

## BANK DEVELOPMENT IN RUSSIA UNDER COVID-19 PANDEMIC: ECONOMIC, LEGAL, AND ORGANIZATIONAL ASPECTS

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### ABSTRACT

**Objective:** This paper covers the influence of the COVID-19 pandemic on bank activity and bank development which is aimed at ensuring competitiveness and stability of the Russian bank system. The aim of this paper is to study the results of bank activity and areas for further development of Russian banks under the COVID-19 pandemic. **Methods:** The study was conducted on the basis of a systematic and integrated approach with a set of general scientific and private scientific methods. **Results:** It is crucial to integrate risk management in business strategy and management systems of Russian banks, to combine accurate and reliable planning and forecasting in banking, to ensure efficient management of spending so as to increase operational efficiency and cost-effectiveness based on digital technology. **Conclusions:** The main approach to risks management should be holistic, comprehensive, and timely implemented into banking activity to ensure its stability and competitiveness in the long run.

**Keywords:** Bank activity; Banking system; Digitalization; Legal regulation; Russian banks.

## DESENVOLVIMENTO DOS BANCOS NA RÚSSIA SOB A PANDEMIA DO COVID-19: ASPECTOS ECONÔMICOS, LEGAIS E ORGANIZACIONAIS

### RESUMO

**Objetivo:** Este artigo aborda a influência da pandemia de COVID-19 na atividade bancária e no desenvolvimento bancário, que visa garantir a competitividade e a estabilidade do sistema bancário russo. O objetivo deste artigo é estudar os resultados da atividade bancária e as áreas para maior desenvolvimento dos bancos russos sob a pandemia do COVID-19. **Método:** O estudo foi realizado com base numa abordagem sistemática e integrada com um conjunto de métodos científicos gerais e científicos privados. **Resultados:** É crucial integrar a gestão de risco na estratégia de negócios e nos sistemas de gestão dos bancos russos, combinar planejamento e previsão precisos e confiáveis no setor bancário, para garantir uma gestão eficiente dos gastos, de modo a aumentar a eficiência operacional e a relação custo-benefício com base na tecnologia digital. **Conclusões:** A principal abordagem à gestão de riscos deve ser holística, abrangente e oportunamente implementada na atividade bancária para garantir sua estabilidade e competitividade no longo prazo.

**Palavras-chave:** Atividade bancária; Bancos russos; Digitalização; Regulamentação legal; Sistema bancário.

### 1 INTRODUCTION

The COVID-19 pandemic led to grave economic, social and other problems. The Russian bank sphere was no excuse. In particular, it includes negative consequences such as the deterioration of banks' financial performance but also there is the emergence of new drivers for the development of banks such as active digitalization.

Once the pandemic broke out, Russia adopted several normative legal acts which changed the Central Bank of Russia's practice in loans and credit agreements (Federal Law No. 106-FZ, 2020). Application of the Code of Administrative Offences was extended (Federal Law No. 99-FZ, 2020), and there were amendments to criminal legislation and criminal procedure law (Federal Law No. 100-FZ, 2020).

Due to the fact that bank activity has a significant role not only during the pandemic containment phase but also in the post-pandemic world, there is a growing need in the study of bank activity in Russia in order to ensure the stability and competitiveness of banks in the volatile environment. There are theoretical and practical works in this sphere such as researches conducted by D.O. Avtonoshkin (2020), S.V. Kazantsev, I.A. Kolpakova, M.Ju. Lev, M.M. Sokolov (2021), A.A. Pomulev (2020), F.V. Sozaeva (2021), N.E. Sokolinskaya (2020). However, given the nature of the body of research in this field, it can be stated that there is a lack of a complex approach to the study of bank development in Russia under the COVID-19 pandemic. Thus, it does allow

effective management under the modern volatile environment.

Therefore, the purpose of this research is to study the performance and perspectives for the development of Russian banks under the COVID-19 pandemic. The aim of the study justifies its structure.

## 2 METHODS

The study was conducted on the basis of a systematic and integrated approach with a set of general scientific and private scientific methods. To study literary sources, concerning the research problem, analysis, synthesis, generalization were used. The normative basis of the study was current regulatory legal acts used in the regulation bank activity and bank development.

