(d) ensuring an effective control environment; and</li> </ul>

	<p>(e) establishing viable contingency planning.</p> <p>Outsourcing policies and processes require the bank to have comprehensive contracts and/or service level agreements with a clear allocation of responsibilities between the outsourcing provider and the bank.</p>
Description and findings re EC8	<p>Currently, the legislation in force does not grant the CBR authority to establish outsourcing requirements for credit institutions.</p> <p>CBR Letter 76-T recommends that banks keep control over any delivery of services they use to perform their activities, as they remain liable in case something goes wrong. The CBR recommends that outsourcing be carried out on the basis of agreements that provide for a delegation of rights, responsibilities, and liability between the credit organization and the service provider. It is also recommended that banks specify in internal policies mechanism to manage risks associated with outsourcing.</p> <p>Also, Letter 26-T recommends that onsite inspectors pay attention to the risks associated with outsourcing, including:</p> <ul style="list-style-type: none"> <li>• the degree of importance of the outsourced functions to the credit organization’s activities and the risk of becoming dependent on the service provider;</li> <li>• whether the credit organization properly assesses the benefits of outsourcing and the potential for the transformation of one type of risk into another;</li> <li>• whether the outsourcing contract provides for the allocation of rights, obligations, and responsibility between the bank and the service provider;</li> <li>• whether the bank has instituted the necessary oversight of the quality of services.</li> </ul> <p>CBR Letter 69-T also recommends to banks using services of external providers, in order to manage the related risk:</p> <ul style="list-style-type: none"> <li>• to have procedures to determine which functions could be outsourced;</li> <li>• to conduct appropriate due diligence for selecting potential service providers;</li> <li>• to have robust principles of structuring the outsourcing arrangement (including property structure of service provider and confidentiality);</li> <li>• to manage and monitor risks associated with the outsourcing arrangement;</li> <li>• to ensure an effective control environment;</li> <li>• to establish viable contingency planning; and</li> <li>• to have comprehensive contracts and/or service level agreements with a clear allocation of responsibilities between the outsourcing provider and the bank.</li> </ul>
<b>Assessment of Principle 25</b>	<b>Largely Compliant</b>
Comments	<p>There are several aspects that would merit some improvements.</p> <p>The corpus of norms that govern OR is detailed, but with the exception of Ordinance 3624-U and Regulation 242-P on internal control, the rest of the relevant norms is made up essentially of recommendations from the CBR, which by their very nature are not binding. This is the case of Letter 76-T on the organization of OR at lending institutions and Directive 92-T on the organization of Legal Risk and Reputational Risk. The CBR has also recommended that the industry adopt the BCBS Principles for the sound management of OR, but these recommendations are not enforceable.</p>

	<p>During the discussions with the CBR, the assessors were left with the impression that OR does not receive the level of attention needed, mostly owing to scarce resources in the relevant field. Onsite OR examinations are performed as a subset of credit and market risk reviews. It is a compartmentalized approach in which the entire OR framework bank-wide is not assessed in a comprehensive way. As indicated by one of the interlocutors, it is a “customized approach.”</p> <p>In the same vein, there are no explicit information technology policies and processes to identify, assess, monitor, and manage technology risks. Further, the current legislation does not grant the CBR authority to establish outsourcing requirements for credit organizations. These principles about appropriate policies and processes to assess, manage, and monitor outsourced activities are contained in CBR recommendations that are not enforceable.</p> <p><b>Recommendations:</b></p> <ul style="list-style-type: none"> <li>• Convert CBR recommendations on OR into binding instruments with a view to establishing a general OR management framework that is comprehensive and mandatory.</li> <li>• Provide further guidance and requirements based on the BCBS documents “Principles for Effective Risk Data Aggregation and Risk Reporting” of January 2013, “High-Level Principles for Business Continuity” of August 2006, and “Outsourcing in Financial Services” of February 2005, which are applicable to banks and banking groups of all sizes and profiles.</li> <li>• Empower the CBR to establish outsourcing requirements and issue mandatory requirements in that regard.</li> </ul>
<b>Principle 26</b>	<b>Internal control and audit.</b> The supervisor determines that banks have adequate internal control frameworks to establish and maintain a properly controlled operating environment for the conduct of their business taking into account their risk profile. These include clear arrangements for delegating authority and responsibility; separation of the functions that involve committing the bank, paying away its funds, and accounting for its assets and liabilities; reconciliation of these processes; safeguarding the bank’s assets; and appropriate independent <sup>134</sup> internal audit and compliance functions to test adherence to these controls as well as applicable laws and regulations.
<b>Essential criteria</b>	
<b>EC1</b>	<p>Laws, regulations or the supervisor require banks to have internal control frameworks that are adequate to establish a properly controlled operating environment for the conduct of their business, taking into account their risk profile. These controls are the responsibility of the bank’s board and/or senior management and deal with organizational structure, accounting policies and processes, checks and balances, and the safeguarding of assets and investments (including measures for the prevention and early detection and reporting of misuse such as fraud, embezzlement, unauthorized trading and computer intrusion). More specifically, these controls address:</p> <p>(a) organizational structure: definitions of duties and responsibilities, including clear delegation of authority (e.g., clear loan approval limits), decision-making policies and processes,</p>

<sup>134</sup>In assessing independence, supervisors give due regard to the control systems designed to avoid conflicts of interest in the performance measurement of staff in the compliance, control and internal audit functions. For example, the remuneration of such staff should be determined independently of the business lines that they oversee.

	<p>separation of critical functions (e.g., business origination, payments, reconciliation, RM, accounting, audit and compliance);</p> <p>(b) accounting policies and processes: reconciliation of accounts, control lists, information for management;</p> <p>(c) checks and balances (or “four eyes principle”): segregation of duties, cross-checking, dual control of assets, double signatures; and</p> <p>(d) safeguarding assets and investments: including physical control and computer access.</p>
Description and findings re EC1	<p>The powers of the CBR with respect to establishing requirements for the internal control system of banks and banking groups are established in the CBL (Article 57<sup>1</sup>), which is the basis of Regulation 242-P. Under the BBAL (Article 11<sup>1-2</sup>), a bank shall comply with the requirements for risk and capital management systems, internal control system, including the requirements for the activity of the head of the compliance service and the head of the internal audit division set by the CBR for banking groups.</p> <p>Pursuant to Regulation 242-P, internal control shall be exercised in keeping with the powers defined by the constituent and internal documents of a bank:</p> <ul style="list-style-type: none"> <li>• by the management bodies of a bank, provided for by BBAL (Article 11<sup>1</sup>);</li> <li>• by its inspection committee (inspector);</li> <li>• by the chief accountant (or his deputies) of a bank;</li> <li>• by the head (or his deputies) and the chief accountant (or his deputies) of a branch of a bank;</li> <li>• by the subdivisions and the employees exercising internal control, including: internal audit division, internal control service (compliance service), a responsible officer (structural division) is designated for efforts to counter money laundering and financing of terrorism and other structural subdivisions and/or responsible employees of the bank (depends on the character and the scale of operations performed, the level and the combination of risks accepted).</li> </ul> <p>In addition to the responsibilities assigned to the BoD (supervisory board) under the BBAL, the Law on Joint-Stock Companies and the Law on Limited Liability Companies, it is required under Regulation 242-P that the board also has the responsibility for creating and reviewing the effective operation of internal controls within the bank, including review of documents and ensuring the adoption of any measures recommended by the internal audit function or other parties such as the external auditor or supervisory authority.</p> <p>Under Regulation 242-P, it is further required that the executive management bodies of banks have the responsibility of implementing the decisions of the AGM and board, and implementing the bank’s strategy and policy with respect to the organization and exercise of internal control. It is the executive management to whom powers should be delegated to draw up rules and procedures in the area of internal control as well as oversight of the exercise of such powers. The executive management has responsibility for the allocation of duties to divisions and officers responsible for specific areas (forms, methods) of internal control.</p> <p>In particular, pursuant to Regulation 242-P the internal control system of a bank shall include the following:</p> <ul style="list-style-type: none"> <li>• control by management bodies of the organization of the activity of a bank;</li> </ul>

- control of the functioning of the system of management of bank risks and assessment of bank risks;
- control of the distribution of powers during the completion of banking operations and other transactions;

Procedures for allocating powers between divisions and officers, in accordance with Regulation 242-P, are to be established by the bank's internal policy and process documents and must include the following:

- reviews that management bodies conduct by requesting reports and information on the results of structural divisions' activities and explanations from the managers of these divisions for purposes of identifying oversight deficiencies, violations and errors;
- control by division managers in the form of reviews of reports on the work of their subordinates;
- material (physical) control in the form of reviews of restrictions on access to tangible assets, revaluations of tangible assets (cash funds, securities in certificate form, etc.), separation of responsibility for the safeguarding and use of tangible assets, and security arrangements at facilities used to store tangible assets;
- reviews of compliance with established limits on the execution of banking operations and other transactions, carried out by obtaining pertinent reports and comparing them with data in primary documents;
- a system for coordinating (approving) operations (transactions) and allocating powers for the execution of banking operations and other transactions that exceed the established limits; and
- reviews of compliance with procedures for executing banking operations and other transactions, reconciling accounts, and informing relevant managers of any deficiencies.

A bank must ensure that official duties are distributed among its officers in a manner that precludes any conflict of interests or conditions in which such conflicts could arise. The following powers must be segregated and may not be granted to one and the same division or officer:

- the power to execute banking operations and other transactions and accomplish their registration and/or recording in accounting documents;
- the power to approve payouts of funds and effect (execute) the actual payout of such funds;
- the power to carry out operations involving accounts of the bank's customers and accounts recording the bank's own financial and economic activities;
- the power to provide consulting and information services to the bank's customers and carry out operations with those same customers;
- the power to evaluate the reliability and completeness of documents submitted for purposes of obtaining loans and monitor the financial condition of a borrower;
- the power to take actions in other areas in which conflicts of interests could arise.

Requirements with respect to the organization of accounting are based on the provisions of the Law on Accounting, including with respect to compliance with the "four eyes" principle, and are set out in Regulation 385-P.

The CBR assesses the activities of the compliance function in the course of inspections as noted in Regulation 242-P (Chapter 5). Such inspections shall take place at least every three years. During the CBR's inspection (Section 5.2) it may seek confirmation of, for example:

	<ul style="list-style-type: none"> <li>• the observance of internal techniques, programs, rules and procedures, and also of fixed limits;</li> <li>• the authenticity, fullness, and objectivity of the systems of accounting and reporting, and the collection, processing, and storage of other data in keeping with the legislation of the Russian Federation; and</li> <li>• the reliability of the established methods of control applicable by the bank.</li> </ul>
<b>EC2</b>	The supervisor determines that there is an appropriate balance in the skills and resources of the back office, control functions and operational management relative to the business origination units. The supervisor also determines that the staff of the back office and control functions have sufficient expertise and authority within the organization (and, where appropriate, in the case of control functions, sufficient access to the bank's board) to be an effective check and balance to the business origination units.
Description and findings re EC2	<p>CBR regulations and practices require an assessment of senior personnel in a bank in relation to board, executive management, and those heading the control functions, established in provisions in the BBAL and as noted below.</p> <p>The internal audit function must have direct access to the board (supervisory board) of the bank. Qualification requirements apply to the members of the executive board, chief executive, and chief accountant and deputies, under the BBAL. These requirements include degree level legal or economic education, at least one-year's managerial experience (two years if the candidate has a different degree).</p> <p>Educational and work experience requirements apply to senior management and also the heads of internal audit and control functions.</p> <p>A bank must apply for approval of candidates for the specified positions to the CBR and will receive a response within one month. A refusal to grant approval is accompanied by an explanation. The bank must also notify the CBR, in writing, of the release of these individuals from their positions. The procedure for assessing compliance is set out in Regulation 408-P of October 25, 2013 "On the Procedure for Assessment of Compliance with Qualification and Reputational Requirements of Persons Cited in Article 11<sup>1</sup> of the Federal Law on Banks and Banking Activities and Article 60 of the Federal Law on the Central Bank of the Russian Federation and on the Procedure for Maintenance of the Database Envisaged by Article 75 of the Federal Law on the CBR."</p> <p>Pursuant to BBAL Article 11,<sup>1-2</sup> the head of the internal audit division or the head of the compliance service of a bank must comply with CBR qualification requirements set down in Ordinance 3223-U of April 1, 2014 "On Demands Made on the Heads of a Bank's Services for the Risk Management, Internal Control, and Internal Audit." The requirements also include educational (degree level) and relevant work experience. Work experience includes (Section 1.2):</p> <ul style="list-style-type: none"> <li>• minimum one year as the CEO (or deputy) of a bank, as a member of a bank's executive board or as the head (or deputy) of one of the following: RM, internal control, internal audit, the other lines of control, performance of banking transactions, risk area, or accounting; or</li> <li>• at least three years in the capacity of a specialist in one of the areas noted above; or</li> </ul>



	<ul style="list-style-type: none"> <li>• at least three years connected with the issues of methodology and assessment of the RM, internal control and (or) internal audit, or of the authorized bodies carrying out the regulation, control, and supervision in the area of financial markets or in the banking area.</li> </ul> <p>For these positions, the bank has three days to notify the CBR of an appointment, and the CBR can require further information for the purpose of assessing the individuals. Ordinance 3223-U does not specify that the CBR has to notify its approval. Continuous professional training is recommended for the head and the officers of the internal audit division and compliance service.</p>
<b>EC3</b>	<p>The supervisor determines that banks have an adequately staffed, permanent and independent compliance function<sup>135</sup> that assists senior management in managing effectively the compliance risks faced by the bank. The supervisor determines that staff within the compliance function is suitably trained, have relevant experience and have sufficient authority within the bank to perform their role effectively. The supervisor determines that the bank’s board exercises oversight of the management of the compliance function.</p>
Description and findings re EC3	<p>Regulation 242-P sets out the requirements for a bank’s internal control system, including its compliance function, which is required to execute its functions in the bank on a permanent basis.</p> <p>The bank shall establish the number of personnel, the structure and the material and technical reserves of the compliance service in accordance with the character and the scale of the operations performed and the level of compliance risk accepted by the bank.</p> <p>The independence of the compliance function is supported by requirements that if the head of the compliance service is not a member of a executive board of the bank, he/she shall be accountable to the CEO of the bank; the head of the compliance function may not participate in banking operations and other transactions; nor is it recommended that the head of the compliance function can be held on a part-time basis. The compliance function staff, including the head, shall be staff personnel of the bank (ie not outsourced). Staff serving in compliance, other than the head of the function, may combine their compliance role with other operational roles in the bank but the bank must have internal policies and measures to minimise and prevent conflict of interests. The bank’s policies document that the head of the compliance function shall have access to the information necessary for them to perform their duties, and as well as the obligations of the bank’s staff to provide such information.</p> <p>Regulation 242-P (Section 3.3.2) notes that the level of the qualifications of the employees, organisational changes, the fluctuation of personnel, etc.), and external factors (changes in economic conditions for the activity of the credit organisation, applicable technologies, etc.), which influence the credit organisation's activity, must be taken into account.</p> <p>The compliance function reports to the executive bodies at least on an annual basis regarding the execution and monitoring of compliance action plans and activities, not least the results of monitoring of business lines of the bank bearing a high level of compliance risk. Moreover, the</p>

<sup>135</sup> The term “compliance function” does not necessarily denote an organizational unit. Compliance staff may reside in operating business units or local subsidiaries and report up to operating business line management or local management, provided such staff also have a reporting line through to the head of compliance who should be independent from business lines.