## 3 RESULTS. THE COVID-19 INFLUENCE ON BANK PERFORMANCE AND ITS USE IN BANK DEVELOPMENT IN RUSSIA

The modern Russian bank system is comprised of commercial banks that are different in size and areas of activity. There are several stages in the development of this system:

- the dynamic development (years 2000 to 2007);
- functioning under global financial and economic crisis (years 2008 to 2009);
- the recovery in the post-crisis period (years 2010 to 2013);
- functioning under new external shocks including sanctions against Russia (years 2014 to 2020);
- functioning under the COVID-19 pandemic crisis (beginning with the year 2020).

As it regards the latter stage, it should be mentioned that the COVID-19 pandemic has influenced banks both in a negative and a positive way, particularly:

- an increase in voluntary liquidation of banks. In this way, at the end of 2020, the number of banks that had been liquidated voluntarily superseded for the first time the number of cancelled banking licenses together with mergers/takeovers (there were 16 canceled licenses and 22 mergers/takeovers);
- in spite of the soft loan programmes in 2020, there was a decrease in loan activity (the ratio of the loan portfolio of individuals and legal entities to the attracted means of individuals and legal entities) by 2 percentage points to 76% since the level of lending was lower than the resource base of Russian banks;
- the recovery of borrowers' cash flow or payment schedule through restructuring

programs. The level of restructured loans had tripled by the end of September 2020 and reached 6 bln rubles. It equals 9,4% of the cumulative loan portfolio. Nevertheless, the level of loan portfolio provisioning has remained quite stable since the imposition of restrictive measures to curb the spread of the COVID-19 pandemic;

- a decrease in asset quality and bank profit under a deteriorating payment discipline of the corporate sector and among citizens due to the COVID-19 pandemic;

- the digital transformation of banks and, consequently, a change in clients' behavior, on the one hand, and a change in banks' business models, on the other hand. The COVID-19 pandemic influenced the way that the clients of Russian banks prefer to make payments: they are less eager to pay in cash and are more likely to pay by cards; moreover, online shopping has become more popular as compared with traditional shopping methods; online payments are made by virtual cards. In this way, the audience of bank mobile applications has increased. Moreover, it is crucial to highlight that not only there is a surge of interest for digital services among retail customers but also entrepreneurs have begun to show concern for the digitalization of bank services. In addition, cryptocurrency and blockchain have become more widespread since the pandemic caused people to search for new technologies in money transfers. According to V.V. Pushkarev (2020; 2021), the development of this economic sector is vulnerable to risks of criminalization;

- an increase in expenditure on information technology due to digitalization. Interestingly, there has been an increase in commission income only in technologically developed banks. According to expert estimates, in the coming two or three years, there will be a reallocation of operating costs towards a greater level of expenditure on information technology, particularly due to economizing through staff cuts as a result of automatization and robotization of business processes and online customer services. Moreover, in the sphere of information technology, there will be greater expenditure on virtualization and security services. The main reasons for that include regulatory requirements, a shift to remote work, digital customer services, favorable hybrid infrastructure and microservice architecture;

- increasing competition of banks in the implementation of digital services. Nowadays, a significant emphasis is put on innovations and constant modernization of customer service which consequently influences the competitiveness of Russian banks. However, in spite of the proactive implementation of new technologies, the further consolidation of the Russian banking sector continues. It considers mainly regional banks since their development prospects mostly depend on the two following

situations: if small banks without a niche leave the banking system, and if banks with a limited target audience preserve their existence with consistent liquidity. Meanwhile, sustainable development of regional banks relies on active government support, represented by the Bank of Russia, aimed at establishing a more favorable competitive environment without any discriminatory requirements against regional banks. In particular, it implies amending the normative and legal base of the Russian Federation which regulates the government support mechanism for regional banks, e.g. in the sphere of loans to small and medium businesses (Shor et al., 2020). Thus, the more regional banks participate in public programmes, the more competitive they become in preserving their client base. Consequently, it will lead to a positive impact on the quality and accessibility of banking operations and transactions for the population and businesses in Russia;

- increasing the competitiveness of the Russian economy through granting new opportunities, suitable in the modern digital environment, to the population and businesses;

According to expert estimates, the repercussions of the pandemic are still unknown. However, this uncertainty cannot be an obstacle in redefining the future development of Russian banks that should take into consideration the experience of the pandemic crisis to increase their stability and competitiveness and accelerate modernization in the post-pandemic world. Meanwhile, it is important to take into account that social, racial, and gender inequalities and climatic and ecologic problems pose certain obstacles in banking activities. As a consequence, under the current volatile environment, banks shall have a crucial role in ensuring sustainable development of the society through taking the following measures:

- integrating risk management in business strategy and management systems of Russian banks;

- to combine accurate and reliable planning and forecasting in banking which implies modeling of risk situations and their effect on the market, clients, and counterparties to develop a systematic approach to the potential emergence of such situations;

- to ensure efficient management of spending (also through its transformation) so as to increase operational efficiency and cost-effectiveness based on digital technology (machine learning, automation of robotic processes, distributed ledger technology, etc.). Implementation of Artificial Intelligence (AI) plays an important role in banking activities since it is interconnected with other digital technologies to ensure greater multiplicative value.