	<p>head of the compliance function must immediately inform the CEO and executive board of the bank of any compliance risks that may entail significant losses for the bank.</p> <p>Furthermore, the CBR, in Letter 173-T, has circulated to banks, the BCBS guidance on “Compliance and the Compliance Function in Banks.”</p> <p>As noted in EC1, Chapter 5 of Regulation 242-P (Chapter 5) sets out in general terms the procedure for the CBR to assess the overall internal control system (inter alia that the bank meets the requirements of the regulation). Furthermore, reviews of the organization of internal control at banks, in keeping with Letter 47-T, also entail assessments of:</p> <ul style="list-style-type: none"> <li>• whether the bank’s internal documents are consistent with regulatory legal acts and other acts of the CBR, and whether the bank is adhering to them;</li> <li>• whether the bank is complying with regulations governing the organization and exercise of internal control.</li> <li>• In the course of reviews of the organization of internal control at banks, in keeping with Letter 47-T, ARs of the CBR determine: <ul style="list-style-type: none"> <li>○ whether the bank verifies compliance with procedures for executing banking operations and other transactions with simultaneous informing of the relevant bank managers as to identified violations, errors and deficiencies;</li> <li>○ whether the bank has internal documents setting forth procedures for monitoring of the internal control system by the bank’s BoD (supervisory board) and CEO and executive board, and whether these procedures are adhered to.</li> </ul> </li> </ul> <p>The staff of the chief inspectorate, but perhaps more particularly the ARs, have the onsite access to ascertain whether the internal control functions have appropriate skill, resources, and authority within the supervised institution. In the view of the CBR, the banks based in the urban centers have not struggled to attract suitably qualified and experienced staff, and many appointments have been international. Across the regions of the Russian Federation, expertise can be harder to come by.</p>
<b>EC4</b>	<p>The supervisor determines that banks have an independent, permanent and effective internal audit function<sup>136</sup> charged with:</p> <ul style="list-style-type: none"> <li>(a) assessing whether existing policies, processes and internal controls (including RM, compliance and CG processes) are effective, appropriate and remain sufficient for the bank’s business; and</li> <li>(b) ensuring that policies and processes are complied with.</li> </ul>
Description and findings re EC4	<p>Regulation 242-P requires (Section 4.5) that the bank must ensure that there is a permanent, independent, impartial internal audit function. A bank must also ensure the conditions for the uninterrupted effective exercise of the internal audit functions (see also EC5 below). The bank must ensure the independence of the internal audit division, in keeping with procedures establishing that the internal audit division:</p> <ul style="list-style-type: none"> <li>• Operates under the direct oversight of the BoD (supervisory board). In accordance with Regulation 242-P, work plans for the internal audit division must be approved by the BoD (supervisory board) of the bank, and reports on the implementation of review plans must be</li> </ul>

<sup>136</sup> The term “internal audit function” does not necessarily denote an organizational unit. Some countries allow small banks to implement a system of independent reviews, e.g. conducted by external experts, of key internal controls as an alternative.

submitted by the internal audit division to the BoD (supervisory board) at least twice a year. In keeping with Letter 119-T, banks are advised to establish in their internal documents a number of independent directors that is sufficient for maintaining balance, independence, and objectivity as regards the approval of work plans for the internal audit division and of adopted management decisions.

- May on its own initiative report to the BoD (supervisory board) on issues arising in the course of the internal audit division's performance of its functions and on proposals for resolving them, and may also disclose this information to the CEO and executive board of the bank.
- Accomplishes its tasks without interference on the part of the bank's management bodies or divisions or of officers who are not employees of the internal audit divisions.
- Does not engage in activities subject to reviews, i.e., is not authorized to participate in the conduct of banking operations and other transactions.
- Is subject to an independent review by the external audit organization or by the BoD (supervisory board) if such review is authorized by the bank's charter.
- Internal audit staff may not participate in inspections of departments or units of the bank in which they themselves had recently been employed.

The remit of the internal audit function, in accordance with Regulation 242-P, includes the oversight of the effectiveness of measures taken by divisions and management bodies, on the basis of review findings, to reduce the level of identified risks or to document the adoption by a division's management and/or by management bodies of decisions to the effect that the identified risks are acceptable to the bank. As noted above, the remit also includes oversight of timely notification of the bank's BoD (supervisory board) of decisions by the head of division and/or management bodies that a given risk is unacceptable to the bank.

In accordance with Regulation 242-P, the internal audit function must assess if policies, processes and internal controls are effective and complied with, for example, the internal audit function is responsible for:

- review and evaluation of the effectiveness of the internal control system as a whole, execution of decisions of the management bodies of the bank (general meeting of shareholders (participants), the BoD (supervisory board), and executive bodies of the bank);
- review of the completeness of the use and effectiveness of the methodology for assessing banking risks and of procedures for banking RM (methods, programs, regulations, and procedures for executing banking operations and transactions, and for banking RM);
- examining the operation of the internal system for overseeing the use of IT systems and databases;
- review of the reliability, completeness, objectivity, and timeliness of accounting and reporting;
- review of the techniques (methods) used to safeguard the bank's assets;
- evaluation of the economic advisability and effectiveness of the control operations conducted by the bank;
- review of internal control processes and procedures; and
- review of the compliance and RM services of the bank.

	<p>In the course of reviews of the organization of internal control at banks, in keeping with Letter 47-T, ARs of the CBR determine:</p> <ul style="list-style-type: none"> <li>• an assessment of the degree to which the bank’s organizational structure, from the standpoint of the distribution of powers between members of the bank’s BoD (supervisory board) and members of the executive board, the definition of the powers of a CEO, and the accountability and responsibility of all the bank’s divisions and officers, are consistent with the nature and scale of the operations conducted by the bank;</li> <li>• whether the internal documents provide for the independence of the internal audit division;</li> <li>• verification of the existence and quality of the internal document regulating the internal audit division’s activities;</li> <li>• whether the bank ensures the actual independence of the internal audit division;</li> <li>• whether the bank ensures impartiality on the part of the internal audit division;</li> <li>• a review of the organization of internal control as regards all aspects of the internal control system.</li> </ul> <p>Special attention is paid to: the internal audit division’s unimpeded and effective performance of its functions, including with respect to oversight of the effectiveness of measures taken on the basis of review findings; and periodic informing of the bank’s management bodies in respect of violations and deficiencies that may have been identified in the policies for monitoring measures to remedy violations identified by internal audit.</p> <p>The CBR explained that the internal documents setting out the governance, policies, and controls of the institution are treated very seriously and regarded almost as having the same gravity as the bank’s own “charter” or articles of association. In practice the assessment of internal control environment falls to the Chief Inspectorate. Firms with whom the assessors met noted that inspections pay attention to the quality of the control environment and whether documented policies and processes were followed in practice.</p>
<b>EC5</b>	<p>The supervisor determines that the internal audit function:</p> <ol style="list-style-type: none"> <li>(a) has sufficient resources, and staff that are suitably trained and have relevant experience to understand and evaluate the business they are auditing;</li> <li>(b) has appropriate independence with reporting lines to the bank’s board or to an audit committee of the board, and has status within the bank to ensure that senior management reacts to and acts upon its recommendations;</li> <li>(c) is kept informed in a timely manner of any material changes made to the bank’s RM strategy, policies or processes;</li> <li>(d) has full access to and communication with any member of staff as well as full access to records, files or data of the bank and its affiliates, whenever relevant to the performance of its duties;</li> <li>(e) employs a methodology that identifies the material risks run by the bank;</li> <li>(f) prepares an audit plan, which is reviewed regularly, based on its own risk assessment and allocates its resources accordingly; and</li> <li>(g) has the authority to assess any outsourced functions.</li> </ol>

Description and findings re EC5	<p><b>Staff resources</b></p> <p>Pursuant to Regulation 242-P, the bank must establish the staffing level, structure and technical equipment of the internal audit division in accordance with the scale of operations and the nature of the banking operations and transactions conducted (Section 4.6.1).</p> <p><b>Independence</b></p> <p>Regulation 242-P (specifically Section 4.7) provides for the independence of the internal audit function, including access and reporting lines to the board and executive management, both as part of a regular reporting cycle and upon its own initiative, and in response to findings in the course of its work.</p> <p><b>Risk management strategy</b></p> <p>In the first annex to Regulation 242-P, it is recommended that the bank's executive board have responsibility for the strategy for risk management and internal control.</p> <p><b>Access to staff and files</b></p> <p>The internal audit division is required to conduct reviews of all the bank's areas of activity, and review may focus on any division or office of the bank. Thus the manager and officers of the internal audit division have authority to:</p> <ul style="list-style-type: none"> <li>• enter the facilities of a division being reviewed, as well as facilities used to store documents (archives) and cash funds and valuables (safes), to process data (computer rooms), and to store data on machine media, given adherence to the access procedures specified in the bank's internal documents;</li> <li>• obtain documents, copies of documents, and other information, as well as any information available in the bank's information systems, that are needed in order to exercise oversight, given compliance with the requirements of Russian Federation laws and the requirements of the bank as regards working with information whose distribution is restricted;</li> <li>• enlist officers of the bank in the conduct of reviews and require them to provide access to documents and other information needed for the reviews.</li> </ul> <p><b>Methodology</b></p> <p>Appendix (3) to Regulation 242-P provides the principal methods of inspection the internal audit function must use. This methodology is periodically updated—most recently in April 2014. The methodology provides a comprehensive view of risks.</p> <p>Also, in accordance with Regulation 242-P, the internal audit inspection plan must take into account changes in the internal control system and new areas of activity at the bank.</p> <p><b>Audit plan prepared and reviewed</b></p> <p>Work plans for the internal audit division are to be drawn up by the internal audit division and must be approved by the BoD (supervisory board) of the bank.</p>
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	<p><b><i>Can assess any outsourced function</i></b></p> <p>Regulation 242-P requires that the internal audit function shall inspect all aspects of a bank's activity without exception, hence including any outsourcing (Section 4.10.1). In terms of the CBR's determination of the adequacy of the internal audit function, a review of the activity of the internal audit division, in accordance with Letter 47-T, must entail:</p> <ul style="list-style-type: none"> <li>• an assessment of the internal audit divisions's full performance of its functions, including as regards the internal audit division's unimpeded and effective performance of its functions, notably with regard to oversight of the effectiveness of measures taken on the basis of review findings by the bank's divisions and management bodies to reduce the level of identified risks; and</li> <li>• an assessment of the professional competence of the head and officers of the internal audit division (whether requirements have been established with respect to the professional competence of the head (his/her deputy) of the internal audit division and whether they are adhered to).</li> </ul> <p>A review of the organization of internal control at a bank, in keeping with Letter 47-T, must assess whether:</p> <ul style="list-style-type: none"> <li>• the bank's internal documents provide for the independence of the internal supervision office;</li> <li>• the bank ensures the actual independence of the internal audit division;</li> <li>• the bank ensures the impartiality of the internal audit division;</li> <li>• the internal audit division conducts reviews in accordance with a plan approved by the bank's BoD (supervisory board) or by an authority empowered by it;</li> <li>• the plan is commensurate with the bank's nature and scale of operations (whether the plan encompasses all significant activities of the bank);</li> <li>• the bank's internal documents establish procedures for informing relevant managers at the bank of factors (internal and external) that tend to increase the level of banking risks, and whether these procedures are observed; and</li> <li>• the bank's BoD (supervisory board), CEO or executive board are periodically informed of identified violations and deficiencies in the procedures established by internal documents for monitoring the adoption of measures to remedy violations identified by the internal audit division and deficiencies in the operation of the bank (or branch thereof).</li> </ul>
<b>Assessment of Principle 26</b>	<b>Compliant</b>
Comments	<p>The regulatory framework for the internal control environment has been refreshed within the past two years based on the important new powers in the CBL (Articles 57<sup>1</sup> and 57<sup>2</sup>) which permit the CBR to apply RM and internal control standards to supervised institutions.</p> <p>Regulation 242-P seeks to codify the three lines of defense model, and creates a framework that should ensure the independence and authority of the heads of internal audit, control, and RM and protect their direct communication with the BoD (supervisory board). Further, the regulation sets qualification standards and mandatory notification requirements to the CBR if there are changes to the individuals holding these positions.</p>

	The CBR has explained the central importance it places on supervised institutions creating and maintaining a control environment that is commensurate with the risk profile and scale of their business activities. Dialogue with industry representatives supported the view that the CBR pays close attention to the internal control systems and uses the inspection processes and also the position of the AR to verify that standards are upheld and observed.
<b>Principle 27</b>	<b>Financial reporting and external audit.</b> The supervisor determines that banks and banking groups maintain adequate and reliable records, prepare financial statements in accordance with accounting policies and practices that are widely accepted internationally and annually publish information that fairly reflects their financial condition and performance and bears an independent external auditor's opinion. The supervisor also determines that banks and parent companies of banking groups have adequate governance and oversight of the external audit function.
<b>Essential criteria</b>	
<b>EC1</b>	The supervisor <sup>137</sup> holds the bank's Board and management responsible for ensuring that financial statements are prepared in accordance with accounting policies and practices that are widely accepted internationally and that these are supported by recordkeeping systems in order to produce adequate and reliable data.
Description and findings re EC1	<p>Banks, the parent banks of banking groups, and the parent institutions of bank holding companies are required to maintain their accounting records in accordance with the requirements of Federal Law 402-FZ on Accounting. According to Article 3, the managers of the institution are responsible for the maintenance of accounting records.</p> <p>Under the law and in accordance with CBR regulations, banks must compile accounting (financial) statements following sectoral standards that are based on the IFRS, following the performance of a mandatory audit. The statements are prepared annually and submitted to the CBR, and disclosed to a wide range of users. Consolidated financial statements are also required to be submitted from the parent banks of banking groups and bank holding companies in accordance with Federal Law 208-FZ on Consolidated Financial Statements. In addition, in 2014 the law was amended so that banks that do not constitute a group according to the IFRS must nevertheless compile financial statements in accordance with the IFRS, submit them to the CBR, and publicly disclose following the mandatory audit.</p> <p>The Law on Accounting (Article 19) establishes that institutions whose accounting (financial) statements are subject to a mandatory audit must organize and perform internal control of the maintenance of accounting records and the compilation of accounting (financial) statements (with the exception of cases in which the manager himself has assumed responsibility for the maintenance of accounting records).</p>
<b>EC2</b>	The supervisor holds the bank's board and management responsible for ensuring that the financial statements issued annually to the public bear an independent external auditor's opinion as a result of an audit conducted in accordance with internationally accepted auditing practices and standards.
Description and findings re EC2	The BBAL (Article 8) establishes the obligation to disclose the annual accounting (financial) statements of a bank, the annual consolidated financial statements of the principal bank of a

<sup>137</sup> In this Essential Criterion, the supervisor is not necessarily limited to the banking supervisor. The responsibility for ensuring that financial statements are prepared in accordance with accounting policies and practices may also be vested with securities and market supervisors.



	<p>banking group, and the annual consolidated financial statements of the principal institution of a bank holding company to a wide range of users, following the procedure and within the deadlines established by the CBR.</p> <p>The disclosure procedure and deadlines are established by the following ordinances of the CBR:</p> <ul style="list-style-type: none"> <li>• 3081-U on the Disclosure by Banks of Information about their Activities (which establishes the procedure for the disclosure of annual accounting (financial) statements by banks);</li> <li>• 2923-U on the Publication and Submission of Consolidated Financial Statements by Banks (which establishes the procedure for the disclosure of consolidated financial statements compiled in accordance with the Law on Consolidated Financial Statements, i.e., in accordance with the IFRS, by the principal banks of banking groups); and</li> <li>• 3087-U on the Disclosure and Submission of Consolidated Financial Statements by Bank Holding Companies (which establishes the procedure and deadlines for the disclosure of consolidated financial statements of bank holding companies and their submission to the CBR by the principal institution of a bank holding company (the management company of a bank holding company if it has been assigned the responsibilities of the principal institution of the bank holding company)).</li> </ul> <p>The accounting (financial) statements of banks compiled in accordance with the Law on Accounting, and the consolidated financial statements of the parent banks of banking groups and the parent institutions of bank holding companies compiled in accordance with the IFRS, must be certified by the signatures of responsible officials: the manager and chief accountant. Said statements are publicly disclosed together with an auditor's opinion regarding their accuracy.</p> <p>According the Law on Auditing (Article 7), auditing activities are carried out in accordance with international auditing standards. International auditing standards adopted by the International Federation of Accountants will be applied within the Russian Federation as set out in Government Resolution 576 on Approval of the Regulation on the Recognition of International Auditing Standards Subject to Application within the Russian Federation. Resolution 576, and thus the international auditing standards, come into force on June 15, 2017. Until this date, Regulation 696-R, i.e., Russian Auditing Standards, will remain in force.</p> <p>The managers of an institution bear responsibility for the preparation of accounting (financial) statements and consolidated financial statements, for the organization of accounting at institutions, for compliance with the legislation in the performance of commercial operations, and for the compilation of complete and accurate information about an institution's activities and its property status according to the Law on Accounting and the IFRS.</p> <p>Should banks provide incomplete or inaccurate information, the CBR has powers under the BBAL (Article 19) and the CBL (Article 74) to apply supervisory measures.</p>
<b>EC3</b>	<p>The supervisor determines that banks use valuation practices consistent with accounting standards widely accepted internationally. The supervisor also determines that the framework, structure and processes for fair value estimation are subject to independent verification and validation, and that banks document any significant differences between the valuations used for financial reporting purposes and for regulatory purposes.</p>

Description and findings re EC3	<p>The Law on Accounting provides for the application of the IFRS as the basis for the development of national accounting standards. CBL Article 57 grants the CBR the right to establish rules for the performance of banking operations, accounting, and reporting for banks and banking groups, and the CBR has issued mandatory rules for accounting by banks—CBR Regulation 385-P.</p> <p>Work is currently in progress on bringing the regulatory acts of the CBR on accounting at banks into line with international standards. Hence, the CBR has developed new accounting rules for fixed assets, intangible assets, and other property of banks, and for the remuneration of employees, as well as a new procedure for the determination of income, expenditures, and other aggregate income, which are entering into force on January 1, 2016. It is expected that this process will be completed by January 1, 2018.</p> <p>According to the requirements of the Law on Consolidated Financial Statements, banks (banking groups and bank holding companies) are governed by the IFRS and internal documents developed on the basis of the IFRS when compiling financial statements. The estimations used by a bank to reflect operations performed, including the measurement of fair value, are subject to confirmation by an auditing firm in the auditor’s opinion.</p> <p>The auditor’s opinion (BBAL, Article 42) contains conclusions on whether the internal controls and organization of the RM systems at a bank or a banking group are in compliance with the requirements established by the CBR on such systems.</p> <p>The CBR, under the powers of the CBL (Article 72), also evaluates the accuracy of the reflection of assets measured at fair value in the reporting statements of banks in accordance with regulatory acts of the CBR and the IFRS, taking into account the following principles (CBR Letter 37-T):</p> <ul style="list-style-type: none"> <li>• consistency of the methods used by a bank for the measurement of assets at fair value with the IFRS requirements;</li> <li>• existence of internal documents approved by a bank’s management bodies;</li> <li>• the degree of consistency of source data used by a bank for the purposes of measurement of assets at fair value with the nature of the assets, the current status of the market, and the source data and assumptions used by market participants to determine prices for similar assets, in accordance with the accepted pricing methods for financial instruments (regarding the level of risks inherent in an asset, the status and degree of activity in the market, and the economic situation);</li> <li>• the existence of databases at a bank that provide for the storage of information about source data (market prices, the value of transactions with respect to a similar asset) and other information used in estimates of the fair value of a bank’s assets, for a retrospective period of at least five years;</li> <li>• the existence of regular monitoring on the part of a bank’s management bodies of the accuracy of the measurement of assets at fair value and the adequacy of the methodology used to determine fair value, including the performance of monitoring by a subdivision that is independent of subdivisions related to the assumption of risks; and</li> <li>• a provision in agreements with organizations that perform the measurement of assets for a bank and/or that provide information used for the measurement of assets at fair value that the organizations performing the measurement bear liability for the presentation of inaccurate data.</li> </ul>
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	<p>The methodology for determining the fair value of trading book instruments, including sources of market information used to determine the value of trading book instruments, must be developed without the involvement of units or employees of the bank who are active in the assumption of market risk and measurement of the value of trading book instruments (Section 3.4 of Ordinance 3624-U).</p> <p>The methodology for determining the fair value of trading book instruments must specify that in the event that the market for the financial instruments ceases to be active, the quoted prices in this market cannot serve as the basis for a reliable determination of their value, in connection with which a bank (principal bank of a banking group), on the basis of IFRS 13—Fair Value Measurement, changes the measurement method and uses several measurement methods, such as the market and income approaches, for example.</p> <p>The procedure and periodicity for performing an evaluation of the methodology for determining the value of trading book instruments must be established at a bank, including an evaluation of the accuracy of the results obtained using said methodology, both under stable conditions and in stress situations, by the internal audit function (or another subdivision independent of subdivisions performing functions related to the assumption of market risk, the development of the methodology for determining the value of trading book instruments, as well as measurement of the value of trading book instruments).</p> <p>The methodology for measuring the value of trading book instruments applied at a subsidiary must be approved in writing by the parent bank of a banking group, and it must be subject to periodic verification to ensure that it is appropriate.</p> <p>Information about trading book instruments measured using quantitative measurement models must be communicated to the management bodies of the bank, and the bank must develop a methodology for estimating the degree of uncertainty of measurements obtained using these models, and when necessary make corrections in the value of instruments measured using the models. The internal audit function of a bank (or another relevant qualified subdivision) performs a quarterly evaluation of the quality (accuracy) of these models based on historical data, and also based on current data in the course of ongoing activities.</p>
<b>EC4</b>	Laws or regulations set, or the supervisor has the power to establish the scope of external audits of banks and the standards to be followed in performing such audits. These require the use of a risk and materiality based approach in planning and performing the external audit.
Description and findings re EC4	<p>The requirements with regard to the content of an auditor's opinion, as well as the procedure for the formation of an opinion about the accuracy of accounting (financial) statements, are determined by federal auditing standards (referred to hereinafter as FAS), and specifically FAS 1/2010—Auditor's Opinion on Accounting (Financial) Statements and Formation of an Opinion about their Accuracy, FAS 2/2010—Modified Findings in an Auditor's Opinion, and FAS 3/2010 – Additional Information in an Auditor's Opinion.</p> <p>Article 42 of the Law on Banks and Banking establishes additional requirements regarding the content of an auditor's opinion on banks' reporting statements, and specifically that an auditor's opinion must contain the results of a review of compliance with required ratios established by the</p>

	<p>CBR and consistency between internal controls and the organization of RM systems and the requirements established by the CBR for the given systems, with regard to:</p> <ul style="list-style-type: none"> <li>• the accountability of RM subdivisions;</li> <li>• the existence of a method approved by authorized management bodies for identifying significant risks, managing significant risks, and performing stress testing, and the existence of a system for reporting on significant risks and capital;</li> <li>• the sequence for the application of methods for the management of significant risks and evaluating their effectiveness;</li> <li>• monitoring by the BoD and executive management bodies of compliance with maximum values for risks and equity (capital) adequacy established by internal documents, as well as the effectiveness of RM procedures being applied and the sequence for their application.</li> </ul> <p>In performing a mandatory audit and other audits, auditing firms, governed by the federal auditing standards, including Rule (Standard) 4—in Auditing, the Auditors’ Code of Ethics, as well as standards established by professional auditors’ associations of which they are members (professional standards), shall independently evaluate what is material according to their professional judgment. When developing an audit plan, an auditor establishes an acceptable level of materiality based on an understanding of the specific aspects and scale of the activities of the audited entity, with the aim of identifying material misreporting (from a quantitative standpoint), in order to ensure the required level of confidence in the judgments that are made.</p>
<b>EC5</b>	<p>Supervisory guidelines or local auditing standards determine that audits cover areas such as the loan portfolio, loan loss provisions, non-performing assets, asset valuations, trading and other securities activities, derivatives, asset securitizations, consolidation of and other involvement with off-balance sheet vehicles and the adequacy of internal controls over financial reporting.</p>
Description and findings re EC5	<p>According to Rule (Standard) 3—Audit Planning, when developing an overall audit plan, an auditor needs to take into consideration the activities of the audited entity, including:</p> <ul style="list-style-type: none"> <li>• general economic factors and conditions in the sector that influence the activities of the audited entity;</li> <li>• specific characteristics of the audited entity, its activities, its financial condition;</li> <li>• requirements regarding its financial (accounting) or other statements;</li> <li>• the accounting and internal control systems;</li> <li>• the accounting policy adopted by the audited entity; and</li> <li>• the impact of new regulatory legal acts in the area of accounting on the reflection of the financial and commercial activities of the audited entity in its financial (accounting) statements.</li> </ul> <p>When performing a mandatory audit, according to the considerations noted above, the auditing firm must consider specific aspects of the activities of the audited entity, including:</p> <ul style="list-style-type: none"> <li>• the loan portfolio;</li> <li>• the adequacy of the evaluation of asset quality and loan loss provisions;</li> <li>• operations with securities and derivative financial instruments;</li> <li>• securitization operations; and</li> <li>• approaches to consolidation, and other issues.</li> </ul>

	<p>In addition, under the BBAL (Article 42), the auditor's opinion must contain the results of a review of the consistency between the internal controls and the organization of RM systems at a bank or banking group and the requirements established by the CBR for such systems.</p> <p>The CBR evaluates the mandatory audit and analyzes reporting statements and other information available to it about the activities of banks (banking groups), such as information contained in materials from an inspection audit, and it compares the results of its analysis with the conclusions of the auditing firm. The CBR makes its assessment on the basis of data produced for public disclosure by the bank (banking group) and result of assessment of reports made for the CBR by the bank (parent bank of the banking group) (supervisory reporting) and an assessment of the quality and coverage of the audit.</p> <p>Should the CBR have doubts concerned the quality of an audit, it may file a request with the Federal Financial and Budgetary Supervision Service under the Russian MoF calling for an external review of the quality of the work of the auditing firm, and/or an unscheduled inspection of a self-regulating auditors' organization of which the auditing firm or individual auditor is a member (Articles 10 and 22 of the Law on Auditing).</p>
<b>EC6</b>	The supervisor has the power to reject and rescind the appointment of an external auditor who is deemed to have inadequate expertise or independence, or is not subject to or does not adhere to established professional standards.
Description and findings re EC6	<p>The CBR does not have the right to reject or rescind the appointment of an auditing firm selected by banks for the performance of a mandatory audit when violations (deficiencies) are identified in the auditing firm's work.</p> <p>At the time of the assessment, a draft law had been submitted by the MoF to the Government for consideration. The draft law was the result of efforts of the CBR, working together with the MoF, to improve the legislation regulating auditing activities.</p> <p>If the proposed law is supported, the changes will include professional competence and experience requirements (minimum three years of experience in the case of mandatory audit of bank, a banking group, or a bank holding company) and also prohibition of services connected with auditing activity (for example, tax and management consulting, statement, restoration and conducting the tax account, legal assistance in areas related to auditing activities, assessment activities, preparation of business plans) to a bank by the bank's audit firm for two years prior to the mandatory audit.</p> <p>In addition, the draft federal law will also grant the CBR the right to require the replacement of an auditing firm in the event that it has information that raises doubts about the quality of an audit that has been performed.</p>
<b>EC7</b>	The supervisor determines that banks rotate their external auditors (either the firm or individuals within the firm) from time to time.
Description and findings re EC7	Mandatory rules for rotation of audit firms are not currently in place in the Federal Law on Auditing. The independence rules for auditors and audit organizations, developed in accordance with the Federal Law on Auditing, provide that the auditor has no right to audit the same entity for more than seven years. After this period, the person must not carry out an audit of the audited

	<p>entity within two years. The proposed draft law, noted in EC6, will—if passed—limit the period that an auditing firm can perform a mandatory annual audit of the same bank to five years.</p> <p>For socially significant entities—meaning a public company whose securities are listed and a financial organization—the federal standards of audit activity (N34) establish the principle of a seven-year rotation for individuals working on the audit team. Similarly, (under N6) the key person (e.g., senior partner) responsible for managing the audit assignment should not serve as such for more than seven years. After this period, the person should not be a member of the audit team, or responsible for management of the audit for this entity within two years.</p> <p>Institutions in which there is a government stake (including Sberbank and VTB, for example) are required to open the audit contract to tender every five years. However, there is no prohibition to prevent the same firm winning the contract again.</p> <p>The Auditor Code, however, which is binding upon audit firms and audit individuals, does provide for the rotation of an audit team, but not of a firm or of a senior partner.</p> <p>The CBR, however, monitors the duration of audit relationships with bank clients through reporting submitted by banks (Form 0409024). This report is submitted upon the conclusion of a contract to perform an audit of the activities of a bank (banking group) and is submitted by banks (banking groups).</p> <p>Since 2015, the CBR has been publishing the identity of the auditors of banks which have failed or had their licenses revoked. The CBR staff noted that although, under current legislation, they have the ability in principle to recommend to a bank that an audit relationship could or should be changed, in practice there is a question of whether the CBR could be deemed to be intervening in a business decision and therefore acting beyond its (the CBR's) proper limits.</p>
<b>EC8</b>	The supervisor meets periodically with external audit firms to discuss issues of common interest relating to bank operations.
Description and findings re EC8	<p>The CBR does not meet with audit firms to discuss issues relating to a specific institution. Existing legislation imposes a restriction on the CBR sharing information obtained in the process of the performance of its supervisory functions with third parties, and this includes external auditors of banks. This restriction applies reciprocally (see EC9 below).</p> <p>In terms of exchange or access to information, external auditors have access to the CBR's inspection reports, provided the bank is willing. Thus, according to Instruction 147-I, a bank has the right to provide a report on an inspection audit to an external auditor for review. In this case, a copy of a report may be provided.</p> <p>In order to address this problem, the Russian MoF together with the CBR, is working on legislative amendments. Specifically, attention is being paid to Article 26 of the BBAL and to the Federal Law on Auditing, which provides for the establishment of a requirement that an external auditor inform the CBR of circumstances in the activities of banks, banking groups, and bank holding companies that have had or could have a significant impact on the accuracy of audited accounting (financial) statements, including significant risks assumed by the audited entity, which may include events</p>

	<p>and/or conditions that could raise doubts about the ability of the audited entity to continue operating without interruption.</p> <p>In addition, in accordance with the draft law, the CBR will be required, at the request of an external auditor, to notify the latter of facts regarding noncompliance by the audited entity (i.e., the bank) with the values for required ratios established by the CBR; of failure by the RM and internal control systems of the audited entity to comply with the requirements of the CBR; of facts that have resulted in the application of supervisory measures by the CBR (under CBL, Article 74); and of cases in which the CBR has forwarded requests to a bank calling for the performance of measures aimed at financial recovery.</p> <p>Also, as envisaged with the draft law, the CBR will have the right to ask an external auditor to provide information in a range of instances. These include cases in which an audited entity has overstated (understated) the current value of assets; cases in which an audited entity has failed to comply with the values for required ratios established by the CBR; information on the RM system and the quality of internal controls by an audited entity; and failures by an audited entity to eliminate deficiencies and violations identified by an auditing firm or an individual auditor in the performance of an audit in previous periods. An external auditor also has the right to provide information to the CBR regarding the presence of circumstances in such an entity's activities that, in the opinion of the auditing firm or individual auditor, could be used by the CBR in the performance of its functions related to banking supervision and oversight and supervision of financial markets.</p> <p>It should be noted that the CBR was involved in lengthy discussions not only with the MoF but also the audit community in the context of working on legislative proposals.</p>
<b>EC9</b>	<p>The supervisor requires the external auditor, directly or through the bank, to report to the supervisor matters of material significance, for example failure to comply with the licensing criteria or breaches of banking or other laws, significant deficiencies and control weaknesses in the bank's financial reporting process or other matters that they believe are likely to be of material significance to the functions of the supervisor. Laws or regulations provide that auditors who make any such reports in good faith cannot be held liable for breach of a duty of confidentiality.</p>
Description and findings re EC9	<p>Currently there are no legal requirements concerning mandatory notification to the CBR by an external auditor with regard to issues that are of material significance or matters that may be of interest to the CBR (or, as noted above, of the provision of necessary information by the CBR to an external auditor).</p> <p>According to the Law on Auditing (Article 9), an auditing firm and an individual auditor do not have the right to transmit information and documents containing confidential audit information to third parties, or to disclose this information and the content of documents without the prior written consent of the entity to whom services were provided.</p> <p>At present, there is no legal protection for an auditor making a notification to the CBR of a significant matter that was uncovered in the course of the auditor's work.</p> <p>As noted in ECs 6, 7, and 8 above, the Russian authorities are in the process of introducing legal amendments. It is hoped these amendments (i.e., if passed) will require the prompt notification of</p>