All things considered, it can be stated that the COVID-19 pandemic catalyzed the digital transformation of Russian banks and got their clients involved in different digital processes. As a result of the shift for digital services, banks managed to decrease their expenditure. However, such processes do not necessarily lead to an increase in client satisfaction. Thus, it is crucial to establish a balance between digital development and the level of client satisfaction. To obtain this goal, banks should focus on retaining digital channels users with target offers and do not restrain completely from non-digital interaction. In this way, the key to success is to combine digital and non-digital interaction in banking activity in which hyper-personalized products act as a basis of bank-client interaction.

Nevertheless, it is crucial to define the factors that curb the development of digital technology in the banking sphere:

- the persistence of regulatory restrictions that impede the implementation of digital technology;
- the low quality of software and bank automation equipment which does not allow introducing new information subsystems;
- the lack of sufficient funds to promote digital transformation.

Under current conditions, when cyberthreats, their speed and variability, improve at an accelerated pace alongside developing technologies, it is crucial to ensure the cybersecurity of banks. So, one of the priority areas in banking activity should be devoted to the monitoring of digital risks through modern means of surveillance and control aimed at sustaining a set level of cybersecurity and enhancing banks' cyber-resilience (Nguyen et al., 2021). Overall, the main approach to risks management should be holistic, comprehensive, and timely implemented into banking activity to ensure its stability and competitiveness in the long run.

Artificial Intelligence (AI) has a distinct role in ensuring banks' cybersecurity since it detects banking fraud through a predetermined set of rules, e.g. through a specially designed mobile application. Overall, AI helps:

- increase bank revenues through higher personalization of services;
- decrease bank expenditure through enhancing automatization that improves performance;
- reduce error rates;
- reveal new areas for development that focus on a more sophisticated means of information processing and generation from banks' data sets.

Thus, if a bank cannot prioritize AI in its activity, it is at risk of being uncompetitive

in the long run. Moreover, there are modern tendencies of development that only exacerbate the risk:

- an increase in clients' expectations;
- growing use of AI by the leading banks;
- a separation of digital ecosystems from traditional financial services.

However, it is possible that AI-based control systems can be flawed and possibly cause harm. That is why security arrangements, that should be integrated into the general security system, are of primary importance in the implementation of AI in banks.

All things considered; the digitalization of banks is rather controversial. On the one hand, bank services and transactions are modernized what increases their quality, accessibility, and performance; consequently, it leads to the growth of demand and an increase in financial performance. On the other hand, the global nature of digitalization entails a greater number of cyberthreats and possible insecurities in bank operations and transactions.

#### **4 CONCLUSION**

It is possible to conclude that the consequences of the COVID-19 pandemic are as follows: the increase of voluntary liquidation of banks; decrease in loan activity; the recovery of borrowers' cash flow or payment schedule through restructuring programs; decrease in asset quality and bank profit; the digital transformation of banks; increase in expenditure on the implementation of information technology; stiffer competition between banks as it regards the implementation of digital services and further consolidation of the Russian banking sector; improvements in the legal framework as it regards the resolution of disputes.

On the one hand, it is possible to enhance the stability and competitiveness of Russian banks with the help of the COVID-19 pandemic experience. On the other hand, it is essential to take into consideration social, racial, and gender inequalities as well as climatic and ecologic risks in banking activities. Thus, it is crucial to integrate risk management in the business strategy and management systems of Russian banks, to combine accurate and reliable planning and forecasting in banking, to ensure efficient management of spending so as to increase operational efficiency and cost-effectiveness based on digital technology. In addition, it is crucial to combine digital and non-digital interaction in banking activity in which hyper-personalized products act as a basis of bank-client interaction.

Under the controversial nature of the digitalization of banks, one of the priority areas in banking activity should be devoted to the monitoring of digital risks through modern means of surveillance and control aimed at sustaining a set level of cybersecurity and enhancing banks' cyber-resilience.

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