	<p>a number of issues by the external auditors and will also provide legal protection for external auditors who disclose such information to the CBR.</p> <p>The draft Federal Law on Amendments to Article 26 of the Federal Law on Banks and Banking and to the Federal Law on Auditing provides for the identification of a list of circumstances in the activities of banks being audited, the occurrence of which requires prompt notification of the supervisory authority by auditing firms (see also EC 8).</p> <p>In accordance with the draft law, the provision of information by an external auditor to the CBR as provided for under the draft law does not result in any legal consequences for the external auditor. Specifically, the draft law establishes that auditing firms have the right to disclose to third parties information about operations, accounts, and deposits of banks and their customers and correspondents, which has been obtained by these auditing firms in the performance of auditing services.</p>
<p><b>Assessment of Principle 27</b></p>	<p><b>Materially Non-Compliant</b></p>
<p>Comments</p>	<p>The deficiencies in the legal framework are such that the CBR is either significantly restricted or entirely prevented from fulfilling a number of the criteria of this principle. It is of the utmost importance that legislation is passed to remedy these concerns with a matter of urgency. It is the understanding of the assessors that draft legislation that had been prepared and submitted to the State Duma would meet these concerns, but the assessors have not reviewed the text. The assessors were informed that the draft law (997129-6) on amending the CBL (Article 26) and the federal law on auditing aimed at ensuring cooperation between audit firms and the CBR was submitted to the State Duma on February 15, 2016.</p> <p>It is important that the supervisor have powers to act in the following circumstances:</p> <ul style="list-style-type: none"> <li>• to reject or rescind the appointment of an external auditor who has inadequate independence or experience, or who does not meet professional standards;</li> <li>• to ensure rotation of the external auditor; and</li> <li>• to meet with the audit firm to discuss matters pertaining to a supervised institution.</li> </ul> <p>It is also important that the auditor should have the responsibility to notify the supervisor of serious matters that come to the auditor’s attention, and both the auditor and the supervisor should have legal protection in respect of the exchange confidential information.</p> <p>The experience in a number of other jurisdictions is that when a more open relationship is possible between the audit and supervisory communities, there is mutual benefit owing to enhanced mutual understanding of concerns and of the audited banks, which in turn can benefit the banking community. It is not, currently, the CBR’s practice to meet with the audit community except for general matters for the reasons noted above. It is, however, suggested that the CBR initiate a general dialogue on a more standard basis, and it is also recommended that the CBR encourage, if possible, a more systematic granting of consent for exchange of information to enhance dialogue with the auditor as needed.</p> <p>It is unclear that, based on the BBAL and CBR regulations, that the supervisor has ensured, or is permitted to directly require that the board and management are held accountable for ensuring</p>

	<p>that financial statements are properly prepared and subject to an independent external auditor's opinion according to international standards (EC1 and EC2). Nevertheless, such requirements are imposed on the banks themselves. Hence, if a bank failed to meet the required standards and this led to incorrect or misleading statements, then the CBR's sanction powers would be triggered and individual members of the management or board could be sanctioned or even removed from office. The effect of EC1 and EC2 may be achieved but it may also be helpful to vest the CBR with more direct powers to ensure that management and boards of banks are held fully accountable.</p> <p>In the light of the framework deficiencies, the CBR has been left with relatively limited space in which to act. The decisions the CBR has taken to publish auditors of failed banks, to assess the quality and coverage of audit, and the willingness to hold a dialogue with the auditing community in respect of changing auditing standards are positive indications and suggest that, when legal restrictions and impediments are removed, the CBR will be well placed to develop its practices in accordance with the international standards, and more importantly, be well placed to exercise more effective supervision.</p>
<b>Principle 28</b>	<b>Disclosure and transparency.</b> The supervisor determines that banks and banking groups regularly publish information on a consolidated and, where appropriate, solo basis that is easily accessible and fairly reflects their financial condition, performance, risk exposures, RM strategies and CG policies and processes.
<b>Essential criteria</b>	
<b>EC1</b>	Laws, regulations or the supervisor require periodic public disclosures <sup>138</sup> of information by banks on a consolidated and, where appropriate, solo basis that adequately reflect the bank's true financial condition and performance, and adhere to standards promoting comparability, relevance, reliability and timeliness of the information disclosed.
Description and findings re EC1	<p>The BBAL sets disclosure requirements for banks, imposing an obligation to disclose the following information on an institution basis (Article 8):</p> <ul style="list-style-type: none"> <li>• annually: accounting (financial) statements and auditor reports on them, information on the accepted risks, risk assessment procedures, and risk and capital management procedures; and</li> <li>• quarterly: interim accounting (financial) statements, information on accepted risks, risk assessment procedures, and risk and capital management procedures. In the event that the interim accounting (financial) statements were audited, the above disclosure shall be made together with the auditor's report.</li> </ul> <p>The parent credit institution of the banking group is required to disclose the following:</p> <ul style="list-style-type: none"> <li>• annually: annual consolidated accounting (financial) statements and auditor reports on them, information on the accepted risks, risk assessment procedures, and risk and capital management procedures; and</li> <li>• quarterly: interim consolidated accounting (financial) statements, information on accepted risks, risk assessment procedures, and risk and capital management procedures. In the event that the interim consolidated financial statements were audited, the above disclosure shall be made together with the auditor's report.</li> </ul>

<sup>138</sup> For the purposes of this Essential Criterion, the disclosure requirement may be found in applicable accounting, stock exchange listing, or other similar rules, instead of or in addition to directives issued by the supervisor.

	<p>The forms, procedure, and terms of disclosing information on accepted risks, risk assessment procedures, and risk and capital management procedures are established by the CBR in the following Ordinances:</p> <ul style="list-style-type: none"> <li>• 3081-U “On the Disclosure by Credit Institutions of Information on their Activities”;</li> <li>• 2923-U “On the Publishing and Submission of Consolidated Financial Statements by Credit Institutions”;</li> <li>• 3876-U “On the Form, Procedure, and Terms for the Disclosure of Information on Accepted Risks and the Procedures for Their Assessment, and Risk and Capital Management by the Parent Credit Institutions of Banking Group”; and</li> <li>• 3580-U “On the Submission of Financial Reporting by Credit Institutions.”</li> </ul> <p>The information noted above on credit institutions and banking groups is required to be prepared taking into account IFRS, recommendations from the documents of the Basel Committee on Banking Supervision (Basel II and Basel III), and must satisfactorily reflect the financial situation and financial standing of credit institutions, including on a consolidated basis. The information should be based on principles for the preparation of statements, such as relevance, reliability, and timeliness.</p> <p>Additionally, parent institutions of bank holdings disclose consolidated financial statements of the bank holdings.</p> <p>Since January 2016, banks and banking groups have been obliged to disclose within three days (on their website) information pertaining to any changes of the equity financial instruments of the bank and banking group.</p> <p>The BBAL (Article 42) also requires that the annual accounting (financial) statements of a bank, annual consolidated financial statements of a banking group, and annual consolidated financial statements of a bank holding company shall be subject to mandatory audit. The auditor must check on the compliance of the institution/group with the required ratios of the CBR, and qualitative issues, such as methodologies for identifying and managing material risks, stress testing, systems of reporting on material risks and capital are included. However, the audit does not cover any RM methodologies and quantitative risk assessment models used by the bank for capital adequacy calculation where the CBR has granted model approval. (At the time of the assessment no models had been approved.)</p>
<b>EC2</b>	<p>The supervisor determines that the required disclosures include both qualitative and quantitative information on a bank’s financial performance, financial position, RM strategies and practices, risk exposures, aggregate exposures to RPs, transactions with RPs, accounting policies, and basic business, management, governance and remuneration. The scope and content of information provided and the level of disaggregation and detail is commensurate with the risk profile and systemic importance of the bank.</p>
Description and findings re EC2	<p>Credit institutions disclose a range of quantitative information, including on a consolidated basis. Credit institutions disclose annual (interim) accounting (financial) statements within the accounting balance sheet (disclosure form), the report on financial results (disclosure form), and appendices (report on the capital adequacy level for risk coverage, amount of loan loss provisions and other assets (disclosure form), details on the required ratios, financial leverage indicator, and liquidity coverage ratio (disclosure form), cash flow statement (disclosure form), and notes thereto).</p>

	<p>On a consolidated basis, the consolidated financial statements are disclosed in accordance with the International Financial Reporting Standards. Such statements are also subject to disclosure by the credit institutions not forming a group of institutions under IFRS.</p> <p>Credit institutions disclose, including on a consolidated basis, information on the accepted risks, risk assessment procedures, and risk and capital management procedures, including, among others, the standardized disclosure forms, particularly the statements related to Form 0409808 "Report on the Capital Adequacy Level for Risk Coverage, the Amount of Loan Loss Provisions and Other Assets" (disclosure form), statements related to Form 0409813 "Details on the Required Ratios, Financial Leverage Indicator, and Liquidity Coverage Ratio," as well as details from the financial and supervisory statements and comparative information on the main elements of equity (capital), the indicators reducing their amount, and the relevant indicators included in the statements. Such disclosures are in order to comply with the provisions of Pillar 3 of Basel II and Basel III, including the LCR and the financial leverage indicator.</p> <p>Moreover, credit institutions that agreed to the procedure (more than 96 percent of existing credit institutions) disclose the following reports on the official website of the CBR:</p> <ul style="list-style-type: none"> <li>• "Turnover Balance Sheet of a Credit Institution";</li> <li>• "Report on the Financial Results of a Credit Institution" (CBR Letter 165-T);</li> <li>• "Information on the Required Ratios and Other Performance Indicators of a Credit Institution" (CBR Letter 72-T); and</li> <li>• "Equity (Capital) Calculation (Basel III)" (CBR Letter 17-T).</li> </ul> <p>Credit institutions also disclose quantitative and qualitative information on remuneration policy and practices that provides details on the authorized entities controlling remuneration payments, details on the procedure and remuneration system, the types of remuneration, the methods of linking performance with remuneration amounts, including for separate employees, and the main performance assessment criteria and the means of remuneration adjustment.</p>
<b>EC3</b>	Laws, regulations or the supervisor require banks to disclose all material entities in the group structure.
Description and findings re EC3	<p>As part of the information on "accepted risks" (BBAL, Article 8), the parent organization of a bank holding company and the parent of a banking group disclose general details on activities, including a list of consolidated and non-consolidated members of the banking group (location, asset volume, volume and share of equity (capital) (net assets) of a member of the banking group in the equity (capital) of the banking group and the results of their activities).</p> <p>The banking group discloses information on the risks for each major member of a banking group with equity (capital) (net assets) of 5 percent and more of the equity (capital) of the banking group and/or the financial result calculated without taking into account the profit (expenses) from the operations (transactions) between the parent credit institution of the banking group and/or members of the banking group with 5 percent and more of the financial result of the banking group.</p> <p>The market participants and industry representatives with whom the assessors met indicated that they were comfortable with the effectiveness of disclosure of ownership of banking group structures.</p>

<b>EC4</b>	The supervisor or another government agency effectively reviews and enforces compliance with disclosure standards.
Description and findings re EC4	The CBR is entitled to take measures (pursuant to CBL Article 74) if a parent credit institution of the banking group violates the requirements of the federal laws owing to participation in a banking group, including the non-disclosure of information, partial disclosure or unreliable information, or a failure to conduct a required audit, or non-disclosure of the consolidated statements and the auditor's report on them. The CBR has exercised its powers under the law when assessing disclosure by banks and banking groups. It was noted that most infringements occur after the point at which a license has been revoked (disclosure obligations are not automatically extinguished upon loss of license).
<b>EC5</b>	The supervisor or other relevant bodies regularly publishes information on the banking system in aggregate to facilitate public understanding of the banking system and the exercise of market discipline. Such information includes aggregate data on balance sheet indicators and statistical parameters that reflect the principal aspects of banks' operations (balance sheet structure, capital ratios, income earning capacity, and risk profiles).
Description and findings re EC5	The CBR regularly publishes information on the banking system as a whole on its website. In particular, the monthly "Review of the Banking Sector of the Russian Federation" publishes analytical indicators and regularly updates time series for individual indicators of this Review. In addition, there is a monthly publication "On the Development of the Banking Sector of the Russian Federation." The BSR is published on an annual basis and covers analytical information about all the key risks and indicators of the Russian banking sector. The Review of the Banking Sector and the BSR are available in Russian and English on the CBR website.
<b>Assessment of Principle 28</b>	<b>Compliant</b>
<b>Comments</b>	<p>The CBR attaches importance to disclosure and transparency. This commitment is illustrated, for example, by the regular (and frequent) publication on the CBR's website of information on the composition and risk profile of the banking sector.</p> <p>It is acknowledged that some of the disclosure standards are at early phases of implementation, but the Basel disclosure framework is in force. The CBR has recently (December 2015) amended its disclosure requirements in relation to the Basel framework in order to enhance its implementation of Pillar 3. The amendments introduce the standard on a consolidated basis from the start of January 2016. Market discipline (i.e., Pillar 3) disclosure requirements are established in Ordinance 3876-U for reporting on the consolidated level (implementation from January 2016) and Ordinance 3081-U for reporting on the solo level.</p> <p>While not necessary in order to achieve compliance with this principle, the CBR may wish to consider adopting some of the best practice approaches of some other leading regulatory authorities who publish information not only at the aggregate but also the individual (including group) level such as time series format on bank performance and risk indicators. Major international financial firms are likely to be subject to such levels of disclosure in one or more of the jurisdictions in which they are active.</p>
<b>Principle 29</b>	<b>Abuse of financial services.</b> The supervisor determines that banks have adequate policies and processes, including strict customer due diligence (CDD) rules to promote high ethical and

	professional standards in the financial sector and prevent the bank from being used, intentionally or unintentionally, for criminal activities. <sup>139</sup>
<b>Essential criteria</b>	
<b>EC1</b>	Laws or regulations establish the duties, responsibilities and powers of the supervisor related to the supervision of banks' internal controls and enforcement of the relevant laws and regulations regarding criminal activities.
Description and findings re EC1	<p><b>Background</b></p> <p>Russia is considered a significant transit and destination country for international narcotics traffickers; criminal elements from Russia and neighboring countries continue to use Russia's financial system and foreign legal entities to launder money.<sup>140</sup> Russian authorities are making efforts to mitigate risks stemming from corruption, as highlighted in the last Corruption Perceptions Index compiled by Transparency International, according to which Russia has risen from 136th to 119th place.<sup>141</sup> Nevertheless, corruption in certain key sectors (e.g. national defense construction) is still an issue and remains a major source of laundered funds, which handicap the fight against ML/TF.</p> <p>Embezzlement of public funds and in particular embezzlement of budget allocations for state defense orders have been mentioned as a matter of national concern. To tackle these issues, the Russian authorities have taken several initiatives at different levels including, but not limited to, <i>deoffshorization</i><sup>142</sup> and curbing illegal outflows of capital to overseas jurisdictions. Other major threats include terrorist financing and fraud.</p> <p>In that context, CBR enforcement powers have been reinforced as explained below. Sanctions against banks and their managers have been imposed, including multiple revocations of licenses for doubtful operations and for severe violations of AML law. The institutional framework has also been reinforced in 2013 with the establishment of a financial sector mega-regulator within the CBR. This was accomplished by bringing the Federal Financial Markets Service (FFSM), which is responsible for regulating insurance, pension funds, securities exchanges, and commodity markets, under the authority of the CBR, which is responsible for regulating banks. This institutional "merger" has <i>de</i></p>

<sup>139</sup> The Committee is aware that, in some jurisdictions, other authorities, such as a FIU, rather than a banking supervisor, may have primary responsibility for assessing compliance with laws and regulations regarding criminal activities in banks, such as fraud, money laundering and the financing of terrorism. Thus, in the context of this Principle, "the supervisor" might refer to such other authorities, in particular in Essential Criteria 7, 8, and 10. In such jurisdictions, the banking supervisor cooperates with such authorities to achieve adherence with the criteria mentioned in this Principle.

<sup>140</sup> The Russian FIU received over 11 million STRs in 2014 with an estimated value of 160 trillion rubles (59 percent more than in the previous period).

<sup>141</sup> <http://www.transparency.org/cpi2015>

<sup>142</sup> The new 2014 law that came into force on January 1, 2015 provides for the determination of a controlled foreign company (CFC), which is a foreign company that is not a Russian tax resident, but is nevertheless controlled by a Russian tax resident. A Russian tax resident will be deemed to be a controlling person of a CFC and shall fall within the ambit of the law if his/her participation or interest in the CFC is at least 50 percent during 2015 and 25 percent thereafter. Profits received by a Russian tax resident from a CFC will thus be subject to taxes with specific qualifications (e.g., double tax agreements).

*facto* increased the scope of AML/CFT oversight of the CBR, which includes not only banks but also a myriad of nonbank financial institutions.

### ***Laws and regulations***

The foundation of the Russian regime against money laundering can be found in the Federal Law 115/FZ of August 7, 2001 on combating money laundering and terrorist financing (hereafter the AML Law). In addition, multiple regulations have been issued by the CBR and the Federal Financial Monitoring Service (Rosfinmonitoring), the Russian FIU. The AML law was amended a few times since the adoption of the third Mutual Evaluation Report (MER) in 2008. The significant revision of the act was made in June 2013 with the introduction of a definition of “beneficial owner” and new provisions to address the risks posed by domestic PEPs.<sup>143</sup> These successive amendments aimed to address deficiencies identified in the 2008 MER and bring Russia to a higher level of conformity with the 40 FATF Recommendations.

Law 115/FZ governs the operation of the AML/CFT system, the list of entities subject to the AML/CFT legislation and their obligations in terms of (KYC/CDD) and reporting, the requirements regarding entities responsible for enforcing the legislation, the role of the CBR in the AML/CFT sphere, and the procedure for cooperation between national agencies and their counterparts.

### ***The supervisory duties of the CBR in AML/CFT***

Pursuant to the CBL (Articles 4 and 56 of Federal Law 86-FZ of July 10, 2002), the CBR is the sole agency responsible for supervising the activities of credit institutions and their compliance with the legislation of the Russian Federation and regulatory acts of the CBR. Therefore, supervision of AML/CFT compliance in credit institutions falls under the umbrella of the CBR. Rosfinmonitoring does not exercise any responsibility in that regard but fully cooperates with the CBR. Also, in accordance with the CBL, the CBR is vested with the powers to enforce AML/CFT laws and regulations. The CBR has used these powers quite often over the past few years and more forcefully since 2013 (see below EC 8 and CP11). The mission was told that CBR has sufficient resources (inter alia Financial Monitoring and Foreign Exchange Control Department), with more than 100 employees at the central office as well as FM divisions at the CBR regional branches with a total of 930 employees. CBR examiners have been trained to conduct AML supervision. The mission was also told that CBR has increased inspection resources for AML/CFT purposes over the past years, especially since the merger with the capital market supervisor.

### ***The role of Rosfinmonitoring***

The Federal Financial Monitoring Service was founded in 2001 as part of MoF (former Financial Monitoring Committee (KFM)). The Russian FIU is an independent body which reports directly to the President of Russia. Rosfinmonitoring is an administrative-type FIU which is a member of the Egmont Group. According to Presidential Decree 808 of June 13, 2012, which defines the objectives

<sup>143</sup> It obliges institutions engaged in transactions with funds or other assets to take reasonable measures for identifying domestic and international organization PEPs, and to apply enhanced due diligence measures if they are considered as posing high ML/FT risks (e.g., need for senior management approval for accepting any relationship with a PEP, identifying source of wealth and funds, and enhanced ongoing monitoring of relationship).



	and powers of the country's FIU, Rosfinmonitoring has three oversight functions: (i) monitoring the implementation by legal and private persons of Russia's anti-money laundering legislation and prosecution of violations in this field; (ii) coordinating activities of federal executive authorities; and (iii) maintaining cooperation with the CBR. Rosfinmonitoring does not exercise any sanctioning responsibility in the area of AML/CFT compliance and does not perform any inspection for monitoring compliance with AML/CFT obligations in credit institutions; as explained earlier, this power rest with the CBR.
<b>EC2</b>	The supervisor determines that banks have adequate policies and processes that promote high ethical and professional standards and prevent the bank from being used, intentionally or unintentionally, for criminal activities. This includes the prevention and detection of criminal activity, and reporting of such suspected activities to the appropriate authorities.
Description and findings re EC2	<p>Supervisory expectations with regard to the existence of policies and processes to guard against financial abuse are contained in the AML law and subsequent regulations issued by the CBR, in particular the following:</p> <ul style="list-style-type: none"> <li>• CBR Regulation 375-P of March 2, 2012 on requirements for AML/CFT internal control processes;</li> <li>• CBR Directive 1486-U of August 9, 2004 on qualification requirements for dedicated officers in the area of AML/CFT;</li> <li>• CBR Directive 1485-U of August 9, 2004 on education and training requirements for credit institutions' personnel; and</li> <li>• CBR Regulation 499-P of October 15, 2015 on requirements regarding the identification of customers and a customer's representatives, beneficiaries, and beneficial owners for AML/CFT purposes.</li> </ul> <p>In addition to its duties in the area of AML/CFT, the CBR is also empowered by the new Article 57.1 of the CBL (introduced by <i>Federal Law 146-FZ on July 2, 2013</i>) to establish requirements for risk and capital management and internal control systems of credit institutions and banking groups, as well as qualification requirements for the managers of the RM, internal audit and internal control functions, which entail all form of risks, including ML/TF. In that context, clear reputation and professional qualification requirement have been introduced for management, officers, and internal control and RM officers.</p> <p>Furthermore, the AML law contains provisions on customer due diligence requiring banks to adopt, develop, and implement control mechanisms to prevent and detect activities related to ML/TF. More precisely, financial institutions are required to (i) establish proper due-diligence policies and methods regarding the clients, including KYC (Article 7); (ii) set up internal control mechanisms to detect unusual activities; (iii) establish procedures to report suspicions to the FIU; and (iv) appoint an officer in charge of communicating these transactions to Rosfinmonitoring.</p> <p>In this regard, banks are subject to two types of reporting. One is mandatory reporting on certain types of transactions involving certain sector deemed to be more prone to be abused by criminals (e.g., real estate operations, operations in precious metals, or those involving high risk countries), which have to be reported to the FIU in three working days (Articles 6 and 7 of the law). The second type of reporting involves suspicious activities (Article 7 of the AML law), which also should be reported to the FIU within three working days. Credit institutions shall report to the FIU within 24 hours when they refuse (1) to execute a client's transaction in case of failure to submit the</p>

	<p>documents and information as prescribed by AML Law; and (2) to execute any client’s suspicious transaction.</p> <p>Criteria for suspicion have been established by the CBR and Rosfinmonitoring and include, e.g., the unusualness of the nature of a transaction that has no apparent economic purpose; a mismatch between the nature of the transaction and the statutory activities of the company carrying it out; transactions carried out through bearer or third party accounts/deposits, or through accounts of companies from countries included in the FATF or other international organizations’ “black lists.” Banks are also required to keep the necessary confidentiality regarding all the information transmitted on the basis of this framework.</p> <p>From the discussions with staff of CBR and the analysis of onsite inspection reports, the mission observed that during its onsite inspections, whether general or targeted, the CBR pays special attention to the adequacy of AML/CFT reporting internal policies in banks.</p> <p>Regarding the STR obligation in particular, it is noteworthy that in the course of their onsite examinations, CBR inspectors examine samples of transactions with the aim, among others, to detect possible suspicious activities. Any doubtful operations detected by a CBR examiner that has not been previously reported by the Bank is signaled report and properly documented in the inspection.</p> <p>The AML law stipulates that the reporting entities should apply written policies, practices, and procedures with the aim of promoting high ethical and professional standards and preventing banks from being used, intentionally or unintentionally, by organized criminal groups or their associates. Banks have implemented Codes of Ethics that provide the framework for maintaining the highest standards of professional ethics. The Codes set out the guiding principles and rules of behavior by which banks operate and conduct their daily business with their customers, vendors, shareholders and with their employees.</p> <p>CBR Letter 92-T also includes recommendations on the implementation of Credit Institutions’ “know your employee,” which provides some form of screening standards not only during the recruitment process but also during internal assignments, depending on the content, scope, and level of responsibility.</p>
<p><b>EC3</b></p>	<p>In addition to reporting to the FIU or other designated authorities, banks report to the banking supervisor suspicious activities and incidents of fraud when such activities/incidents are material to the safety, soundness or reputation of the bank.<sup>144</sup></p>
<p>Description and findings re EC3</p>	<p>Banks report suspicious transactions to Rosfinmonitoring in accordance with the AML law through the medium of a suspicious activity report. These reports must be filed with the FIU within a particular timeframe. Banks are not required to file a copy of the suspicious activity report with the CBR. However, any incident involving fraud that is material to the safety, soundness or reputation of the bank will be captured by the internal control and RM system.</p>

<sup>144</sup> Consistent with international standards, banks are to report suspicious activities involving cases of potential money laundering and the financing of terrorism to the relevant national center, established either as an independent governmental authority or within an existing authority or authorities that serves as an FIU.

	<p>In accordance with CBR Letter 92-T of June 30, 2005,<sup>145</sup> it is recommended that for the purposes of assessing business reputation risk, credit institutions should take into consideration several indicators, including—the identification of cases of embezzlement, forgery, and the use of confidential information obtained from customers and counterparties by employees for personal purposes. In that regard, the CBR has also taken strong measures against banks—including revocation of license within a matter of days—where important frauds were discovered, including falsified bank accounts, Ponzi schemes, and use of shell companies.</p>
<b>EC4</b>	<p>If the supervisor becomes aware of any additional suspicious transactions, it informs the FIU and, if applicable, other designated authority of such transactions. In addition, the supervisor, directly or indirectly, shares information related to suspected or actual criminal activities with relevant authorities.</p>
Description and findings re EC4	<p>There has been a long standing and fruitful relationship between CBR and Rosfinmonitoring. The two agencies designed together the Russian AML/CFT apparatus. The AML law contains a provision according to which the CBR provides the FIU with all information and documents necessary for the performance of its functions, following the procedure agreed upon by the two agencies. To that end, a memorandum of understanding has been signed (BR-D-12-1 of May 17, 2004) that sets forth the conditions of such cooperation, including information exchange. The Head of the FIU sits at BCR's National Financial Board. The sharing on AML/CFT onsite inspection report drafted by CBR examines is however not allowed but certain information can be passed to the FIU.</p> <p>In addition, the CBR has concluded agreements on cooperation in information sharing with other competent authorities, including the Office of the Prosecutor General, Law Enforcement and other Federal Government Authorities (2013), as well as with the Ministry of Internal Affairs (2004).</p>
<b>EC5</b>	<p>The supervisor determines that banks establish CDD policies and processes that are well documented and communicated to all relevant staff. The supervisor also determines that such policies and processes are integrated into the bank's overall RM and there are appropriate steps to identify, assess, monitor, manage and mitigate risks of money laundering and the financing of terrorism with respect to customers, countries and regions, as well as to products, services, transactions and delivery channels on an ongoing basis. The CDD management program, on a group-wide basis, has as its essential elements:</p> <ul style="list-style-type: none"> <li>(a) a customer acceptance policy that identifies business relationships that the bank will not accept based on identified risks;</li> <li>(b) a customer identification, verification and due diligence program on an ongoing basis; this encompasses verification of beneficial ownership, understanding the purpose and nature of the business relationship, and risk-based reviews to ensure that records are updated and relevant;</li> <li>(c) policies and processes to monitor and recognize unusual or potentially suspicious transactions;</li> <li>(d) enhanced due diligence on high-risk accounts (e.g., escalation to the bank's senior management level of decisions on entering into business relationships with these accounts or maintaining such relationships when an existing relationship becomes high-risk);</li> </ul>

<sup>145</sup> Recommendations for Organization of the Management of Legal Risk and Business Reputation Risk at Lending Institutions and Banking Groups.

	<p>(e) enhanced due diligence on politically exposed persons (including, among other things, escalation to the bank's senior management level of decisions on entering into business relationships with these persons); and</p> <p>(f) clear rules on what records must be kept on CDD and individual transactions and their retention period. Such records have at least a five-year retention period.</p>
Description and findings re EC5	<p>a) and b) The requirements for customer identification are laid out in the AML law. In that regard, further improvements have been made to correct weaknesses in the Customer Due Diligence and KYC requirements identified in a previous FATF report. KYC requirements encompass customer identification including the verification of beneficial owner. On that particular point, Federal Law 134-FZ added the definition of the beneficial owner to the Article 3 of the AML Law. On January 28, 2014 the CBR issued Letter 14-T, with clarifications regarding identification of beneficial owners. The letter clarifies, among other things that (i) the notion of a beneficial owner of a client is applicable not only to clients that are companies, but also to individuals;(ii) there may be one or several individuals being beneficial owners; (iii) if a client refuses to provide information about its beneficial owners, a bank can refuse to open a bank account/conduct the client's business. The CBR Regulation 499-P on October 15, 2015 that supersedes Regulation 262-P of August 19, 2004 provide further details on that area.</p> <p>It is important to note that, while the amendment made to the AML/CFT law added a definition of beneficial owner that is consistent with the FATF standard,<sup>146</sup> the implementation of these new provisions are challenging. Banks are facing difficulties in identifying the ultimate beneficial owner of legal entities.</p> <p>The revised AML/CFT Law also requires financial institutions to take measures on a regular basis to (re-)assess i) the purposes of the economic activity, ii) the financial standing of the customer; and iii) the business reputation of the customer (AML/CFT Law, Article 7, clause 1, sub 1.1). Although this is not an explicit requirement to conduct ongoing due diligence, this is the closest the Russian AML/CFT Law gets to ongoing due diligence.<sup>147</sup></p> <p>With the adoption of Federal Law 134-FZ, the AML/CFT Law also includes a specific prohibition for credit institutions to maintain accounts in fictitious names, namely: "Credit institutions are banned from opening and maintaining anonymous accounts (deposits), i.e., when a natural person or a legal entity does not provide the documents necessary for the identification, as well as from opening and holding accounts of holders using fictitious names (pseudonyms)."</p> <p>c) As discussed under EC2, the AML law subject banks to a reporting mechanism. During the discussion with Rosfinmonitoring, the mission was informed that STRs provide enough information to the FIU to conduct its duties, including a description of the reasons that led the bank to report its suspicions.</p>

<sup>146</sup> "Beneficial owner for the purposes of this Federal Law means a natural person who directly or indirectly (through third persons) owns (has a predominant stake of over 25 percent in the capital of) a client being a legal entity or has the possibility of controlling the actions of the customer." (Federal Law 115-FZ, as amended)

<sup>147</sup> In CBR's opinion, a requirement "to take measure on a regular basis" is equivalent to "conduct ongoing due diligence" in the context of the FATF recommendations.

	<p>d) and e) Banks should also exercise scrutiny over high-risk customers. In that regard, Rosfinmonitoring Letter 17 provides financial institutions with additional information regarding higher risk transactions and higher risk customers. Amendments to the AML law mentioned above also call for the screening of domestic PEPs whose account opening is subject to board's prior approval. The CBR told the BCP assessors that PEPs (domestic and foreign) are subject to enhanced scrutiny, including the control of source of PEPs funds.<sup>148</sup></p> <p>f) In accordance with Article 7, Item 4, of Federal Law 115-FZ, documents and information necessary for personal identification and concerning operations must be retained for at least five years.</p> <p>In practice, the Chief Inspectorate of the CBR inspects banks' compliance with these principles at both the central and regional levels.</p> <p>Before going onsite, there is a pre-inspection phase that consists in collecting data from different sources, including the CBR's Financial Monitoring Department, the prudential inspection division and the FIU. Materials collected include, inter alia, information on payment made by clients, data on borrowers with no real economic activity, feedbacks on STRs with granular details on certain types of transactions involved). This pre-inspection phase allows the CBR to narrow down the focus on the inspection and determine a sample of operations or customers to look at.</p> <p>In the course of an inspection, the CBR examiners will review, among other things, the KYC practice of the bank, the identification of the beneficial owner, the contracts on which the transactions are based, the source and destination of cash flows, and the counterparties of the client. Also, attention will be given to any sign of unusualness; if the inspection detects any suspicion, the action taken by the credit institution to comprehend the economic rationale of the transaction will be scrutinized. Further, examiners will determine whether the operation was reported to the FIU on a timely manner. Any deviation will be described and properly documented in the inspection report.</p> <p>In general, credit institutions should be examined at least every two years. In practice, depending on deficiencies identified, the AML inspection cycle may vary from six months to three or four years. It is important to note that AML/CFT issues have been part of many full-scope scheduled inspections: 376, 308, and 225 respectively in 2013, 2014, and 2015. In 2013, 10 scheduled targeted AML inspections were performed out of 678. In 2014, 19 scheduled targeted AML inspections were performed out of 532, and in 2015, 5 out of 449. For unscheduled inspections, 3 out of 263 and 3 out of 190 were performed respectively in 2014 and 2015, representing overall 1 to 2 percent of the entire number of onsite visits. More focused AML onsite visits would permit expanding the scope of surveillance and looking more deeply into areas of particular concern.</p>
<b>EC6</b>	<p>The supervisor determines that banks have in addition to normal due diligence, specific policies and processes regarding correspondent banking. Such policies and processes include:</p> <p>(a) gathering sufficient information about their respondent banks to understand fully the nature of their business and customer base, and how they are supervised; and</p>

<sup>148</sup> Russia also enacted new legislation designed to combat official corruption and money laundering. On May 19, 2013, new legislation came into force banning senior public officials and executives of state corporations, as well as their spouses and underage children, from setting up bank accounts or holding stocks or bonds overseas.

	(b) not establishing or continuing correspondent relationships with those that do not have adequate controls against criminal activities or that are not effectively supervised by the relevant authorities, or with those banks that are considered to be shell banks.
Description and findings re EC6	In the past, policies and processes regarding correspondent banking were found to be weak. The Russian authorities have taken a series of measures to redress the problem. Pursuant to Regulation 375-P and according to the discussions with the CBR, banks have to take into account the nature of business operations carried out by a correspondent bank, quality of supervision, and also whether or not a correspondent bank has been subject to ML/TF investigation. Also, in accordance with Article 7, Item 5, of the AML law, credit institutions are prohibited from establishing and maintaining a relationship with nonresident banks that do not have permanent management bodies within the states in which they are registered. Furthermore, in accordance with Item 2.5 of CBR Regulation 499-P of October 15, 2015, <sup>149</sup> when establishing a correspondent relationship with a nonresident bank, a bank should collect information about AML/CFT measures taken by the given nonresident bank. Also, a decision to establish a correspondent relationship with banks should be made with the approval of the chief executive officer or an employee authorized by him.
<b>EC7</b>	The supervisor determines that banks have sufficient controls and systems to prevent, identify and report potential abuses of financial services, including money laundering and the financing of terrorism.
Description and findings re EC7	<p>According to the AML law and CBR regulations, banks are subject to a wide range of obligations in the area of internal control and even more so since the issuance in 2015 of CBR Regulation 3624-U on RM system in banks. CBR Regulation 375-P governs banks' obligations in relation to internal control for AML/CFT purposes. These rules oblige banks to have multiple programs for identifying their customers, tracking and reporting suspicious transactions, and managing ML/TF related risks. In that regard, credit institutions are required to take measures to classify customers according to certain risk factors, including the profile of the customer, the nature of operation he performs, and the nature of the counterparties or countries involved.</p> <p>The mission was told that these aspects are monitored during onsite visits. In fact, CBR teams detected multiple instances in which a bank's AML/ CTF rules of internal controls did not comply with legislation. In that regard, one key task for the CBR and its regional divisions is to ensure the effective introduction of a risk-based approach in banks with a view to mitigating the risk associated with ML/TF. At the same time, based on information obtained through its supervisory activities, CBR issued a number of enactments describing signs of suspicious transactions, along with recommendations for credit institutions on additional monitoring of suspicious transactions. This was meant to help banks identify certain customer transactions requiring increased attention.</p>
<b>EC8</b>	The supervisor has adequate powers to take action against a bank that does not comply with its obligations related to relevant laws and regulations regarding criminal activities.
Description and findings re EC8	As discussed under CP11, the Russian enforcement regime for banks is governed by the CBL (Article 74), the banking law (Article 19), and by other regulations (e.g., the AML law). <sup>150</sup> The CBR is empowered to impose measures (discussed immediately below) when a bank or any of its administrators or shareholders have committed certain offenses detailed in the law, consisting of, inter alia, violation of the banking law and other acts including AML law, the CBR regulations, by-laws and orders. The same regime will apply

<sup>149</sup> On the "Identification by Lending Institutions of Customers, Customer's Representatives, Beneficiaries, and Beneficial Owners for the Purposes of Anti-Money Laundering and Combating the Financing of Terrorism."

<sup>150</sup> Federal Law "On Countering the Legalization (Laundering) of Criminally Obtained Incomes and the Financing of Terrorism."

whenever a bank is threatening depositors' interests, providing or disclosing incomplete or inaccurate information, ignoring CBR orders, engaging in money laundering operations, or carrying out transactions outside the ambit of its license.

The CBR may, depending on its view of the seriousness and nature of detected shortcomings, take one or more of a broad selection of supervisory measures, as deemed appropriate. These measures are of different nature and range from relatively minor administrative fines to more severe sanctions, including the replacement or disqualification of an officer. In 2016, the CBR has continued to exercise its powers to institute proceedings and review cases of administrative infringements linked to credit institutions and their officers not complying with legislative requirements on AML/CFT, including revocation of the license.

In that regard, since the issuance of the *Federal Law 484-FZ of December 29, 2014*, repeated violations of AML/CFT legal provisions also constitute a ground for the mandatory revocation of a banking license. This new tool has been used multiple times over the past couple of years. As shown in the table below, licenses have been revoked at a very high pace, sometimes in a matter of weeks, to discipline banks that committed repeated gross violations of the AML law and/or because those banks were found guilty of conducting large-scale suspicious operations.

CBR sanctions have been imposed on both legal entities and individuals. Administrative sanctions on legal entities and individuals are applied in accordance with Article 15.27 of the Code of Administrative Offense. The amount of administrative fines, however, appears to be low and not a sufficient deterrent, as shown in the table below. Depending on the seriousness of the breach, the maximum amount of fines ranges between US\$12,600 on banks (RUB 1,000,000) and US\$600 (RUB 10,000) on individuals (e.g., executive officers).

The CBR maintains aggregated statistical data on sanctions imposed on banks. However, it does not provide a breakdown of violations that could permit it to understand whether the measures are proportionate to the gravity of the offense. As a result, assessors are not in a position to determine the extent to which the CBR resorts to other types of measures (e.g., administrative sanctions) permitted by law to discipline less serious breaches or flaws in banks' AML systems.

**85 licenses revoked on AML / CFT grounds since 2011:**

Year	The Number of Credit Institutions that had Their Licenses Revoked for Violations of Legislation in the Field of AML/CFT
	3
	1
	8
	36
	34
	14



	Type of Breach	Type of Sanction
	Failure to submit report on transactions subject to mandatory monitoring or suspected of being related to ML or FT.	Warning or administrative fine on executive officers in amount of RUB 10,000 up to RUB 30,000. Administrative fine on legal entities in amount of RUB 50,000 up to RUB 100,000.
	Failure to submit report on transactions that are subject to mandatory monitoring to the designated AML/CFT authority, and/or failure to submit report on transactions related to ML or FT.	Administrative fine on executive officers in amount of RUB 30,000 up to RUB 50,000. Administrative fine on legal entities in amount of RUB 200,000 up to RUB 400,000. Administrative suspension for up to 60 days.
	Non-compliance with the legislation as it pertains to freezing funds or other assets or suspension of transactions with funds or other assets.	Administrative fine on executive officers in amount of RUB 30,000 up to RUB 40,000. Administrative fine on legal entities in amount of 300,000 up to RUB 500,000 thousand. Administrative suspension for up to 60 days.
	Failure to inform the AML/CFT authority on refusal to enter into bank account agreement with customers or carry out transactions on the grounds specified in AML/CFT Law 115-FZ of August 7, 2001.	Administrative fine on executive officers in amount of RUB 30,000 up to RUB 40,000. Administrative fine on legal entities in amount of RUB 300,000 up to RUB 500,000. Administrative suspension for up to 60 days.
	Failure to provide information requested by designated AML/CFT authority on customer transactions and customer beneficial owners or information on account activity that is available to an institution engaged in transactions.	Administrative fine on legal entities in amount of RUB 300,000 up to RUB 500,000.
	Obstruction by an institution engaged in transactions with funds or other assets of inspections conducted by the designated or relevant supervisory authority or failure to comply with instructions for AML/CFT purposes issued by such authority.	Administrative fine on executive officers in amount of RUB 30,000 up to RUB 50,000. Disqualification for one up to two years. Administrative fine on legal entities in amount of RUB 700,000 up to RUB 1,000,000. Administrative suspension for up to 90 days.
	Failure by an institution engaged in transactions with funds or other assets or by its executive officer to comply with AML/CFT legislation that has resulted in ML or FT established by the valid court conviction, unless such actions (inactions) constitute a criminal offense.	Administrative fine on executive officers in amount of RUB 30,000 up to RUB 50,000. Disqualification for one up to three years. Administrative fine on legal entities in amount of RUB 500,000 up to RUB 1,000,000. Administrative suspension for up to 90 days.
<b>EC9</b>	The supervisor determines that banks have: (a) requirements for internal audit and/or external experts <sup>151</sup> to independently evaluate the relevant RM policies, processes and controls. The supervisor has access to their reports;	

<sup>151</sup> These could be external auditors or other qualified parties, commissioned with an appropriate mandate, and subject to appropriate confidentiality restrictions.

	<p>(b) established policies and processes to designate compliance officers at the banks' management level, and appoint a relevant dedicated officer to whom potential abuses of the banks' financial services (including suspicious transactions) are reported;</p> <p>(c) adequate screening policies and processes to ensure high ethical and professional standards when hiring staff; or when entering into an agency or outsourcing relationship; and</p> <p>(d) ongoing training programs for their staff, including on CDD and methods to monitor and detect criminal and suspicious activities.</p>
Description and findings re EC9	<p>a) The AML law and CBR regulations on internal control subject banks to the obligation of establishing an organization and procedures for internal control purposes as a permanent process implemented by management bodies and by the persons performing internal control functions. The internal control shall consist of management oversight, risk control (including AML/CFT), reporting and information, and internal audit. The existence and effectiveness of compliance with these requirements is assessed onsite by the CBR. The BCP team reviewed a sample of "weekly updates" prepared by CBR ARs, in which the AR paid attention to the internal control mechanisms. In several instances, inconsistencies between internal control and AML requirements were observed. In one case, the AR noted that the internal procedures did not include clear provisions in relation to the structure, tasks, functions, and responsibilities of the AML unit. In another instance, 5 days were given to the bank to update its AML internal control procedures.</p> <p>b) As part of this framework, a dedicated officer must be appointed at a lending institution who is responsible for compliance with the internal control rules for AML/CFT purposes (CBR Directive 1486-U of August 9, 2004).<sup>152</sup> Discussions held by the mission with major banks confirmed the existence of these dedicated officers.</p> <p>c) The current regulation also contains provisions regarding technical and professional requirements for particular job positions in addition to the standard due diligence to be followed for hiring, including checks on the absence of previous convictions (see CP14 for more details).</p> <p>d) CBR norms refer also to training of bank employees in the area of AML/CFT. Personnel education and training requirements can be found in CBR Directive 1485-U of August 9, 2004,<sup>153</sup> which requires that an AML/CFT education and training program be developed for personnel, and that the plan for the implementation of the AML/CFT training program for the current year be approved by management. Employees of specific departments must undergo this training, namely staff of the AML/CFT unit, the legal department, the security department, the internal control function, and the internal audit unit. Continuing education is carried out with the following periodicity: for responsible officials—at least twice a year, and for other employees—at least once a year. The AML/CFT training program must be updated regularly, at least once a year.</p> <p>The requirements under a), b), c), and d) are checked and evaluated during onsite inspections.</p>
<b>EC10</b>	The supervisor determines that banks have and follow clear policies and processes for staff to report any problems related to the abuse of the banks' financial services to either local management or the relevant dedicated officer or to both. The supervisor also determines that banks have and utilize

<sup>152</sup> "Qualification Requirements for Dedicated Officers at Lending Institutions Responsible for Compliance with Internal Control Rules for the Purposes of Anti-Money Laundering and Combating the Financing of Terrorism and Programs for the Implementation of Internal Controls at Lending Institutions."

<sup>153</sup> "Requirements for the Education and Training of Personnel at Lending Institutions."

	adequate management information systems to provide the banks' boards, management and the dedicated officers with timely and appropriate information on such activities.
Description and findings re EC10	<p>Banks have dedicated internal control officers for the purpose of preventing money laundering and the financing of terrorism. In that regard, Regulation 375-P sets forth the distribution of responsibilities among employees for the identification and reporting of operations that are subject to mandatory monitoring and operations that raise suspicions. This also includes a mechanism for cooperation between employees and the dedicated AML officer when the former identify signs of concerns that need to be reported to the latter. The procedure for drafting and submitting the report to the dedicated officer and the reporting line for informing senior management is also contemplated in the CBR regulation.</p> <p>Moreover, Ordinance 3624-U contains several provisions requiring the board to be informed of all RM related issues. For example, a report on risk exposures shall be prepared by the RM service and submitted directly to the board and senior management with the periodicity stipulated in the text. Also, in consonance with the regulation on internal control, the information on measures taken to follow the recommendations of the internal audit service and to eliminate the identified breaches—including on AML—are submitted to the board at least twice a year.</p> <p>The BCP team reviewed a sample of "weekly updates" prepared by CBR ARs and noted several references to AML/CFT deficiencies in their reports. In one case, for example, it was observed that there is no escalation mechanism allowing staff to report to a bank's senior management or to the internal audit any violation of which they become aware and which involved other bank employees.</p>
<b>EC11</b>	Laws provide that a member of a bank's staff who reports suspicious activity in good faith either internally or directly to the relevant authority cannot be held liable.
Description and findings re EC11	The AML law does not explicitly states that banks, their directors, and their employees are exempt from disciplinary, administrative, civil, and penal liability for submitting the information to the competent authorities for the purpose of executing the provisions of the AML law. The language under Article 7, Item 8 of the law (Rights and Responsibilities of Organizations Performing Operations with Monetary Funds and other Assets) can however be understood as providing similar protection. In effect, it stipulates that the submission to the relevant authorities of "reports, information and documents" by personnel of reporting institutions, their directors, and employees is not considered to be a "breach of official, banking, tax, commercial, or communication secrecy," provided that the transaction is reported for the purpose and based on the procedures of the AML/CFT Law.
<b>EC12</b>	The supervisor, directly or indirectly, cooperates with the relevant domestic and foreign financial sector supervisory authorities or shares with them information related to suspected or actual criminal activities where this information is for supervisory purposes.
Description and findings re EC12	<p>The CBR cooperates actively with other domestic and foreign relevant authorities. Even though Rosfinmonitoring is not a financial sector supervisory body, it is responsible, among others, for "monitoring the implementation by legal entities (and individuals) of AML legislation and maintaining cooperation with the CBR. As a result, a close and fruitful cooperation has been established with the CBR.</p> <p>Further, the interdepartmental Working Group on Combatting Illegal Financial Transactions (IWG) was established by order of the President of the Russian Federation on July 31, 2014, in addition to the already existing Interagency Commission on AML/CFT. For a more in-depth study of existing</p>

	<p>tasks, Rosfinmonitoring set up a permanent IWG Expert Group comprising representatives of the CBR, other public authorities, as well as the scientific and professional communities. In 2014, the working group held 13 meetings.</p> <p>It is also noteworthy that the CBR revoked multiple licenses of credit institutions for violations of banking laws, including based on the material provided by Rosfinmonitoring.</p> <p>The CBR also cooperates with public authorities of the Russian Federation (including Russian regions) and law enforcement agencies. Nineteen reports on transactions and deals of credit institutions and their customers, possibly involving illegal activities, were sent to the Prosecutor General's Office of the Russian Federation, 22 reports on transactions of credit institutions and their customers that did not have apparent economic or lawful purpose were also sent to the Federal Financial Monitoring Service.</p> <p>The Russian Federation is a member of the FATF, MONEYVAL, and one of the founding members of the Eurasian Group (EAG), which is a FATF-style regional body uniting Belarus, India, Kazakhstan, China, Kyrgyzstan, Russia, Tajikistan, Turkmenistan, and Uzbekistan.</p>
<b>EC13</b>	Unless done by another authority, the supervisor has in-house resources with specialist expertise for addressing criminal activities. In this case, the supervisor regularly provides information on risks of money laundering and the financing of terrorism to the banks.
Description and findings re EC13	As mentioned earlier, the CBR chief inspectorate does not have a dedicated AML task force but many—if not all—examiners are qualified to assess AML/CFT compliance issues. The CBR also provides regular feedback—through letters of recommendations—to the industry on AML/CFT, especially to attract attention about specific ML schemes that have been detected in the course of an inspection or signs of unusualness. One example of this is a recent recommendation regarding ML techniques involving retailers. Training sessions have also been organized in cooperation with the FIU which are also an opportunity to provide information on ML/TF related risks.
<b>Assessment of Principle 29</b>	<b>Largely Compliant</b>
Comments	<p><b>Background</b></p> <p>The Russian Federation is a member of the FATF, MONEYVAL, and one of the founding members of the Eurasian Group (EAG). As a result, it was subject to a joint evaluation by the FATF, MONEYVAL, and EAG in 2007. The MER of the Russian Federation was examined and adopted by FATF in June 2008. At that time, the Russian Federation was rated as being Compliant (C) on 10 recommendations, Largely Compliant (LC) on 13 recommendations, Partially Compliant (PC) on 21 recommendations and Non-compliant (NC) on three recommendations. As a result, Russia was placed in a regular follow-up process and reported back to the FATF several times; it was subsequently removed from regular follow up in the FATF follow up procedures in October 2013. A new comprehensive AML/CFT mutual evaluation is set for 2018-19, and Russia's next progress report will be presented to FATF in 2019.</p> <p>According to the latest reports available (e.g., the FATF 6<sup>th</sup> Follow-Up Report of October 2013 and the third round written progress report submitted to MONEYVAL of September 2014), the Russian Federation has made important progress with a view to correcting deficiencies in the domestic AML/CFT regime.</p>

Regarding the core and Key FATF recommendations relevant to CP29 that were rated PC in the MER, several improvements were made, in particular in the area of KYC/CDD.<sup>154</sup> Other non-core or key FATF recommendations relevant to this CP 29 previously rated PC were also addressed via government regulations and subsequent amendments to the AML law.<sup>155</sup> Other improvements have been made by lifting certain limitations on the CBR for conducting onsite AML/CFT inspections (amendments to Article 1 of Federal Law 294-FZ by Federal Law 60-FZ of April 2009).

***CBR supervision of AML/CFT issues is intrusive***

The CBR is paying particular attention to this matter. Assessors were presented evidence, both from the supervisor and from market participants that actual supervision of integrity risks is intensive and intrusive. The review of inspection reports and other relevant materials provided to the mission revealed a high degree of attention to ML/TF issues. The most common deficiencies identified by the CBR Chief inspectorate are in the following areas (i) KYC/CDD; (ii) AML/CFT internal control; (iii) identification of UBO; (iv) frequency in updating customer's information; (v) timely STR reporting to the FIU; and (vi) AML training to employees.

***Many CBR examiners have been trained to conduct AML supervision***

The mission was told that CBR has increased inspection resources for AML purposes over the past years, especially since the merger with the capital market supervisor. In CBR's opinion, the supervisor has enough staff to conduct all necessary inspections.

***The CBR has a good track record in enforcing AML/CFT law and regulations***

The supervisory authorities are well aware of ML/TF related problems and have been forceful against credit institutions. As a result, incompliance with the AML law and CBR regulations account for about 25 percent—if not more—of the total number of violations detected in recent years (the other areas of concerns are in credit risk and accounting). Lack of compliance with money laundering standards is the most frequent reason behind sanctions, including revocation of licenses. From 2013, license revocation has been done at a pace never seen in any country, suggesting a stronger prudential response but also some delays in identifying problems at an early stage.

<sup>154</sup> FATF Recommendation 5 is now rated LC thanks to new features introduced by Federal law 134-FZ; the most salient aspects are: (i) specific prohibition on maintaining existing accounts in fictitious names; (ii) requirement to conduct CDD in case of a suspicion of ML/TF; (iii) obligation to update annually customers' information as well as within seven days should any doubt arise about the veracity of previously obtained CDD information; (iv) introduction of a definition of beneficial owner; (v) requirement to establish the nature and intended purpose of business relationship; (vi) obligation for FIs to complete identification of a client, client's representative and/or beneficial owner before the establishment of a business relationship.

<sup>155</sup> Federal Law 176-FZ, which amended the AML/CFT Law (Article 6, Item 1, Sub-Item 2) now requires FIs to pay special attention to business relationships and transactions with persons from or in countries which do not or insufficiently apply the FATF recommendations.

***The CBR has raised awareness in the market on AML/CFT issues***

Workshops devoted to the practical application of the AML/CFT Law have been organized with the participation of representatives of professional associations (such as the Association of Russian Banks) on a regular basis. The CBR has also continued to closely interact with credit institutions to ensure further improvement of AML internal controls. To that end, over 70 letters containing recommendations on identifying transactions potentially related to ML/FT carried out through credit institutions have been issued by the CBR. Going forward, it would be advisable to focus awareness raising on other kinds of related risks, including those stemming from undisclosed UBOs.

***Cooperation with other domestic relevant agencies has proved to be successful***

There have been several MOUs between the CBR and relevant agencies that led to regular sharing of information. One important example of successful interagency cooperation between the CBR and Rosfinmonitoring is the operation to close Siberia's largest illegal encashment center, carried out by the local law enforcement agencies, the Main Department of the CBR in the Kemerovo region, and Rosfinmonitoring's SFD Directorate. In 2014, the CBR revoked the licenses of two credit institutions of the Kemerovo region. The criminal investigation resulted in criminal charges being brought against one of these credit institution directors and the seizure of approximately RUB 3 billion worth of assets.<sup>156</sup> Another example is the fight against illegal financial transactions related to the siphoning of money into offshore tax havens and encashment. The work carried out jointly with local law enforcement authorities and branches of the CBR resulted in a RUB 22 billion decline in the value of suspicious transactions related to the siphoning of funds into offshore jurisdictions through a Primorsky Territory-based credit institution, an amount which constitutes a significant proportion of the offshore-related business in the region.

In light of the above, the present evaluation recognizes the significant progress made by the Russian authorities on both regulatory and supervisory fronts.

There are, however, a few points that the authorities may wish to consider.

- The scope of supervision could be increased through more targeted AML inspections. It is important to note that AML/CFT issues have been part of many full-scope scheduled inspections: 376, 308, and 225 respectively in 2013, 2014, and 2015. The number of targeted—and scheduled—AML inspections (5) has been low compared to non-AML full scope inspections (224 in 2015) and general inspections including AML (225 in 2015). This number is even lower for unscheduled targeted AML onsite visits (3 in 2015). Going forward, more focused AML onsite visits would be desirable to look more deeply into areas of particular concern for the CBR.
- While the conduct of a national risk assessment is not an obligation under CP 29, the assessors are of the opinion that such assessment would provide valuable information to the CBR on major threats and vulnerabilities and permit more effective allocation of resources and prioritization. The same holds true for banks to support the conduct of their own risk assessments. Banks need to improve their understanding of risks. The nature and magnitude

<sup>156</sup> See the Rosfinmonitoring activity report for 2014.

	<p>of ML flaws identified by the CBR call for more progress on that front, especially in relation to transparency of legal entities (e.g., shell companies) and UBOs.</p> <ul style="list-style-type: none"> <li>• Proportionality in using sanctions for AML/CFT breaches is also advisable. As discussed above, the CBR has been forceful in disciplining banks which committed serious violations of AML laws, especially by withdrawing licenses. However, since the statistics on AML provided to the assessors were not broken down by type of sanction, it is impossible to determine if the CBR has used other types of administrative measures to enforce less serious AML deficiencies in banks. In addition, the amount of the fines that can be imposed for breach of AML rules are extremely low and as a result not a sufficient deterrent.</li> <li>• Along the same lines, further transparency of the criteria used to sanction banks in the AML area would be desirable. Lack of clarity and transparency in the way AML law and regulations are enforced has been mentioned by market participants, which in turns creates the sentiment that banks are disciplined even for minor problems. This could ensure that CBR supervisory actions are in most cases predictable, consistent, and proportionate.</li> <li>• Even though external auditors are not under the oversight of the CBR (they are under the ambit of the MOF), it would be a good practice for the community of Russian authorities to ascertain whether external auditors cover AML risks as part of their duties. Based on the discussion with market participants and audit companies, it is understood that external auditors do not pay attention to the way RM and internal control—including for AML purposes—are implemented, which is a weakness. In that regard, the team welcomes the recommendations made by the MoF on January 22, 2016, according to which auditors should examine if the bank observes KYC, AML internal control, record keeping requirements, and reports to the FIU any violation of the AML/CFT law.</li> </ul>
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## SUMMARY COMPLIANCE WITH THE BASEL CORE PRINCIPLES

Core Principle	Grade	Comments
1. Responsibilities, objectives and powers	LC	The legal framework currently in place reasonably provides the necessary powers to authorize banks, conduct ongoing supervision, oversee compliance with laws, and undertake corrective actions to address safety and soundness concerns. However, responsibilities and objectives of CBR are particularly broad and appear to be intertwined, while some functions seem to concur with the objectives related to safety and soundness of the banking system.
2. Independence, accountability, resourcing and legal protection for supervisors	LC	CBR is a respected institution. While many governance, accountability, and transparency measures are in place, there are some issues of concern notably in respect of legal protection for staff and transparency of dismissal



Core Principle	Grade	Comments
		procedures. There is also scope for improvements in the arrangements for decision making in order to better support and communicate the objectivity and independence of CBR to external audiences.
3. Cooperation and collaboration	C	CBR is in a position to exchange information and to cooperate with home supervisors over Russian-based subsidiaries of foreign banks through a number of bilateral memorandums of understanding (MoUs). Adequate information sharing arrangements are also in place with all relevant domestic authorities.
4. Permissible activities	C	There have been cases of financial pyramids in recent years that caused harm to more than nine thousand people. However, according to the CBR, in none of these cases the perpetrators have used in one way or another the words "bank" or "banking" to attract and defraud the customers.
5. Licensing criteria	LC	The Russian licensing regime for banks appears exhaustive. The legal and regulatory framework provides CBR a set of instruments and tools to ensure that the licensing process is sound. The professional qualifications required for applicants could be strengthened.
6. Transfer of significant ownership	C	The vetting process of CBR for transfer of significant ownership has been significantly improved.
7. Major acquisitions	MNC	The regulation does not establish requirements for banks to seek prior CBR approval when making domestic investments in nonbank institutions.
8. Supervisory approach	LC	<p>CBR has developed its risk-based approaches since the last assessment and is in the early phases of introducing the next stage of risk based supervision using Basel Pillar 2 (ICAAP and SREP).</p> <p>Where CBR is less well-advanced is in the field of resolution assessment and planning.</p> <p>From a forward-looking perspective, CBR needs to remain alert to the potential for banks to seek to manipulate the regulatory perimeter, and CBR must remain assiduous in using all forms of information available to it so that the potential for regulatory arbitrage does not arise.</p>
9. Supervisory techniques and tools	LC	<p>CBR has developed a careful and scrupulous system of supervisory techniques, integrating its onsite and offsite approaches. Existing practices largely meet the terms of the principle, but there is no requirement for banks to notify CBR in advance of any substantive changes, or of material adverse developments.</p> <p>As CBR matures and develops its experience with risk-based supervision, there are some areas, in relation to the nature of communication and flexibility in the system, which merit attention to ensure that future practices remain as effective as necessary.</p>

Core Principle	Grade	Comments
10. Supervisory reporting	LC	<p>CBR has strong powers and rights of access to information and uses its inspection process to obtain assurance on the substance and quality of information it receives.</p> <p>CBR is introducing some valuable developments, including the establishment of a dedicated department to the issue of valuation; a move to an XBRL taxonomy for supervisory reporting; and CBR is now legally able and, in practice, poised to commission work from external auditors for supervisory issues.</p> <p>CBR does not, however, other than in certain specific circumstances, have the right to require the prompt notification of a material issue that has come to the attention of an external expert in the course of that expert's work for CBR on a supervisory matter.</p>
11. Corrective and sanctioning powers of supervisors	LC	<p>The enforcement arsenal is very broad, and CBR has used all corrective and sanctioning measures at its disposal, ranging from restricting banks' activities to revocation of licenses. More forceful measures against senior executives and board members would be needed at times. Amounts of fines, particularly for AML/CFT, are not deterrent enough.</p>
12. Consolidated supervision	LC	<p>Subsequent to the last assessment, the legal and regulatory framework in respect to consolidated supervision has been significantly developed and enhanced.</p> <p>The transformation of CBR into a "mega regulator" appears to have facilitated more systematic information sharing in relation to nonbank group entities as well as coordinated inspection programs. Nevertheless, CBR is at an early stage of making use of the new framework, and greater attention is needed with respect to groups that have foreign establishments.</p>
13. Home-host relationships	LC	<p>Despite legislative obstacles to the exchange of supervisory information, there has nonetheless been progress in the field of home and host supervisory cooperation. A number of colleges are active. Little progress has, however, been achieved at this stage on cross-border crisis planning or in group-wide recovery and resolution planning for internationally active groups.</p>
14. Corporate governance	LC	<p>The current regime for CG is governed by piecemeal regulations, which makes it difficult to understand. Moreover, the current norms are different in nature: some of them are binding, other are just optional (CG Code, CBR Letters) and as such not enforceable.</p>
15. Risk management process	LC	<p>Russia has made significant progress in improving the RM supervisory and operational framework. There is, however, a lack of perspective on the effective implementation of this new regime in banks owing to the fact that key aspects have not been implemented yet.</p>
16. Capital adequacy	LC	<p>There have been significant achievements in fostering the national capital adequacy regime. The mission also</p>

Core Principle	Grade	Comments
		recognizes the remaining challenges that CBR and the banking sector alike will face in the years to come. The impact of the prudential framework will depend to the greatest extent on the way banks will meet their new obligations (ICAAP) and how CBR will monitor and supervise them (SREP). These are critical challenges that remain to be evaluated going forward.
17. Credit risk	C	CBR has a comprehensive approach to the supervision of credit risk, combining offsite scrutiny with onsite investigation. CBR performs its own stress tests on the portfolios, monitors regional and sectoral trends, and performs considerable cross checking of information on major exposures.
18. Problem assets, provisions, and reserves	LC	Fair-value determination is a big issue for the banking industry, even more so in a volatile environment. As a result, there is a concern that the existing valuation of collateral in the banking sector does not reflect the net realizable value, taking into account prevailing market conditions.
19. Concentration risk and large exposure limits	LC	The ICAAP Regulation 3624-U of April 15, 2015 contains new provisions on concentration risk. A decision has also been made to lower the maximum limit on a bank's exposure to a single counterparty or a group of connected counterparties from 25 percent of the eligible capital to 20 percent, as recommended in the 2008 FSAP. CBR has a wide range of powers to address situations where banks are taking excessive concentration risk. However, the definition of economic linkages is not implemented yet, which undermines CBR's ability to oversee the entire spectrum of concentration.
20. Transactions with related parties	MNC	Important amendments have been introduced since 2015 to the CBL to streamline the legal regime applicable to Related Parties. In particular, the law now captures a person or a group of people connected to the bank. The new regime on exposures arising from transactions of person(s) connected to the credit institutions will not be implemented before January 2017. The regulatory framework for related party transactions does not require that lending to RPs be on the same terms and conditions as those generally offered to the public. CBR lacks authority to impose penalties on directors who personally benefited from these favorable conditions. In the definition of connectedness, the concept of economic linkages has been introduced under the new Article 64 of CBL but it will not be implemented before 2017.
21. Country and transfer risks	MNC	There are no specific requirements for management of country risk and transfer risk except for exposures on residents residing in off-shore zones.

Core Principle	Grade	Comments
22. Market risk	LC	Banks' activities giving rise to market risk are less developed than in some other jurisdictions, but market volatility—notably but not exclusively in FX—may leave some banks with less experience of market RM more exposed. Until 2014, CBR did not have the legal powers to enforce RM and control standards. Thus, in common with the other risk areas, the enhanced framework under Ordinance 3624 is valuable but as yet at a very early stage of implementation.
23. Interest rate risk in the banking book	LC	As in other risk-focused areas, the regulatory framework has been enhanced but many of the new provisions that require banks to improve their management practices, including a greater emphasis on stress testing, are not yet fully in force.
24. Liquidity risk	LC	For systemic banks, which includes all internationally active institutions, the CBR liquidity metrics and RM standards are well developed and reflect the components of this core principle. The CBR's understanding and responsiveness with respect to liquidity risk issues commands industry respect. The new standards are, however, not fully implemented yet and CBR is at the outset of its scrutiny of whether the banks are meeting the new standards as intended.
25. OR	LC	The norms that govern OR, while detailed, are made up essentially of recommendations by CBR which, by their very nature, are not binding. The ordinance on ICAAP requires banks to have RM strategies, including for OR, but this new regime has not been implemented yet. Reporting mechanisms would also need to be improved. CBR does not have the authority to establish outsourcing requirements for credit organizations.
26. Internal control and audit	C	The regulatory framework for the internal control environment has been refreshed within the past two years based on the important new powers in the CBL (Articles 571 and 572) which permit CBR to apply RM and internal control standards to supervised institutions.
27. Financial reporting and external audit	MNC	The deficiencies in the legal framework are such that CBR is either significantly restricted or entirely prevented from fulfilling a number of the criteria of this principle. It is of the utmost importance that legislation is passed to remedy these concerns as a matter of urgency. Current weaknesses in the regulatory framework mean that the supervisor may not: reject or rescind the appointment of an external auditor who has inadequate independence or experience or who does not meet professional standards; ensure rotation of the external auditor; or meet with the audit firm to discuss matters pertaining to a supervised institution. Likewise, the auditor may not notify the supervisor of serious matters that come to the auditor's attention.

Core Principle	Grade	Comments
28. Disclosure and transparency	C	Some disclosure practices are still in the relatively early phases of implementation but CBR attaches importance to transparency measures and ensures regular disclosures on the performance of the banking sector through the banking sector review.
29. Abuse of financial services	LC	CBR has made significant efforts to ensure proper implantation of integrity standards in the banking industry. CBR supervision of AML/CFT issues is intensive and intrusive. CBR also has a track record of enforcing AML/CFT requirements. CBR has raised awareness in the market on AML/CFT issues. Workshops devoted to the practical application of the AML/CFT Law have been organized with the participation of representatives of professional associations. Lastly, cooperation with other relevant domestic agencies has proven to be successful.

## RECOMMENDED ACTIONS AND AUTHORITIES' COMMENTS

### A. Recommended Actions

Recommended Actions to Improve Compliance with the Basel Core Principles	
Reference Principle	Recommended Action
Principle 1	<p>Include language in the CBL that would clearly segregate CBR's safety and soundness duties from other assigned objectives.</p> <p>Allow CBR to have access to banking data older than five years.</p>
Principle 2	<p>Introduce legal protection for staff who act in good faith.</p> <p>Introduce a legal requirement so that the reason for the dismissal of the Governor of CBR and the head of the supervisory function must be publicly disclosed.</p> <p>Consider, through legal amendments if necessary, ensuring that Ministers or ministerial representatives do not participate as observers in board discussions on regulations that govern banking supervision.</p>
	<p>Consider, though legal amendments if necessary, transferring the ownership of CBR to a different state body in order to confirm in a transparent manner, that there is no conflict between CBR as a supervisory authority and the other functions and objectives that CBR must fulfill.</p>

Reference Principle	Recommended Action
Principle 3	Establish a formal mechanism of cooperation with the French Supervisory and Resolution Prudential Authority.
Principle 5	<p>Amend the banking law to establish a life-ban from the banking industry of persons who committed gross and recurrent violations.</p> <p>Establish formal procedures to subject a newly established bank to follow up onsite inspection to ascertain that the bank is performing according to the terms and conditions of the license.</p> <p>Establish formal mechanisms at the CBR head office level for interviewing applicants. The content and objective of these interviews should also be specified.</p> <p>When a new bank belongs to a group, ensure that controlling/parent entity closely follows the performance of the new entrant.</p>
Principle 6	Include an explicit requirement obliging banks to notify the supervisor as soon as they become aware of any material information which may negatively affect the suitability of a major shareholder or a party that has a controlling interest.
Principle 7	<p>Require ex-ante CBR approval of acquisitions of domestic nonbank financial institutions.</p> <p>Subject major acquisitions in non-financial companies to enhanced CBR scrutiny, in particular with respect to the compliance with limits.</p> <p>Explore the possibility to set restrictions for major acquisitions in nonfinancial sectors deemed to pose particular concern.</p> <p>Establish an explicit provision by which the supervisor determines, where appropriate, that new acquisitions and investments will not hinder effective implementation of corrective measures in the future.</p> <p>Subject any major acquisition to a formal follow up mechanism to ascertain that the new activities acquired do not expose the bank to undue risks.</p>
Principle 8	Finalize and implement regulations on resolvability of banks and complete resolution assessments for all banks.
Principle 9	<p>Introduce formal requirements for a bank to notify CBR in advance of substantive changes to its operation or structure and of any material adverse events.</p> <p>Introduce a policy of rotation for individuals who serve as ARs.</p> <p>Review CBR's communication strategy with banks, to include a greater focus on the relationship with the Board (supervisory board) and to amend instructions and regulations as needed.</p> <p>Review the CBR's on- and offsite internal supervisory processes to ensure maximum flexibility and swiftness of supervisory response.</p>

Reference Principle	Recommended Action
Principle 10	<p>Introduce legislative amendments to grant CBR the power to require external experts to promptly notify CBR of material issues that come to the attention of the experts in the course of their work for CBR. The information notification requirement should not be restricted to the specific scope of the inspection but should include information that would be relevant to CBR for supervisory purposes.</p>
Principle 11	<p>Explore possible amendments to the CBL to:</p> <ul style="list-style-type: none"> <li>-permit CBR to take enforcement measures against shareholders who violated the law or CBR's regulations, even if the violation is older than one year;</li> <li>-augment the 30-day timeframe during which CBR has to send an order to a party who committed a violation; and</li> <li>-provide CBR the possibility to impose changes in banks' internal organization and structure.</li> </ul> <p>Complete the revision of Instruction 59 on "Penalizing Credit Organizations for Violating Prudential Standards" so that criteria for sanctions used by CBR become more transparent.</p> <p>Establish formalized guidelines for determining the quantum of an administrative fine.</p>
Principle 12	<p>Build on and develop early current practices of group wide assessment of risks and exposures, with particular attention to cross-border issues.</p> <p>Assess the adequacy of supervisory practices in host jurisdictions where Russian subsidiaries and branches are established.</p> <p>Establish an active and intrusive consideration of whether Russian subsidiaries and branches are subject to sufficient scrutiny by their own group management.</p> <p>Introduce legal amendments to permit CBR to close foreign offices within the consolidated banking group.</p>
Principle 13	<p>Continue to foster college practices and conclude crisis management and recovery and resolution planning for internationally active banking groups.</p> <p>Consider legislative amendment to remove the requirement for written consent from a bank to permit a foreign supervisory authority to have access to its offices.</p>
Principle 14	<p>Include in relevant regulation a specific provision requiring a bank's board to understand the bank's and banking group's operational structure that impede transparency (for example, special-purpose or related structures).</p>



Reference Principle	Recommended Action
	Convert existing CBR recommendations on CG into binding regulations.
Principle 15	<p>Consider the proportion of resources dedicated to RM—and internal control—in CBR’s onsite programs.</p> <p>Perform a horizontal review across the system, to ascertain the implementation of the new RM system, with a particular emphasis on the role of the board towards developing and overseeing management of the banks’ entire risk profile.</p>
Principle 17	Introduce formal requirements to ensure that banks’ credit policies must identify size and risk thresholds above which approval must be granted by the board or senior management.
Principle 18	Accelerate the process of amending the law to provide CBR with additional legal tools in the areas of provisioning and collateral valuation.
Principle 19	<p>Conduct a horizontal review across the industry to verify the degree of conformity with Large Exposure Limit Requirements in light of the new statutory ratio N-25.</p> <p>Instruct the industry to increase efforts to establish a clear understanding of relatedness between customers’ connected economically.</p> <p>Include in the inspection program for 2017/2018 an analysis of the way concentration risks have been included in banks’ RM frameworks in light of the new ICAAP regime.</p>
Principle 20	<p>Strengthen the definition of RPs, which appears neither organic (as it results from the combination of different legal texts) nor exhaustive (as it does not seem to cover all the cases envisaged under this Principle).</p> <p>Establish legal prohibition for related party transactions performed on more favorable terms than corresponding transactions with non-related counterparties.</p> <p>Subject borrowers to the obligation to declare any relatedness with the bank.</p> <p>Include in the law a provision requiring major shareholders to disclose their “business interests.”</p> <p>Require banks to report immediately to CBR any serious breach of the statutory ratios applicable to RP.</p>

Reference Principle	Recommended Action
	<p>Subject banks with LLC status to the obligation whereby transactions with RPs and the write-off of related-party exposures exceeding specified are subject to prior approval by the bank's Board.</p> <p>Define in a regulation the types of transactions that give rise to related party exposures.</p> <p>Exercise control over the observance by credit institutions of calculated maximum risk per person related to a credit institution.</p>
Principle 21	<p>Establish specific guidelines or regulations for country or transfer risk outside of the general RM requirements and risk exposure to offshore residents.</p> <p>Establish specific policies to address provisioning for country and transfer risks.</p> <p>Require detailed prudential return on country risk and transfer risks.</p> <p>Ensure greater focus of oversight—both at onsite and offsite levels—on risks stemming from country (including sovereign) risks and transfer risks.</p>
Principle 22	<p>Consider revising the Net Open Position limits in view of recent currency volatility.</p>
Principle 24	<p>Consider extending the RM components of Regulation 510-P to the non-systemic sector, in a proportionate manner, for example, in respect of the funding and contingency requirements, to ensure that banks have clear expectations and to assist CBR acting in as timely a manner as possible in the event of deficiencies.</p>
Principle 25	<p>Convert CBR recommendations on OR into binding instruments with a view to establishing a general OR management framework, comprehensive and mandatory.</p> <p>Provide further guidance and requirements based on the BCBS's documents "Principles for effective risk data aggregation and risk reporting" of January 2013, "High-level principles for business continuity of August 2006, and "Outsourcing in Financial Services" of February 2005, which are applicable to banks and banking groups of all sizes and profiles.</p> <p>Empower CBR to establish outsourcing requirements and issue mandatory requirements in that regard.</p>

Reference Principle	Recommended Action
Principle 27	<p>The deficiencies in the legal framework should be urgently remedied so that the supervisor has powers to act in the following circumstances:</p> <ul style="list-style-type: none"> <li>- to reject or rescind the appointment of an external auditor who has inadequate independence or experience or who does not meet professional standards.</li> <li>- to ensure rotation of the external auditor.</li> <li>- to meet with the audit firm to discuss matters pertaining to a supervised institution.</li> </ul> <p>It is also important that the auditor have the responsibility to notify the supervisor of serious matters that come to the auditor's attention.</p>
	<p>Both the auditor and the supervisor should have legal protection in respect of the exchange confidential information.</p> <p>Prior to legal changes, and to the extent possible, CBR should foster a closer communication with the bank auditing community on issues of general interest and encourage, to the extent possible, discussion with audit firms on specific banks having obtained the requisite consent for exchange of information.</p>
Principle 28	<p>Consider adopting some of the best practice approaches of some other leading regulatory authorities who publish information not only at the aggregate but also the individual (including group) level, such as time series on bank performance and risk indicators.</p>
Principle 29	<p>Increase intensity of supervision through targeted AML inspections.</p> <p>Promote a more risk based approach to ML/TF issues in both the industry and CBR.</p> <p>Use more proportionality when enforcing AML laws and regulations.</p> <p>Ensure further transparency of the criteria used to sanction banks in the AML area.</p> <p>Ensure that external auditors pay attention to AML/CFT issues in their analysis of RM and internal control framework.</p>

## B. Authorities' Response to the Assessment

The Russian Federation authorities truly appreciate professionalism, clear focus, and constructive approach of the assessment team in undertaking the assessment. Thanks to the smooth and efficient collaboration between the CBR and the assessment team, this complex project was effectively completed using limited time and resources dedicated to the exercise.

We are pleased to note that since the previous assessment substantial improvements have been made and this progress is recognized in the Report. Due to the creation of a mega-regulator,

banking supervision can obtain more information on the activities of banks, banking groups, and financial conglomerates. Amendments to legislation, including the expansion in Bank of Russia powers, have enhanced supervision over banks' operations with other financial market participants. Moreover, the powers of the CBR to use professional judgment have been enlarged. The CBR is fully committed to further strengthening the supervisory framework based on BCP principles and other international best practices.

Among the banking risks, credit risk traditionally calls for special supervisory attention. Amid vigorous build-up of loan portfolios by banks, more attention is paid to the actual business performance of borrowers and their ability to service loans, and to the quality and adequacy of collateral used to adjust the value of created provisions. CBR bank supervision has approved a program for improving supervision and asset valuation. A new department will be established to assess the risk in all banks, and important legal amendments are being discussed in parliament to empower the CBR to make its own assessment of collateral values.

However, as some of the reforms are only being implemented, this has affected some of the grades. We recognize that the legal framework governing CBR's relationship and interactions with external auditors is deficient. Important legislative changes (i.e. on information sharing, requirements for an external auditor) are being discussed in parliament.

CBR remains committed to implementing the new legal definition of RPs on January 1, 2017. Requirements for banks to enter into transactions with RPs on same terms and conditions as those generally offered to the public will be prepared for discussion as amendments to the banking law in order to address the current FSAP recommendation.

As to the management of country and transfer risks, CBR is of the opinion that country risk is partly addressed through general RM requirements, risk weights in the capital adequacy calculations, classification of the borrower, and provisioning of operations with offshore companies. This said, CBR is now looking into the experience of other jurisdictions with this issue and approaches to building stronger regulation.

Regarding FX RM in credit institutions, the CBR believes that it is relatively more developed in comparison with other types of market risk, as the first regulation on open FX positions limits (Instruction 41) was issued by the CBR in 1996, i.e. several years before the introduction of capital requirements for market risk, and since then it has been steadily improved.

As for liquidity risk regulation, the liquidity coverage ratio (the LCR) was introduced in compliance with the Basel III requirements since January 1, 2016, together with the corresponding reporting requirements on the LCR. This was confirmed in the final RCAP report on LCR implementation in Russia, issued by the Basel Committee on March 15, 2016.

Yet, the recent legislative changes enhancing CBR's risk based approach may not have shown their full potential in practice. Thus the CBR regulations on ICAAP and SREP will increase the intensity of RM, and future assessments may benefit from longer implementation in practice.

CBR is of the opinion that findings and recommendations of the assessment team on Core Principle 29—Abuse of financial services—are beyond the scope of the respective essential criteria. CBR will nonetheless take into account recommendations on the above matter.

The Russian Federation authorities welcome the possibility to enhance both regulation and supervisory practices and are now putting together an action plan to address valuable FSAP recommendations. Some of the approaches recommended for implementation in Russia require time for additional study.

The Russian Federation authorities would like to thank once again the assessment team for fruitful cooperation.